



## **LEBA reply to Ofgem Retail Market Review**

### **Intervention to enhance liquidity in the GB power market**

London, 8<sup>th</sup> May 2012

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Dear Ms Egginton & Mr MacFaul,

The members of the London Energy Brokers' Association ("LEBA") welcome this opportunity to respond to the questionnaire issued on behalf of Ofgem. Given the vital importance of a liquid and robust energy market to the UK, as well as the direct impact on the domain expertise of our member firms, LEBA's responses will focus on those matters within the questionnaire that relate directly to topics that are connected specifically to the operational aspects of the UK power market as operated by our member firms.

To put our response into context, the four LEBA member firms operating as OTC Wholesale Market Brokers, (together with APX as a Regulated Market) are global firms providing, inter-alia, OTC intermediation services in the cash and derivative Rate, Credit, Foreign Exchange, Equity and Commodity marketplaces. Our members collectively have a physical presence in all major financial capitals globally as well as many secondary financial centres and provide intermediation services to, among others, customers in all 27 EU member states. Furthermore, LEBA member firms arrange the vast majority of OTC and derivative transactions executed daily around the world operating as limited activity & limited licence firms that act as non risk-taking intermediaries with a principal client base made up of global banks, primary dealers, leading regional banks, government agencies, asset managers, oil companies and energy generators/utilities. Our primary function is to source, develop, manage and publicise liquidity pools for our customers to assist them in their global risk mitigation processes.

The four relevant LEBA member firms are active on the "Prompt" and "Curve" UK Power markets. Contrary to the misleading data illustrated by OFGEM in their proposals, LEBA member firms currently arrange c.60% of UK power, whilst N2EX maintains a market share of c. 40%. Excluding the "Within Day" markets operated by APX, they arranged over a billion MWh of UK delivered power in 2011 (1,054,289,265 MWh of which 36,258,405 MWh or c. 3% was cleared) which represented c. 7% of the 15 billion MWh of European power arranged by member firms. For 2012 to date, LEBA member firms are on course to arrange a very similar volume (330,064,936 MWh year to date as of end April 2012).

On that basis, contained within our response below you will find an elaboration of the following views and opinions:

- Each of the proposed courses of action within the proposals would greatly diminish both liquidity and volumes in the UK power markets. A liquid wholesale market cannot be built from a retail market rulebook, however the reverse is true.
- The existing [LEBA indices](#) are fair, free and open. They already provide the basis for the transparent market identified by OFGEM.
- 25% of the total market would encompass almost the entire current traded volumes (*i.e. the "retail tail" wagging the "wholesale dog"*)
- Irrespective of the final choice of mandated platform (or broker), the effect will be the same (*and the unintended consequences of a segregated or tiered market would dominate*)
- We are concerned that OFGEM seem to favour N2EX as a delivery platform above all other more proven venues as a matter of course - this will inevitably lead to suggestions of "unhealthy" competition
- The lessons of "Project Discovery" would appear to remain unlearnt
- The proposals do nothing to integrate the wholesale UK power markets into the wider European markets which should be the primary avenue to increased liquidity

## **CHAPTER: One**

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

Objectives need to balance deep, liquid and transparent markets that deliver choice and efficiency with security of supply. Few stakeholders would differ from these objectives. We would find it helpful for the government to explicitly outline how these objectives could be more simply met via further integration with the European wholesale markets, and that maintaining a competitive environment not only in the supply and delivery, but also in the markets for power should be central. We note here that OFGEM tend to favour monopolies in seeking to mandate trading venues, which we believe not only destroy choice and efficiency, but also innovation and self regulation.

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

Other objectives should encourage single liquid homogenous markets which include choice in and competition between, trading venues; integration and fungible markets into European power supplies; increased trading of derivatives relative to long term contracts; and less state intervention in the pricing of power.

## **CHAPTER: Two**

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

LEBA notes that OFGEM encourage trade in UK power to move between venues by stating that more trade on the N2EX platform is a positive development [*towards positive change (notably increased volumes traded day-ahead on exchanges)*]. We would question that this is indeed the case and why OFGEM feel that it is their role to "sponsor" one commercial competitor over another.

LEBA would also contend that OFGEM is incorrect that *“trading along the curve remains thin and we have concerns that the market is not sufficiently delivering a range of products which support hedging and robust reference prices along the curve”*. As pointed out at the OFGEM roundtable of 02 May 2012, we feel that OFGEM seeks to reproduce the markets which prevailed when ENRON acted as a somewhat dubious monopoly clearing house to the UK power market. LEBA would contend that these were not in fact *“the best of times”* for the UK power markets. As a corollary, we note that the *“churn”* in the German power markets has declined significantly over the past twelve months possibly indicating that this objective from OFGEM may be akin to *tilting at windmills*.

LEBA disagrees that there is not a robust reference price, since the LEBA indices are published daily and have never been queried in respect of their integrity.

Furthermore LEBA fundamentally disagrees with the concepts that OFGEM are considering of curve reference prices. Rather, a liquid derivatives market does not require set reference prices down the curve, but rather a robust settlement index. Trades down the curve are bespoke and are priced from the generic or implied yield curve. We note that the principal of allowing markets the freedom and flexibility to find their modus operandi may be being challenged here by these OFGEM proposals in favour of a de facto state setting of market pricing as a form of rationing.

Recent LEBA data as illustrated below would also seem to contradict the trends stated by OFGEM since volumes have remained fairly range bound, with the proportion in the prompt market also not showing any trends.

The increased flows onto exchanges noted by OFGEM is a direct result of a misinterpretation of the reported data by OFGEM, taking LEBA arranged trades and adding this number to the N2EX reported volumes. We note that despite representations to this error in meetings with OFGEM, the report was not amended prior to the two roundtable meetings, and the erroneous data considered as factual by both participants and the chair.

	OTC Prompt MWh	OTC Total MWh	Prompt Proportion
Jan-11	4,161,384	89,830,242	5%
Feb-11	4,080,140	103,353,861	4%
Mar-11	4,001,896	145,984,801	3%
Apr-11	3,219,924	71,663,975	4%
May-11	2,931,860	68,585,391	4%
Jun-11	2,923,404	85,345,925	3%
Jul-11	3,324,180	81,252,055	4%
Aug-11	3,117,420	91,971,617	3%
Sep-11	3,582,052	89,811,244	4%
Oct-11	4,110,588	78,964,989	5%
Nov-11	3,553,648	94,689,970	4%
Dec-11	3,242,136	52,835,197	6%
Total		1,054,289,265	2012 Ave = 4%
Jan-12		98,646,790	
Feb-12		101,403,575	
Mar-12		76,744,680	
Apr-12		53,269,891	

Taken together, it is not clear to LEBA that the empirical base case to OFGEMs proposals is sufficiently solid upon which to build any proposals.

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

Leading on from question (3) above, OFGEM need to correctly evaluate:

- i. The current state of the wholesale power markets both in the UK and in Europe
- ii. Why mandating a monopoly trading venue, with the implicit granting of commensurate intellectual property rights, would add to the efficacy of a traded market
- iii. The impact any retail proposals may have on the wholesale markets
- iv. Determine any problems with the current UK power market indices, specifically the LEBA indices as robust settlement prices for financial contracts along a curve
- v. Explain the rationale for any requirements for reference data, beyond market price, for traded curve financial derivative data.

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

LEBA entirely disagrees with both objectives one and two.

In order to promote simple and widespread access to curve products, a liquid financial derivatives market needs to grow which embodies a level playing field and settles onto a robust reference price. Counterparties may or may not choose to clear these derivatives. Any Ofgem encouragement of a forward delivered market would only serve to deflect away from this objective and favour the incumbent large players.

LEBA has offered robust reference prices daily since June 2003 which are taken and trusted by the entire market. These fixings have the history, clear methodology plus open and fair access to be able to act as settlement prices without coercing the market participants into any single venue or exchange. It remains an uncomfortable juxtaposition that Ofgem support and sponsor a closed member exchange in preference to an open and fair market.

### **CHAPTER: Three**

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

Whilst we query the “*immediate objectives*” themselves as in no way serving the agreed longer term objectives set out in question 1, it follows from the answers given above that LEBA members DO NOT AGREE that the MA is the appropriate mechanism to meet any desirable outcomes.

Rather, such an auction would fractionate and create a tiered market of low liquidity and multiple prices. Resulting complexities would serve as a disincentive for all small participants and outside players to enter the market.

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

LEBA reiterate that each of the mechanisms identified, a Mandatory Auction (MA); Mandatory Market Making (MMM); a Self-Supply Restriction (SSR); and a Direct Trading Obligation (DTO) would serve to fractionate and create a tiered market of low liquidity and multiple prices. Resulting complexities would serve as a disincentive for all small participants and outside players to enter the market.

Retail choice and liquidity can only be a product of a liquid wholesale market which is open to disintermediation.

Rather, Ofgem should seek to build a liquid and homogeneous wholesale market based on short dated reference prices and a financial derivatives curve which settles onto this, aided by multiple cleared solutions for new smaller and financial players. The basis for the market should be fungible with continental European power and physical delivery of power facilitated by adequate market coupling into the continental European grid.

This simple and clear solution should have been the focus and objective of Project Discovery.

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

It follows from the answers above that LEBA does not agree that a mandatory auction would help to achieve any of the following: encourage the regular availability of a range of hedging products, any, or improve access to any remaining wholesale market; or aid the generation of robust reference prices.

Evidently for choice to be paramount each and any venue should be able to host a Mandatory Auction which would be criteria for compliance for participants to join where they see fit. This multiple layering of auction choices may resemble some forms of market operation in the credit markets which enable and encourage a continuous market to operate around the periodic auctions. This would help to prevent the two tier market from emerging.

***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?***

Buy-side rules would appear to LEBA to be a by-product of an ever increasing rate of government interference with the market. In essence they will make these markets more technocratic and more divorced from the general market clearing prices and volumes in the market. Compliance complications will raise costs to all market participants. LEBA would encourage the path to simplicity. Either split the big six firms into smaller firms or mandate a virtual division of the generation units from the downstream units.

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

LEBA would only see benefits to alternative approaches. Namely: clarity, simplicity, fungibility and efficacy.

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

LEBA does not see any benefits in either approach.

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

LEBA does not see any benefits in either approach.

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## Annex 1: LEBA Indices

UK Power - May 04, 2012				
	Index (£/MWh)	Volume (MWh)	Index Date	Comment
<b>Baseload Indexes</b>				
Day Ahead (7.30-8.00am)	47.4390	2,827	08-May-12	0
Day Ahead Weekend (7.30-8.00am)	46.1319	1,644	05-May-12	0
Working Days (7.30-5.00pm)	47.6436	3,047	08-May-12	0
Day Ahead Weekend (7.30-5.00pm)	46.1319	1,644	05-May-12	0
All Days Saturday (7.30-5.00pm)	46.1319	822	05-May-12	4
All Days Sunday (7.30-5.00pm)	46.1319	822	06-May-12	4
Month Ahead Window (4.00-4.15pm)	44.5250	20	Jun-12	1
Month Ahead Window Average	45.1222	810	May-12	0
<b>Block Indexes</b>				
Mon-Fri Peak Blocks 3848.6 (7.30-8.00am)	54.6176	710	08-May-12	0
Mon-Fri Blocks 18.2 (7.30-8.00am)	35.7622	3,430	08-May-12	0
Mon-Fri Blocks 38.4 (7.30-8.00am)	54.4659	0	08-May-12	2
Mon-Fri Block 6 (7.30-8.00am)	47.7290	0	08-May-12	2
Mon-Fri Block 8 (7.30-8.00am)	49.0000	1,550	08-May-12	0
Mon-Fri Peak Blocks 3848.6 (7.30-5.00pm)	54.6350	800	08-May-12	0
Weekend Peak Blocks 3848.6 (7.30-8.00am)		0	05-May-12 to 06-May-12	1
Weekend Blocks 18.2 (7.30-8.00am)	35.9862	2,202	05-May-12 to 06-May-12	0
Weekend Blocks 38.4 (7.30-8.00am)		0	05-May-12 to 06-May-12	1
Weekend Block 6 (7.30-8.00am)		0	05-May-12 to 06-May-12	1
Weekend Block 8 (7.30-8.00am)	48.5000	50	05-May-12 to 06-May-12	1
<b>Bank Holiday Baseload</b>				
1st B-Hol Day Ahead (7.30-8.00am)	45.9274	3,042	07-May-12	0
1st B-Hol Working Days (7.30-5.00pm)	45.9385	3,142	07-May-12	0
2nd B-Hol Day Ahead (7.30-8.00am)				
2nd B-Hol Working Days (7.30-5.00pm)				
<b>Bank Holiday Block Indexes</b>				
1st B-Hol Mon-Fri Peak Blocks 3848.6 (7.30-8.00am)	51.8113	1,170	07-May-12	0
1st B-Hol Mon-Fri Blocks 18.2 (7.30-8.00am)	35.8084	3,488	07-May-12	0
1st B-Hol Mon-Fri Blocks 38.4 (7.30-8.00am)	54.4659	0	07-May-12	2
1st B-Hol Mon-Fri Block 6 (7.30-8.00am)	47.7290	0	07-May-12	2
1st B-Hol Mon-Fri Block 8 (7.30-8.00am)	48.6384	1,355	07-May-12	0
1st B-Hol Mon-Fri Peak Blocks 3848.6 (7.30-5.00pm)	51.8225	1,244	07-May-12	0
2nd B-Hol Mon-Fri Peak Blocks 3848.6 (7.30-8.00am)				
2nd B-Hol Mon-Fri Blocks 18.2 (7.30-8.00am)				
2nd B-Hol Mon-Fri Blocks 38.4 (7.30-8.00am)				
2nd B-Hol Mon-Fri Block 6 (7.30-8.00am)				
2nd B-Hol Mon-Fri Block 8 (7.30-8.00am)				
2nd B-Hol Mon-Fri Peak Blocks 3848.6 (7.30-5.00pm)				

\*\*\*Comments\*\*\*

All volumes are quoted in Megawatts and prices are quoted in £ per megawatt hour

- 1 - calculated with less than 5 trades
- 2 - calculated using average of last 3 days
- 3 - calculated using average of last 2 weekends
- 4 - calculated using average of all weekend trades between 07:30 and 17:00
- 5 - UK Public Holiday - Index derived from previous business day
- 6 - calculated using an extended window

[Click here for AM POWER INDEXES historical data](#)

[Click here for ALL DAY POWER historical data](#)

[Click here for EXPIRED POWER INDEXES historical data](#)

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Contributing Brokers	
GFI Brokers Limited	<a href="http://www.gfigroup.com">www.gfigroup.com</a>
ICAP Energy Limited	<a href="http://www.icap.com">www.icap.com</a>
Marex Spectron Energy Services Limited	<a href="http://www.marexspectron.com">www.marexspectron.com</a>
Tullett Prebon Energy Limited	<a href="http://www.tullettprebon.com">www.tullettprebon.com</a>



## **Annex 2: LEBA Member Firms**

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### **WMBA and LEBA**

The Wholesale Market Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) are the European industry associations for the Interdealer Brokers (IDBs) in the Over-the-Counter (OTC) financial, energy/commodity, equity, credit, cash and derivative products. Together, the associations have seventeen members comprising the majority of the IDB sector, which are listed below.

WMBA and LEBA members are Limited Activity firms that act as intermediaries in wholesale financial markets, with a principal client base made up of global banks, primary dealers, leading regional banks, asset managers, oil companies, energy generators and transmission operators.

### **LEBA Members:**

Evolution Markets Ltd  
GFI Energy  
ICAP Energy Ltd  
PVM Oil Associates Ltd  
Spectron Group Ltd  
Tradition Financial Services Ltd  
Tullett Prebon Energy Ltd

### **WMBA Members:**

BGC Partners  
GFI Group  
Gottex Brokers SA  
ICAP plc  
Martin Brokers (UK) Ltd  
Reuters Transaction Services Ltd  
Sterling International Brokers Ltd  
Tradition (UK) Ltd  
Tullett Prebon Ltd  
Vantage Capital Markets LLP

For further information please visit [www.wmba.org.uk](http://www.wmba.org.uk) and [www.leba.org.uk](http://www.leba.org.uk)