

September 10th, 2010

GB Markets
Ofgem
9 Millbank
London
SW1P 3GE

Dear Sir,

GB wholesale electricity market liquidity: summer 2010 assessment

Please find First Utility's response to your request for information below.

Chapter 2

Question 1: Do you agree that the proposed framework provides an adequate range of evidence for assessing market liquidity?

Our view is that the metrics provided are adequate. As a smaller participant in the market, First Utility would request that Ofgem give special regard to the metrics contained within Table 3: "Meeting independent suppliers' and others' wholesale requirements (supporting retail and broader contestability)". We believe that the ability of smaller participants to hedge their market risk and obtain an appropriate range of products in non standard clip sizes are the true test as to whether or not appropriate levels of liquidity exist in the traded power market.

Chapter 3

Question 1: Do you agree with the assessment of the metrics in this chapter?

Metric 1 – Aggregate Churn

Financial churn as related to physical delivery is a good indication of a healthy traded market. We agree that interconnection with the Dutch market via the Britned link should have some impact on market liquidity, particularly as the Netherlands is a mature traded market. We agree that Feed In Tariffs should also have an effect on market liquidity, although the full impact of this may be some years away.

Metric 2 – Bid Offer Spreads

There is no question that bid offer spreads tend to widen the further along the forward curve one goes. Although this has always been the case to some extent, we would question whether the widening in spreads at the further end of the curve in the last year is related to tightening of market participants' credit policies in response to the recent uncertainty in the world economy in general.

Metric 3 – Use of Platforms Which Promote Price Transparency

It is true that the Nordpool market, which is generally accepted to be the most liquid market in Europe, shows very high levels of exchange activity and it is likely that there is a correlation between the two. However, we should suggest that this metric might not be as reliable in the UK market

given that Nordpool is made up of several interconnected countries. This factor might make exchange trading in that market more attractive than in the UK which has very little interconnectivity due to being an island. Nonetheless, information from platforms of this type is very useful for the purposes of providing a reference price.

Metric 4 – Volume of Trading Along the Forward Curve

Information such as this is useful for overall liquidity purposes but smaller suppliers such as First Utility tend not to trade at the far end of the curve. Ofgem's analysis suggesting that trades at the far end tend to be infrequent but fairly large in size would lead us to believe that this is probably generators selling output well ahead.

Metric 5 – Availability of Financial Derivatives

The volume of financial derivatives such as options traded in the UK market has fallen quite considerably in comparison to the early years of the last decade. We would argue that these tend to be used more in speculative wholesale trading rather than trading for the purposes of hedging customer risk. As wholesale trading tends to drive market liquidity, we agree this is a particularly useful metric for assessing this.

Metric 6 – Participation by Banks / Other Financial Institutions on Trading Platforms

As mentioned above, our view is that it is speculative wholesale trading that drives market liquidity. Therefore, we would agree that participation by financial institutions on trading platforms is a good metric for assessing market liquidity.

Metric 7 – Diversity of Products

As a smaller market player, standard baseload, peak and offpeak products are not always sufficient for First Utility's needs. We would like to see more trading in hourly products (or failing that, in IFA block products) as this would assist us in meeting our hedging requirements.

Metric 8 – Number of Counterparties Active in the Market Providing Hedging Offers to Small, Independent Suppliers

We would like to draw the distinction between counterparties offering simple base and peak to smaller players and those offering some degree of shape. Clearly the latter is more valuable. Also, some of the counterparties who are willing to provide hedging offers to smaller players charge such high risk premiums as to make the whole undertaking unviable.

Metric 9 – Participation of Small / Independent Market Participants on Trading Places

We agree that this metric should be considered in conjunction with Metric 8. As previously stated by Ofgem, it is difficult for smaller players to participate on exchanges due to credit requirements and lack of suitable products offered.

Metric 10 – Availability of Suitable Products with Small Clip Sizes

The availability of suitable products with small clip sizes is absolutely crucial for smaller participants and we urge Ofgem to monitor this metric particularly closely.

Metric 11 – Qualitative Feedback

We would agree with the broad views provided by independent market players in response to the previous consultation.

Question 2: Do you have any comment on the level of improvement in the metrics that would make a significant difference for market participants?

As stated above, we urge Ofgem to closely monitor metrics 6 – 10 inclusive as we believe that it is these which drive what we would consider to be a truly liquid and competitive market, i.e. one which allows smaller players to meet their hedging needs relatively easily and at a viable cost level.

We would also like to reiterate that we have seen no further improvement in liquidity in the seven months since the February consultation and believe that market intervention by the regulator is required to remove this barrier to entry in order to allow smaller players to compete effectively.

Please do not hesitate to contact me should you require any further information.

Yours faithfully

Chris Hill

Chris Hill
Regulation