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3rd May 2012
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The Renewable Energy Company (Ecotricity) Consultation Response to The Retail Market Review: Liquidity Proposals

Dear Camilla,

Ecotricity is an independent renewable energy supplier and generator with around 60,000 domestic and non-domestic customers.

We welcome Ofgem's plans to improve liquidity in the wholesale energy market. This is an issue that we have long been concerned about and have been actively engaged with Ofgem for the past 2-3 years. We responded to the consultations in April and September 2010 and my colleagues Asif Rehmanwala, Mark Hollands and Khalid Tai have met with Ofgem regarding our liquidity concerns.

Ecotricity's response is divided into two parts:

A) Answers to the questions outlined in the consultation; and
B) Our conclusion/summary views on the proposals outlined in the consultation.

A) Answers to questions outlined in the consultation paper

Question 1: *Do you agree with the objectives we have identified?*

Yes, we support Ofgem's objectives for an efficient wholesale power market. Increasing the availability of products that support hedging; robust reference prices along the curve and;

an effective near term market are key to improving liquidity and are the appropriate overarching aims of this consultation.

Question 2: *Do you think there are other objectives we should be considering?*

We believe that increasing the number of market participants should also be an aim. An increase in both physical and financial traders will increase churn and be good for liquidity. However, although some increase in speculative trading would be beneficial, it should not be dominant as this could create unwanted increased price volatility.

There should also be a focus ensuring that longer term products, which are currently only available through OTC and bilateral trades, should also be available on exchanges. It is important that this includes shaped products.

Question 3: *Do you agree with our views on market developments since summer 2011?*

We agree that market churn has deteriorated and believe that this is at least in part due to uncertainty in the market over policies such as the RMR and EMR.

We also agree that the market is not providing sufficient access to traded products for independents. Shaped products are particularly hard to obtain. Our experience is that this is only a problem for products more than a year ahead. We are not concerned with the near term market, because as noted by Ofgem, this is functioning effectively.

The bid offer spreads along the curve remain too wide. There has been a slight narrowing, however, this could be purely related to low prices and does not necessarily indicate an increase in liquidity or more robust pricing.

We agree that the proportion of OTC trading that occurs beyond two months has not increased.

It is true that the GB market is dominated by OTC rather than exchange based trading. In our experience the only way in which products over 2 weeks ahead can be bought is through OTC or bilateral trading. These products are not available on exchanges.

Question 4: *What specific further developments would be necessary to meet our objectives?*

There should be a review within 3 to 6 months of the mandatory auction being set. The criteria for this review should be set out in advance of the MA going live as this would make comparisons easier. The criteria to be measured should include whether the requirement to buy 20% more or less is working and whether overall liquidity is improving or simply being diverted from the voluntary market.

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Question 5: *Do you agree that objectives one and two are current priorities given market developments?*

Yes, objectives one and two: the availability of products which support hedging and robust reference prices along the curve; should be Ofgem's priorities. As stated in our response to Question 3, objective three is closer to being met. Furthermore, improvements in long term liquidity will have positive effects on short term liquidity, whilst the same cannot be said for the reverse.

Question 6: *Do you agree that the MA is the most appropriate mechanism to meet our immediate objectives?*

The MA is a positive step; however, there are a number of problems with it. We do not believe that the obligation to participate should be restricted to the Big Six (vertically integrated) suppliers. Large scale generators such as Drax and International Power should also be required to participate. We have detailed other concerns in our response to question 8.

As detailed in our previous liquidity consultation responses we still believe the most appropriate mechanism is a continuous market exchange mechanism (MEM) as oppose to the current discrete MA. A continuous mechanism is the most efficient, robust and transparent mechanism to meet the objectives.

Question 7: *Do you agree that, at the present time, the other mechanisms identified would not be appropriate for Ofgem to pursue?*

As per our previous consultation responses on market liquidity, we believe that both the direct trading obligation and the self supply restriction (SSR) would have been appropriate. However, we do not support the Mandatory Market Maker.

For the direct trading obligation to work it would need a credit support mechanism. There would need to be requirements to ensure ease of access to products, minimal premiums and a workable collateral mechanism.

A self supply restriction would be set by market share and relate to both domestic and business customers. It would need to be accompanied by measures to ensure that independents have access to small clip sizes.

Question 8: *Do you agree with the key features of the MA we set out?*

We support the specified volume being set at 25% of generated output and are very pleased that the Big Six will be required to sell this and not simply make it available.

We stress that the auction frequency being set on a monthly basis is problematic. The auction may, for example, coincide with a spike in the market, which would make purchasing in advance unprofitable. As we have previously stated we believe that a far more effective solution would be a Mandatory Exchange Mechanism, which would be a continuous traded market where a mandated percentage of available capacity would need to be sold.

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We believe that the benefits of this would extend beyond the near term as it would bring more liquidity and more robust pricing than a monthly auction.

We are also concerned that the purchase and sale departments of a company would communicate to each other and would therefore be able to game the market. We appreciate that the buy-side rule requiring those obligated to have a 20% difference in the amounts they buy and sell will limit this potential, but will not eliminate it.

Ofgem state that certain products must be sold in minimum volumes each month and that over the year the minimum volume sold must amount to 25% of generated output. We have strong concerns about how the required 25% will be divided over the year. There needs to be measures to ensure that the obligated parties do not sell the majority of their products at one point creating an artificial annual spike akin to that seen in ROCs. A requirement to make an equal amount available every 12 months could be a potential solution to this.

We are pleased that Ofgem want to see small clip sizes: an appropriate size would be 0.1MW.

As stated in our response to question 2, there needs to be more emphasis on shape further along the curve, with the level of shaping reducing over time. For season 1 it should be possible to buy in two hour blocks; for season 2 four blocks; for 12- 24 months ahead peak/off peak should be available and; for 24-36 months ahead base load is sufficient.

Question 9: *Do you consider it appropriate to have buy-side rules in place and do you have any comments on the detail of such rules?*

We support the rule requiring those obligated to buy 20% more or less, however we are concerned how workable this will be and how it will be monitored. We would like more detail on how it will be monitored, enforced and policed and how penalties for breach will be dealt with.

We strongly support the rule against the Big 6 being able to foreclose the auction.

Question 10: *Do you consider that there are benefits and risks to the approaches that we have not identified?*

We would like to propose that there be a reporting obligation on all trades. This requirement should include price and volume and be reported to Elexon, which would be the only body to see the raw data. Elexon could then produce a report on overall volumes and prices traded and send this to Ofgem. This should apply not only to the MA but also to all trades on APX.

We believe that this would substantially improve knowledge of actual liquidity. This would improve confidence, which in turn would improve liquidity.

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Question 11: *Which approach do you consider is best placed to deliver our objectives at least in terms of cost and risk?*

We strongly favour Option 1, having all exchanges on a single platform. It would be counter-productive to split volume between different platforms as this would increase administration costs for all involved, present more potential credit problems and be harder to monitor the buy side rules.

Question 12: *Do you consider that both approaches are able to meet our objectives?*

No, Option 2 would not meet the objectives. Option 1 is best placed for the reasons outlined in Question 11.

B) <u>Our conclusion/summary views on the proposals outlined in the consultation</u>

Overall Ecotricity strongly supports the move to improve liquidity in the wholesale market and believe it is imperative that changes are implemented as soon as possible. We believe that the self supply restriction and the direct trading obligation were better proposals than the MA, however the MA could still deliver improvements. In order to deliver the required step change in liquidity we feel a key priority is that shaped products are available along the curve and we strongly support making the MA continuous rather than once a month. We believe that more measures are needed to ensure that the MA cannot be gamed and that the buy-side rules are enforced.

Ecotricity are grateful for the opportunity to comment on this consultation on the RMR liquidity proposals and we look forward to your response and next steps.

We also welcome any further contact in response to this letter. Please contact Emma Cook on 01453 769301 or <u>emma.cook@ecotricity.co.uk</u>.

Yours sincerely

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