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Dear James,

Consultation on Liquidity Proposals for the GB wholesale Market

Thank you for the opportunity to comment on the above proposals. As you are aware, Good Energy is a small electricity and gas supplier. We supply in excess of 26,000 electricity customers with electricity sourced from over 1000 renewable generators and nearly 3,000 gas customers who support over 300 solar thermal heat generators.

For your ease we have answered the questions in your consultation, expanding where necessary to cover other issues.

Chapter 1

Q1. Do you agree that the harm caused by low levels of liquidity is sufficient to merit policy intervention, if such low levels persist?

Possibly. However any policy intervention should have the ultimate aim of increasing competition in supply and generation, especially in removing the barriers to decentralised generation. Policy intervention which improves liquidity, but embeds the dominance of the large market players should be avoided.

Q2. Do you agree that the focus should be on the electricity market?

The primary focus should be on the electricity market, although we believe that the gas market for suppliers without shipper licences should be investigated at some point.

Chapter 2

Q1. Do you think our high level success criteria are appropriate?

Yes as long as they are taken as a whole as no one criterion on its own is a demonstration of improvement. We also feel that the ultimate success is that the market share of both generation and supply held by the non-incumbent players shows a sustained decrease.

Q2. Do you have a view on how these can be quantified and the appropriate target levels of performance?

- Volumes traded in standard products, are a good measure but they must be measured as traded, not offered. The number of parties offering products should also be a measure of success
- On availability of key longer dated products, the measure should not be availability, but take-up. The key concern on longer dated products is collateral, so having them available, but with collateral requirements which means they are not taken up would not be a success.
- Use of trading platforms will appeal to certain suppliers to meet certain requirements. If the market begins to function properly, then smaller suppliers should be able to buy products directly from counterparties with ease. If increase use by smaller parties is evident because they are unable to get direct offerings from counter parties it could be an indication of failure.

- Feedback from smaller parties and new entrants is the key indicator. This may best be measured by how much they believe trading considerations are constraining their growth plans.

Q3. When should market success be judged?

Market success will be when there are competitive credit terms for standard products, and products are widely available to a range of suppliers and generators. Our view is the current market as defined under BETTA has high penalty rates for imbalance – but rather than sending investment signals to generators, who indeed are put off by the large risk, this tends to just penalises those that have less information, by definition the smaller market players.

Chapter 3

Q1. Are there other policy options, beyond those set out in chapters 4 to 8 which merit attention?

As a pure liquidity improvement exercise, then we believe that the policies outlined are correct, but they must be considered in the wider work of project discovery and movement to increase the amount of renewable generation in the market. The work on market liquidity must compliment the wider direction of change. We believe also a complete review of pricing under BETTA and the imbalance market could have a significant impact on liquidity – if you added better transparency on trading within the market that would then mean that non-physical players could also have a larger role.

Chapter 4

Q1. Is a direct trading obligation an appropriate solution to the problems related to wholesale market liquidity?

For any obligation to work successfully, then once imposed it should encouraged those obligated to maximise the opportunity. For this to work successfully it would need to encourage those obliged to offer a good range of products to meet the requirements of smaller players rather than providing the minimum they believe Ofgem will let them get away with. It is unlikely that any obligation will deliver the diversity of products that smaller suppliers required.

Equally, such an option could increase the reliance of small suppliers on their main competitors, and potentially have the unintended consequence of preventing independent providers from entering the market, which would be a preferred option.

Finally, this will all depend on the related credit requirements for the obligation and how that is offered. The key issue for any small supplier in this market is the requirements by counterparties on risk.

Q2. Which licencees should be subject to the obligation?

The obligation should rest with any party controlling, directly or indirectly (e.g. by long term contracts) a certain percentage share of the UK generation market. Research would need to be carried out to ascertain the appropriate percentage.

Q3. What requirements should be put in place relating to products, pricing, collateral and other conditions of trade?

It is unlikely that there is a perfect answer to this. The simplest answer is that obliged parties should offer terms for whatever product smaller suppliers want. However, could larger parties commit to this, and who would decide that the terms offered were reasonable? They cannot be tied back to comparison with internal trades, as these can be manipulated by shifting the costs between the different parts of the business. Equally, they are unlikely to have done a recent internal trade that matches that requested.

This would require a level of transparency that does not currently exist, and perhaps just by offering transparency on price, products and conditions of trade we might see a changing market.

Q4. Is it appropriate to extend the obligation to cover generation purchases?

No. Previous research by Ofgem has shown that Suppliers are willing to offer terms to smaller generators, whilst renewable generators below 5MW have the protection of the Feed in Tariff where larger suppliers are mandated to purchase their output.

Q5. What costs would this option pose?

Ensuring compliance if this option is chosen is likely to be the biggest costs. There may also be a hidden cost on smaller suppliers by removing the opportunity for an independent player to offer better terms.

Chapter 5

Q1. Is a market making arrangement of the kind set out in this chapter an appropriate solution to the problems related to wholesale market liquidity?

One of the elements of NETA was that market consolidators would appear to deliver a similar role as set out in this chapter. In reality this did not happen, principally due to the lack of trades outside the big 6 who were either vertically integrated or carried sufficient weight to buy wholesale, and a lack of transparency of the trades that were occurring. The imposition of a market maker would be a fix, but whether there would be sufficient volumes to make such a service viable is questionable. If it is enforced on the market to improve liquidity, it may also reduce the opportunity for a market driven market maker to enter the market. It is also questionable whether the major player would be willing to cover the market risk without passing this through in some form of premium.

Q2. What products should be made available through a market maker?

As with the trading obligation option, there is no perfect option. The products that should be available will be those that market participants require. Whether these will be offered on acceptable terms is questionable. A market maker would need better information to perform this task and to ensure that they were providing a service that was reasonable, published information would need to become available.

Q3. What volume obligation would be appropriate?

We agree that a small volume market is likely to lead to a separate market, so a larger volume would be appropriate.

Q4. Would the establishment of a "Market Making Agent" facilitate the introduction of market making?

Possible – but this might emerge without having to impose it if we had a transparent market and different credit requirements. There are elements of the Nordpool and the transparency of trading that might be of use to aid this.

Q5. What Costs would this option impose?

There will be set up costs for the agent themselves, which will need to be covered with possibly membership costs of using the exchange, which in themselves may deter membership by small suppliers. Participants will also incur costs in system design to interact with the agent.

Chapter 6

Q1. Are mandatory auctions an appropriate solution to the problems related to wholesale market liquidity?

There would be a number of problems with setting up mandatory auctions. Our experience of auctions is that it tends to push up the price as soon as it gets close the requirement, so if the amount available at the auction is less than is required – for whatever reason, the price can increase significantly. Our experience is that not all participants behave rationally in an auction situation as there is an element of "what do you do if you can't buy your power", if there is no other source. Those participants who have the best information therefore will win in an auction, and generally that will not be the smaller players, unless the information about everyone's demand etc.. is made more clear.

A good example to improve medium term (6 month ahead) power liquidity via an existing auction, whilst reducing the need for onerous credit terms, the current NFPA auction could be split into separate ROC and Power (+ LEC + REGO) components, with ROCs related to the NFFO sites sold through the NFPAs eROC Auction, and Power sold through the ePower Auctions. Doing this would allow Suppliers to purchase only what they needed – Power and/or ROCs - typically large Suppliers need ROCs and small

Suppliers need power. Additionally splitting the ROC and the Power would increase the visibility and liquidity of both the medium term (green) power price and the ROC price, which can only be good for competition, and would prevent Suppliers taking a hit on the market price volatility of either the ROC or the Power if they only wished to purchase one of them from the Auction.

Q2. How should the volume of generation subject to mandatory auction be set?

This could be quite complex. Mandated generation should really be for portfolio generators, and single site generators should be exempt. Renewable generation should also be exempt from longer term auctions as specific day and volume delivery beyond a 24 hour window is difficult to meet. There may also need to be some lead time as current generation may be locked into long term contracts and thus unavailable without breeching that contract.

Q3. Who should be obliged to offer into this auction?

This would have to be non renewable portfolio players of a sufficient size, although voluntary participation should not be excluded.

Q4. What design features should be incorporated into the auction process and rules?

Whilst vertically integrated players should not be barred from the auction, they should not be allowed to bid for their own products although this may be complex. Auctions should also take place within normal working hours. The auction makes sense to be run in the same way as the NFPAs ePower auction process as this is well established and works fairly well, although it would need some slight modification to deal with the above.

Q5. Should the mandatory auction apply to day-ahead volumes and/or to longer dated products?

Most small suppliers tend to be covered by gate closure, and ride the balancing mechanism as any fine tuning may be unwound by final results in the final reconciliation run. Therefore there is likely to minimum take up by smaller suppliers for a day ahead auction. There may be more scope for a longer dated product auction as long as there was sufficient variety and depth of products made available.

Q6. What costs would this option impose?

The main costs would be the set-up and running costs of the auction itself. Depending on how the auction is set up there may be system costs on participants.

Chapter 7

Q1. Is a self supply restriction an appropriate solution to the problems related to wholesale market liquidity?

By definition, if a self supply restriction is put in place then market liquidity would improve as long as the information improves too. This wouldn't necessarily address the credit requirement, and it may be possible for a counterparty to exclude everyone except itself from trading with it, due to its credit requirements (what might be amusing if the credit terms excluded it trading with itself!)

Q2. Who should be covered by the self-supply restriction?

The self-supply restriction should cover any participant who has a significant percentage of the generation either by direct or indirect control. The percentage level would have to be analysed.

Q3. How should the extent of a self supply restriction be set? Should it relate to the supply of domestic customers?

A self supply restriction should cap the amount of energy that can be self supplied. The effect of this would be to allow self supply of baseload, whilst forcing more liquidity into peak and curve. It would be difficult to ring fence domestic against I&C, so it should apply across the whole portfolio.

Q4. Should a self supply restriction be accompanied by measures to ensure small participants have access to the products they need? If so, which products?

Yes, all standard tradable products: Baseload, Peak, Off Peak, Extended Peak, Nights, Blocks, etc…

Q5. How could the previous problems related to enforceability be overcome?

Previous problems related to the fact that it applied only to in area sales. By basing self supply restrictions on generation output, this problem should be diminished.

Q6. What costs would this option impose?

Costs are likely to be minimal, although monitoring and enforcement would require an increase in Ofgem management.

Chapter 8

Q1. Do you think any of the possible approaches outlined in this chapter have merit and should be pursued further?

The high collateral requirement imposed on smaller market participants is another symptom of a non competitive market. In a competitive market, smaller suppliers would potentially favour those parties which offered less onerous collateral requirements. Due to the lack of a competitive market, the big 6, who have no real commercial reason to deal with smaller suppliers, do so only if they can push the risk down to a near zero mark. A key indicator of this is that smaller parties with good payments record do not receive better collateral terms, but continue to face zero risk collateral requirements from larger counter parties.

We support the view that any solution must not encourage under capitalised new entrants unable to deal with the occasional volatility that the energy markets face, and thus do not support any approach which socialises the risk across small participants. However, larger parties should be prepared to differentiate their collateral requirements to reflect the relative strengths of smaller market players than the current blanket zero risk strategy they adopt.

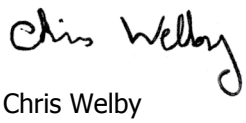
One approach could be for Ofgem to be more pro-active in monitoring the financial health of market participants. This could benefit not just energy counterparties, but network operators and the balancing mechanism.

Conclusion

The illiquidity in the current electricity market is a symptom, not a cause of a dysfunctional market caused by lack of sustained competition. Although like an itch that accompanies a rash, can aggravate the problem and impede its recovery. Any steps to improve liquidity, without taking additional steps to improve competition would merely prop up this dysfunctional market. The solution would be to remove barriers to decentralised energy generation, and suppliers being allowed to focus on niche offerings or certain communities, rather than the current mentality that all suppliers must be willing to supply all customers.

I hope you find this response useful. If you wish to discuss further, please do not hesitate to contact me.

Kind regards,



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