



**Consumer
Focus**
Campaigning for a fair deal

**Consumer Focus response to Ofgem's
consultation *GB wholesale electricity
market liquidity: summer 2010
assessment***

September 2010

Our response to *GB wholesale electricity market liquidity: summer 2010 assessment*

Consumer Focus is the independent champion for consumers across England, Wales, Scotland, and (for postal consumers) in Northern Ireland. We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do. We are a statutory organisation that works in a devolved setting, with work priorities varying across different parts of the country, by all working to common strategic goals.

Through campaigning, advocacy and research, we champion consumers' interests in private and public sectors by working to secure fairer markets, greater value for money, and improved customer service. We have a particular focus on the interests of consumers in markets that are 'designated' by Government as requiring additional consumer advocacy. Currently these include energy and postal service consumers. Consumer Focus also has a commitment to work on behalf of vulnerable and disadvantaged consumers, and a duty to work on issues of sustainable development.

We provide detailed comments below on Ofgem's summer assessment and we welcome this assessment of the current state of the GB wholesale power market. The metrics devised are generally appropriate, providing a wide range of indices for determining how liquid the wholesale market actually is.

While we understand the reasons why Ofgem has decided not to give individual weighting to the different metrics, we would still place greater importance on some metrics than others. This is because some metrics are more related to the problems affecting the wholesale market identified by market participants than others, especially forward market trading and the trading requirements of small and independent participants. For this reason we would place more importance on the following metrics:

- Bid offer spreads for standard products (particularly those of longer maturity)
- Trading activity on the forward curve
- The number of counterparties providing hedging offers to small and/or independent participants
- The participation of small and/or independent participants on trading places
- Availability of small clip sizes
- Feedback from small suppliers, independent generators, large electricity buyers and potential market entrants.

The evidence provided for these six metrics are not encouraging in terms of indicating a liquid wholesale market and therefore a contestable electricity market.

We would also add that the metrics place too much emphasis on volumes traded on exchanges at the expense of volumes traded on over-the-counter (OTC) intermediated markets ie via brokers. We would reiterate that both exchanges and OTC intermediated markets help provide transparency of prices and volumes thus increasing liquidity and market contestability. Ofgem should aim to provide greater emphasis and weight in its

assessment to volumes which are traded on OTC intermediated markets. This is important as only a small fraction of traded power contracts in GB is executed on exchanges (in stark contrast to other European wholesale power markets. This in itself shows that the GB market is not as healthy as markets on the continent). This would help stakeholders understand whether rather than ‘concentrating’ trading the introduction of a new power exchange (the N2EX) is in fact ‘fragmenting’ trading and thus worsening liquidity. This is a fear we have heard constantly from numerous market participants.

Furthermore, there is no transparency or analysis of volumes not traded on either exchanges or OTC intermediated markets ie power traded bilaterally. This is where a large amount of power is contracted between parties, often internally within the same company. More transparency is required of these volumes to provide a better understanding of the current state of trading in the GB power market.

We have concerns about the calculation of volumes traded on the N2EX Day Ahead Prompt market (figure 5 in the summer assessment). The figure provided gives the impression that volumes on this prompt market increased markedly in approximately May 2010. This would give stakeholders the impression that there has been an improvement in liquidity caused by the introduction of this market initiative. However, our understanding from speaking with stakeholders is much of this increase in volume is in fact OTC ‘give up’ which would not have been initially traded on the exchange but on an OTC market (Ofgem mentions this in a paragraph below figure 5). While the use of clearing services for OTC trades can help reduce counterparty risk the use of this service is not a direct cause of an improvement in liquidity on the exchange as the trades were originally transacted on an OTC market. Ofgem must separate trading which actually occurs on the N2EX Day Ahead Prompt from that which is only cleared on it. This will ensure that stakeholders are not misled on the extent to which N2EX is contributing to an improvement in the performance of the wholesale power market.

We would reiterate our point from our previous consultation response, on liquidity proposals for the GB wholesale electricity market, that churn ratios can provide an illusionary picture of the state of wholesale market trading when used in isolation. A high churn ratio might be compatible with a liquid traded market but it could very well mask minimal trading on different parts of the wholesale market. For example, trading might be concentrated in the prompt market with a dearth of trading in the forward market while the churn ratio would indicate a healthily traded market overall. To be fair to Ofgem it has not viewed this metric in isolation but it must be careful not to do so.

The above comments should help improve Ofgem’s assessment of the wholesale market. Below we outline our two major criticisms on the assessment document.

The first is on Ofgem’s conclusion on the state of the wholesale market, that ‘Overall, the market is delivering some aspects of liquidity well, but not all the aspects of liquidity that support contestability’. Our opinion is more negative. The aspects of the wholesale market which are performing well (for example trading in the prompt market) are aspects which did not concern any market participants. The aspects which are of concern to some market participants (forward market liquidity for example) have shown minimal improvements at best, and in some cases deterioration in performance. Ofgem should prioritise its assessment by focusing on any improvements to aspects of concern to a great number of stakeholders. The statement that the wholesale market meets the needs of large vertically integrated participants is an example of what Ofgem should not pay too much consideration to; no one ever claimed this was not the case.

The second criticism is that we are very disappointed that Ofgem has failed to update and give greater detail on the embryonic regulatory remedies it consulted on in February 2010. Ofgem must make the development of these remedies a strong priority so that it is in a position to implement one or more of them. Considering that there was widespread

support among a wide spread of stakeholders for some form of regulatory intervention, it is a shame that Ofgem has not committed to this course of action and has instead committed to a further assessment at the end of the year. Our objectives for the wholesale market have not changed since our last consultation response to the February consultation *Liquidity proposals for the GB wholesale electricity market*. Our view on the need for regulatory intervention has strengthened in light of the evidence Ofgem has presented in its summer assessment.



**Consumer
Focus**

Campaigning for a fair deal

**Consumer Focus response to Ofgem's consultation
*GB wholesale electricity market liquidity: summer 2010 assessment***

Written by Cem Suleyman, Consumer Focus

For more information please contact Cem Suleyman at
cem.suleyman@consumerfocus.org.uk or on 020 7799 8054

Copyright: Consumer Focus

Published: September 2010

If you require this publication in Braille, large print or on audio CD please contact us.

For the deaf, hard of hearing or speech impaired, contact Consumer Focus via
Text Relay:

From a textphone, call 18001 020 7799 7900

From a telephone, call 18002 020 7799 7900

Consumer Focus

4th Floor
Artillery House
Artillery Row
London SW1P 1RT

www.consumerfocus.org.uk

Tel: 020 7799 7900

Fax: 020 7799 7901

Media Team: 020 7799 8004 / 8005 / 8006