

Ofgem
Vanja Munerati
European Strategy
9 Millbank
London SW1P 3GE

APX-ENDEX
Mr. J.A.J. van Hardeveld
21 Southampton Row
WC1B 5HA London

Date: 23/04/2010
Reference: 10040294/JHARD/DBURG
Subject: APX-ENDEX response to the Ofgem consultation on 'Liquidity Proposals for the GB wholesale electricity market' (Ref 22/10).

Dear Ms. Munerati,

Thank you for providing us with the opportunity to respond to the Ofgem consultation paper on *Liquidity proposals for the GB wholesale electricity market*. As an energy exchange with ten years of experience in the British energy market we welcome the opportunity to offer our views on possible measures to increase liquidity in the market.

As expressed in our previous response, APX-ENDEX agrees with Ofgem's observation that compared to many other European markets, liquidity in the Great Britain (GB) electricity market is relatively low while the GB wholesale market for gas remains relatively liquid. Ofgem's focus on the lack of liquidity in the GB electricity market, particularly further along the curve, is therefore very relevant. We consider the five recommendations below key to improving liquidity in the GB market:

Key recommendations

- Growth of liquidity and market participation through market coupling with Continental Europe across new interconnectors;
- Take away cross border barriers to facilitate new entrants bringing more competition;
- Assessment timeline should recognise the start date of market coupling over the BritNed cable that will raise liquidity substantially;
- Accessibility and depth of the forward curve should become a priority for the assessment criteria; and
- Parallel development of a liquid day ahead index and a physically settled forward market.

Our response is divided in six different sections. In the first section we provide some general remarks on European market integration and further discuss the ability of market coupling to improve liquidity in the GB market. The second section discusses the need to take away cross border barriers in order

to facilitate new entrants bringing more competition to the market. The following section provides our recommendations on the timeline used by Ofgem for assessing market led initiatives. The fourth section gives our views on the set evaluation criteria for market led initiatives. The fifth section discusses the recommendation of the parallel development of a liquid day ahead index and a physical forward market. Finally, we end our response with a short conclusion.

Growth of liquidity through Market Coupling

The European Union (EU) is working to create a true European internal market for energy. A GB market that is closely integrated with the Continental European markets and the Irish market is key to achieving this goal but also enhances diversity of supply, competitive dynamics, price resilience, social welfare and security of supply of the GB market.

The integration of GB with neighbouring electricity markets can be achieved by means of market coupling, recommended by the Electricity Regulatory Forum (or Florence Forum) as the day ahead target model for European integration. APX-ENDEX has initiated and strongly supports this model which has provided excellent results in other regions of Europe.

For instance, the market coupling between The Netherlands, Belgium and France (the Trilateral Market Coupling¹), has proven that market coupling brings large improvements regarding optimal transmission capacity utilisation and price convergence (see Appendix A). There is clear evidence that market coupling can rapidly create a liquid and efficient market even when there is not a liquid pre-existing market (see appendix B), as has been the case with the establishments of power exchanges elsewhere.

Working closely together with regulators, Transmission System Operators (TSOs) and other exchanges, APX-ENDEX is playing a leading role in several initiatives to extend market coupling, such as the Central West Europe (CWE) market coupling project to couple the German, Dutch, French, Luxembourg and Belgian markets, and the integration with the Scandinavian markets through the NorNed cable that is already connecting The Netherlands with Norway.

In the GB market APX-ENDEX will offer seven days a week market coupling to The Netherlands and the wider Pentalateral electricity market² with the launch of the BritNed cable in the first quarter of 2011. With currently 57 members³ on our GB power exchange (representing the bulk of the GB power market) ready to trade on the GB auction and an average of 620.000 MWh traded⁴ daily in the CWE area, the coupling of the GB market to the German, French, Dutch, Belgium and Luxembourg markets will create a new momentum in the GB power market. The GB day ahead market will instantly benefit from what is, in effect, a major market maker (the whole North-Western European market) with an

¹ Trilateral Market Coupling (TLC) refers to the market coupling between The Netherlands, Belgium and France established in November 2006.

² The Pentalateral electricity market (also mentioned as Central West Europe (CWE)) consists of the Dutch, Belgian, French, Luxembourg and German markets.

³ For a full overview of the GB power members please visit our website www.apxendex.com

⁴ An average of 620.000 MWh is traded daily in the CWE area (The Netherlands, Belgium, France, Luxembourg and Germany), totaling to a yearly volume of 227.000 MWh.

attractive price level. This will provide the critical core liquidity and a proven, stable reference price for the electricity market in Britain further to develop.

Take away cross border barriers to facilitate new entrants bringing more competition

It is currently foreseen that the target model for European market integration will be embedded in EU law and will no longer be optional. It is being advanced by the proposed EU Framework Guideline on Capacity Allocation and Congestion Management – which could lead to legally binding Network Codes as early as next year. It is therefore of importance that the different policy measures considered by Ofgem are consistent with market integration and are compatible with the emerging target model for European integration.

As brought to Ofgem's attention in our recent response to the Interconnector policy consultation, certain current arrangements in the GB market such as the user charges (BSUoS and Triad charges) hinder the efficient integration with Continental European markets and the Irish market as they effectively act as cross border charges. APX-ENDEX therefore recommends exempting interconnectors from cross border charges or charges that have the same economic effect.

Assessment timeline should include the start of Market Coupling

In its consultation document Ofgem proposes to have an initial assessment of industry initiatives during the summer of 2010 and hold a further assessment in December 2010 or early 2011. APX-ENDEX has no objections against the date set for the initial assessment during the summer of 2010, but suggests extending the moment for further assessment of the market initiatives to include the initial start date for the launch of market coupling over the BritNed cable in the first quarter of 2011.

Accessibility of the forward curve a priority for the assessment criteria

In order to evaluate the success of the market led initiatives Ofgem describes four different assessment criteria, which will be further specified during the summer of 2010. APX-ENDEX would recommend giving priority to the accessibility of the forward curve for the assessment criteria, as we consider the accessibility of products further ahead on the curve as one of the main issues of concern in the GB wholesale electricity market. Especially for small suppliers, the question is whether they are able to trade products with small clip sizes and a small bid offer spread further ahead on the curve.

Parallel development of liquid day ahead index and forward market

We do not consider the lack of a liquid day ahead auction and the establishment of a credible index as a prerequisite for the establishment of a liquid forward market. In our view a physically settled forward market should be developed in parallel with the establishment of a liquid day ahead index. The establishment of a credible daily index will even in favourable circumstances take considerable

time, as demonstrated in other countries. Focussing on the creation of a financially settled futures market based on a day ahead index would therefore slow down actual progress and it would unduly delay the solving of the acute problems small suppliers experience when sourcing their portfolios.

Conclusion

APX-ENDEX fully supports Ofgem's activities in the field of liquidity in the GB wholesale electricity market. Market coupling represents one of the most promising means to create a more competitive and liquid wholesale electricity market. APX-ENDEX wishes to work with regulators, transmission owners, market participants and all other relevant parties in order to develop the right solutions to achieve this.

Should you have any queries please do not hesitate to contact Jethro van Hardeveld, Public and Regulatory Affairs, email j.vanhardeveld@apxendex.com or phone +44 (0)7795 801308.

Yours sincerely,
APX-ENDEX



Bert den Ouden
(CEO)

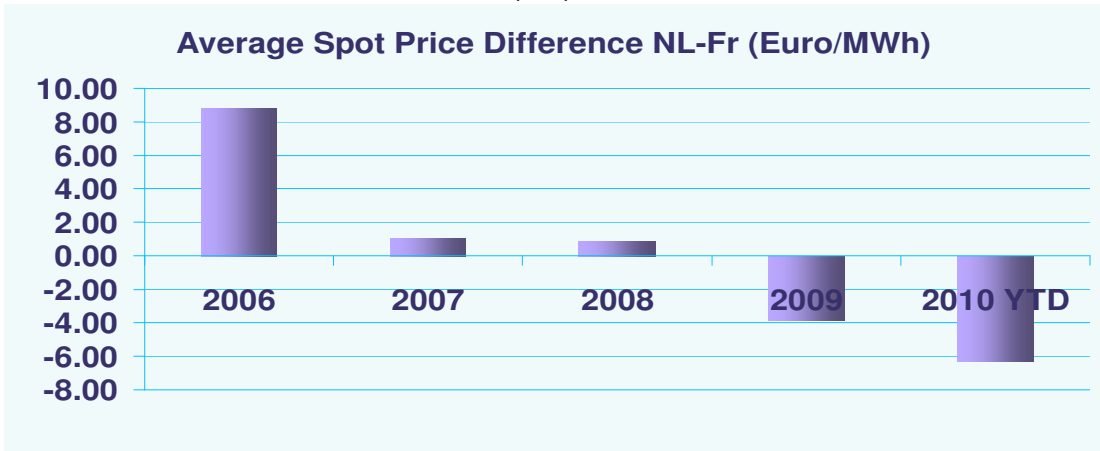


Lucas Schmeddes
(CFO)

Appendix A. Price convergence spot and futures after market coupling

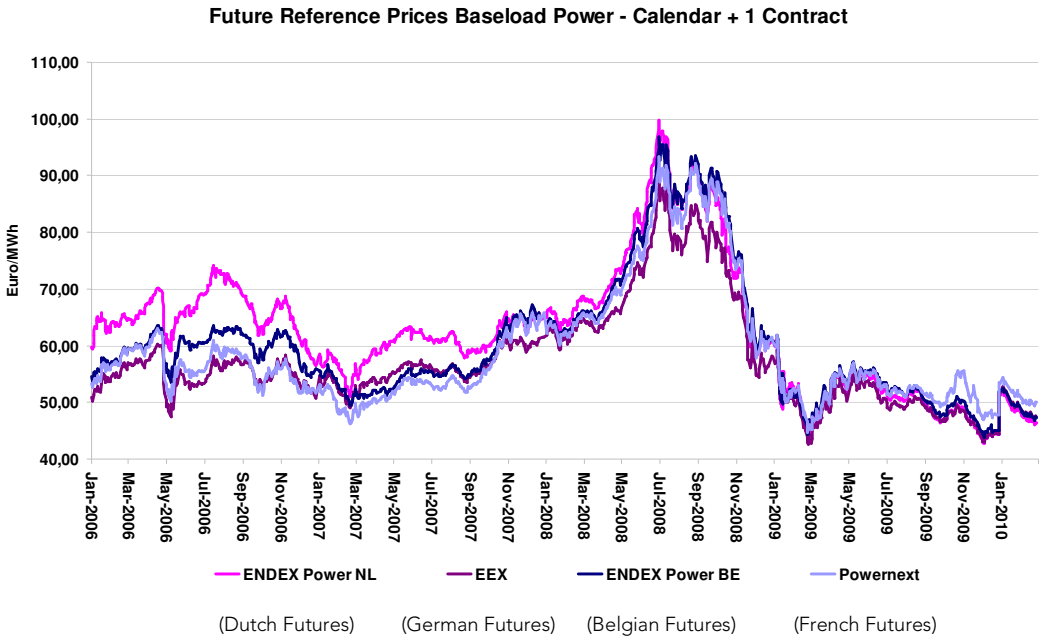
Market coupling results in the convergence of different price areas, as has been observed after the market coupling of The Netherlands, Belgium and France in 2006. The below figure one illustrates the price convergence between the price zones of The Netherlands and France (whereby market coupling creates a single price area) and the decrease of Dutch spot prices.

Figure 1. Decrease of spot price differences after market coupling and the decrease of Dutch spot prices



Price convergence furthermore is not merely observable in spot markets after the market coupling of The Netherlands, Belgium and France, the price differences (as shown below in figure two) between the power futures in different markets also decrease over time.

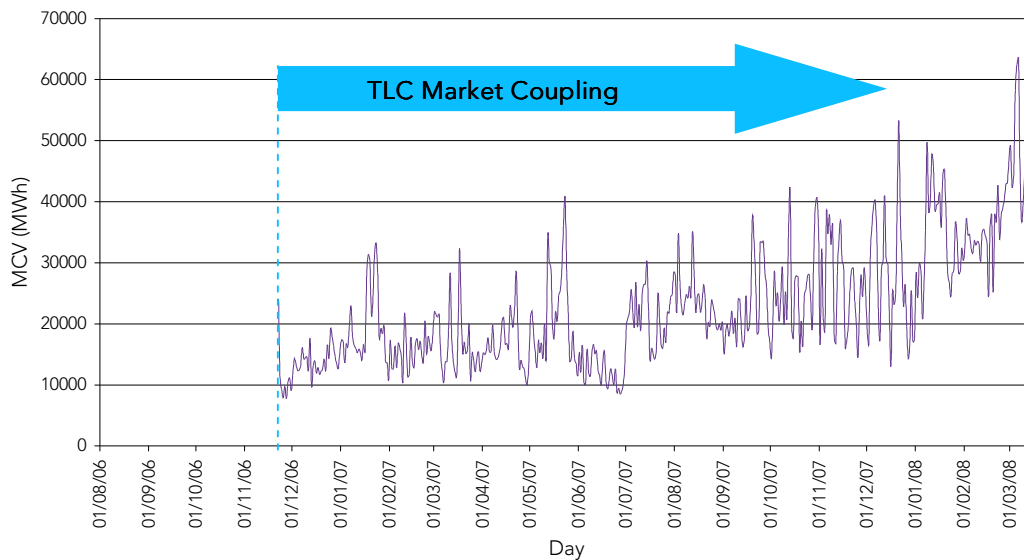
Figure 2. Price convergence power futures prices after market coupling



Appendix B. Growth of liquidity on the Belgian day-ahead market (Belpex) after Market Coupling

The Trilateral Market Coupling (TLC) required the establishment of Belgium's power exchange Belpex and resulted in the development of the now liquid Belgian spot market. The figure below (Figure one) shows the development of day ahead volumes on the Belgian power auction since the start of TLC on the 22nd of November 2006.

Figure 3. Development of day-ahead volumes on the Belpex exchange



It is important to note that directly after the launch of TLC, the Belgian day ahead auction instantly attracted substantial liquidity. On the first day of trading over 24GWh was traded⁵ on the Belpex day ahead auction. In the whole of 2009 the Belpex exchange facilitated the trade in 10.14 TWh in day ahead volumes.

⁵ On the 22 November 2006, 24,098.2 MWh was traded on the Belpex day ahead auction.