

Camilla Eggington  
GB Markets  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Dear Camilla,

**Retail Market Reform: Intervention to enhance liquidity in the GB power market consultation**

Statoil UK Limited 'STUK' welcomes the opportunity to respond to the proposals outlined in the consultation document and appreciate the level of stakeholder engagement with Ofgem in the process through the two workshops held in advance of the consultation closing date. STUK is supportive in principle of efforts to enhance liquidity in the power market, however would urge that any regulatory intervention be as light a touch approach as possible to allow the market to develop post any intervention. STUK would also note that the reluctance of traders to trade further out on the forwards curve more than two or three seasons ahead, may be due to a range of factors in addition to concerns about liquidity. Electricity Market Reform 'EMR', notably the Carbon price floor, confirmed only 2 years ahead, and the yet to be designed capacity mechanism are inevitably having an impact on power trading activities. In light of these concerns, there is a danger that, in spite of any intervention measures implemented by Ofgem, the market may not show significant depth improvements along the curve until the EMR proposals are given greater definition.

Whilst STUK are broadly supportive of attempts to improve liquidity, we believe that there is value in re-examining the Market Maker option (longer-dated), or construct a hybrid of the Market Maker and Mandatory auction options. An obligation on the relevant parties to post bids and offers for a range of longer dated products adhering to the volume thresholds proposed by Ofgem, would in our view, provide a significantly greater probability of improving depth and liquidity in the market than a Mandatory Auction. There is a danger that that if an auction was scheduled to be held on a monthly basis, that any increase in trading would only be around the time of the auction leaving little activity in the market at other times, evidence of this limited time window activity is apparent in the VPP markets in US and in France.

STUK believes not only that the Mandatory Market Maker option better fulfils Ofgem's objectives, but is also the 'lighter touch' regulatory approach. The Mandatory Market maker option would allow the 'big 6' increased flexibility to decide when to post bids/offers and take a view in relation to their own positions. As long as they fulfilled the volume obligation over an agreed period, for example on an annual basis, then the companies in question would meet their regulatory obligations in this area. Such an approach better facilitates continuous trading rather than a one off monthly volume auction.

STUK recognise that Ofgem will want to assess and analyse how any interventions measures impact on the market, and we would urge Ofgem to formulate up front, in consultation with industry parties, appropriate and transparent critical success criteria so that all parties are aware of the extent to which the market is performing against such criteria. This will, in STUK's view, decrease the regulatory uncertainty associated with a 'wait and see' approach and increase industry confidence in the market.

Subject to STUK's comments above, we agree with Ofgem that offering a range of products as outlined on page 27 in the consultation document in small clip sizes as well as financial products would improve the range of products available. An improved range of products, in conjunction with a mandatory volume release would improve the probability of increasing liquidity in the market.

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

STUK is in broad agreement with the key objectives identified by Ofgem, and is supportive of an increase in the products available and the need for an effective near term market. We agree that more robust pricing along the curve would encourage forwards trading but also recognise that one of the key drivers for this is the proposed Feed in Tariffs, Contracts for Differences 'FIT's CfD's' which form part of the EMR process. There may also be a need to use a pricing reference for the yet to be designed Capacity Mechanism.

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

STUK proposes that Ofgem consider the inclusion of a specific objective relating to improving access to the market and reducing barriers to entry. An increased number of market participants can only improve the probability of enhancing liquidity.

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

We agree that there have been significant developments on the day ahead market, especially since the launch of the N2Ex auctions. STUK welcomes these developments and agrees that Ofgem focus its efforts on the forward market.

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

Please refer to comments above relating to the Market Maker longer dated option.

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

STUK agrees that objectives 1 and 2 are of primary concern rather than objective 3, but would take the opportunity to re-iterate the need for an additional (or perhaps replacing objective 3 as the near term market is functioning effectively) objective on reducing barriers to entry. In our view, this is an area that needs further consideration and industry discussion, although STUK recognises the challenges in this area, particularly in relation to credit issues. It is STUK's view that credit issues are the key issue preventing an increase in participation in the power market and would urge Ofgem to have further detailed discussions with industry players on this issue.

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

STUK does not agree that MA is the option that best meets Ofgem's immediate objectives. STUK favours the Mandatory Market Maker proposal as detailed earlier in this response.

STUK strongly recommends that any volume release be on an on-going rather than one off basis. Traders in the market need the facility to buy or sell volumes at any specific moment and cannot wait for a scheduled auction. There is a danger that if an auction happened on a monthly basis that any increase in trading would only be around the time of the auction leaving little activity in the market at other times.

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

STUK believes that the Market Maker option merits further consideration and discussion, please see our comments above.

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

Please refer to STUK's comments above. We do agree that the proposed volume thresholds are appropriate, however recognise the difficulty in the specifics of how the volume obligation is calculated due to changes in plant usage and availability.

**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?**

STUK believes that buy-side rules should be in place and agrees that the obligated parties should not be able to net off their volume positions at 0.

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

We would suggest that an existing trading platform would provide the most logical and lower cost platform for this process and prevent liquidity becoming more fragmented by introducing another trading platform into the market. The development of a new trading platform would also be extremely costly and presumably result in large costs being smeared across market participants or industry players depending on how any cost recovery mechanism was designed.

There is a significant risk that a Mandatory Auction could have a detrimental impact on the NBP gas forward curve and liquidity when mandatory sellers hedge their fuel positions either before or after the power volume sales (there is currently evidence of this correlation as a varying proportion of volume is thermally produced through gas). If a large proportion is generated from gas then this could equate to a significant volume gas even in a liquid market such as the NBP.

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

STUK believes that any process to choose the platform should be an industry wide discussion with players represented by an expert industry representative group heavily involved in the process at every stage. We are concerned that if the obligated companies choose their own platform that this could result in a split of existing liquidity and also add significant delays to any projected lead times. STUK is assuming that any 'auction' or volume release would occur through a cleared platform provider to ensure confidence in market participants. We have a preference for option 1 as the lower cost, most logical and more timely option. However, as a non-commercial organisation driving a commercial project, we would urge Ofgem to utilise the expertise available in the industry as much as possible both in advance of and during any procurement process. It would be helpful if, at the earliest opportunity, Ofgem could provide further definition and clarification of its governance role relating to this project going forward.

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

Please refer to comments above.

Finally, STUK trusts that Ofgem has carefully considered the implications of such an intervention in the context of relevant primary legislation, notably the Financial Services, Competition and Markets Acts. STUK hopes that Ofgem will give its comments due consideration and looks forward to a continuing dialogue with Ofgem on this issue. Please do not hesitate to contact me if you require any further information.

Yours sincerely

Elsa Wye  
Principal Adviser, UK Regulatory Affairs  
Statoil (U.K.) Limited