

GB Markets Team
Ofgem
9 Millbank
London
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22 April 2010

Dear Sirs

Re: Liquidity Proposals for the GB wholesale electricity market

Please find below the response from Opus Energy Limited to the above consultation document.

Opus Energy Limited is an independent supplier of electricity and gas to the UK business sector. Typically classed as a “smaller supplier”, Opus supplies just over 70,000 businesses ranging from SMEs to large Corporate groups such as John Lewis, Thorntons and Stagecoach.

Levels of Liquidity

We agree with the document’s conclusion that action is needed to address the spiral of ever decreasing levels of liquidity in electricity wholesale markets, and believe that this situation has arisen as a consequence of increased levels of vertical integration and the exit of financial players.

It is important to recognise that turnover of prompt volumes as a measure of the success of any initiative to improve liquidity is not the answer. Instead we need to ensure (i) that products of appropriate granularity and term are available; and (ii) that there are sufficient independent players or mechanisms in the marketplace where suppliers and new entrants can source product so that their ability to supply is not dependent on their competitors (ie the “Big 6”).

Without liquidity and a healthy number of market participants, independent suppliers could become unable to acquire the wholesale products they need which enable them to offer consumers a viable alternative to the “Big 6”. As a consequence competition, and the check that this brings to the pricing policies of the “Big 6”, may falter.

N2EX

We are hopeful that the newly launched N2EX, with the backing of the main industry players, will see a healthy turnover of trading levels in the prompt. If this does, in turn, attract new participants to the market who are actively trading in longer dated financial products (ie contracts beyond 6 months), we believe that this would be beneficial to smaller suppliers.

The ability of financial players to hedge positions in a liquid market, without the need to actively participate in the physical market could increase their commercial incentive to offer risk and credit solutions to independent suppliers and generators. **Consequently, we agree with Ofgem’s response that it is appropriate to “wait and see” how the N2EX develops.**

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Auction / (Market Maker)

Where the N2EX does not evolve as hoped then intervention will be needed. We consider that any intervention must:

1. mandate that vertically integrated players offer longer-dated volumes of electricity to market within a structured and controlled mechanism; and
2. that such a mechanism should be designed to attract new market participants so that a virtuous circle can be developed (ie where the release of volumes supports independent suppliers, which attracts intermediaries leading to improved levels of liquidity.)

We consider that the mandated release of volumes through regular auctions best achieves these two objectives. The market maker approach might also achieve these objectives, although we are uncertain how the scheme's minimum and maximum volume levels would be controlled by the regulator if there is a price offered and bid for trade at all times.

Where volumes of electricity are released by auction, these should be in pre-defined products such as 1MW or 5MW blocks of Baseload, Peak and Off Peak (and possibly also a pre-defined load shape) for periods up to 24 months forward. These types of product would support independent suppliers and generators, and attract new market participants.

Any trading party should be able to participate in the auctions. This will ensure intermediaries, through interests of arbitrage, can enable appropriate premium to be established for the granularity and/or shape provided in these products. For the same reason, independent generators should also act as a voluntary provider of product to the auctions (whereas the "Big 6" would be mandated).

Obligation on Generators to offer terms to smaller suppliers

Placing an obligation on the "Big 6" to offer terms to smaller suppliers is not a long term solution to the problem of liquidity. It does not facilitate a break away from the cycle of falling levels of liquidity. In fact, by taking business away from the few independent players that do offer services to small suppliers, this option is only likely to entrench the vicious circle.

Such relationships are also likely to be fraught with dispute leading to requests for the authority to arbitrate on pricing and terms. At Opus, we would be wary of entering into a commercial relationship with a counterparty that has no commercial interest in trading with us, particularly where this involves around 85% of our business' cost of supply.

Credit

Any solution needs to be of long term duration such that providers of capital can understand the returns available to them. Due to the current structure of the market, it is difficult for new entrants to gain access to capital. Correctly set up, a new market structure should attract capital. However, it shouldn't involve the provision of "free" capital in a way that would encourage inappropriate risk taking by poorly capitalised companies. Further company failures in this sector will only deter new entrants and make financial institutes wary of trading or offering capital to parties active in this sector.

We also consider that it would be inappropriate for Ofgem as the regulator, in the light of recent failures and bailouts in the financial markets, to be encouraging risk taking with no consequence by undercapitalised players.

Summary

- We are hopeful that the N2EX will succeed in attracting new liquidity and participants to the sector and consider that the “wait and see” approach is appropriate.
- Where the N2EX does not succeed in attracting new entrant participants to the wholesale markets, policy intervention will be needed to break the spiral of ever decreasing levels of longer-dated liquidity, which will in turn become harmful to competition.
- Any proposed solution should provide products of the granularity and term needed by smaller suppliers and new entrants, rather than just an increased turnover of trade volumes in the prompt. It should be mechanised and designed to attract participants other than the Big 6 (ie new suppliers, intermediaries and financial institutes).
- We consider that the introduction of mandated auctions, proposed by Ofgem, best achieves these objective.
- The provision of “free” capital would encourage inappropriate risk taking by poorly capitalised companies and will lead to further company failure. These failures will only act to deter new entrants and to make financial institutes wary of trading or offering capital to parties active in this sector

If you have any questions on any of the views above, please do not hesitate to contact me.

Yours faithfully,



Louise Boland
Director