



Response by European Energy Exchange AG (EEX)

to the Consultation by Ofgem on

Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition

Reference: 163/12

Datum / Date

15.02.2013

Ort / Place

Leipzig

Dokumentversion / Document Release

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A. INTRODUCTION

As exchange for power and power-related energy-products European Energy Exchange (EEX) believes that liquid wholesale markets are necessary to provide optimal sell and purchase conditions to trading participants and best prices to end consumers. We welcome the efforts made by Ofgem to improve liquidity conditions in GB power markets. However, we also think regulatory market intervention should be as low as possible. We therefore appreciate Ofgem's approach to closely monitor market development, to double check whether market intervention is needed and to take action only after careful investigation.

EEX has been providing trading platforms for more than twelve years now. We would like to share some of the experience we have gained over the years rather than answering each question.

B. OFGEM'S FINDING ON THE SITUATION IN GB WHOLESALE POWER MARKETS

We share the view that encouraging signs of liquidity improvement, in particular in short-term markets, can be observed in GB power markets. However, we also agree that there is room for improvement in derivative markets.

Like Ofgem, we consider the churn rate as being a rather rough measure for a market's liquidity. In Germany, just like in GB power markets we experienced a declining churn in the last two years. One conclusion could be that less trading occurred in wholesale market. However, at the EEX-derivative market we observe that the share of relatively short maturities, in particular month contracts, is increasing compared to yearly contracts. From our point of view, this is a result of a rising influence of renewable energy sources and an increasing weather-dependency of electricity markets. It is our experience that more short-term trading does not compensate less long-term trading, resulting in a lower churn while overall trading activity (e.g. number of traded contracts) might be stable or even rising.

C. SECURE AND PROMOTE SCHEME

We welcome Ofgem's approach to secure positive market developments and promote further market-driven progress. We think this is a less intensive intervention to the market, supports market forces and is likely to be more effective in the long-run than more intensive interventions. Based on our experience in power wholesale markets, we would like to make some additional remarks to Ofgem's suggestions for its 'Secure and Promote' licences.

Adequate trading conditions for independent market participants

According to Ofgem's findings, independent market participants seem to have difficulties in finding adequate trading conditions in wholesale markets. As an exchange we are convinced that these problems could be solved by strengthening exchange trading. Exchanges provide anonymous trading, small as well as big trading participants find the same conditions and there is no possibility for discrimination. Furthermore, exchanges make market conditions transparent and hence reduce information asymmetries between market participants.

Credit and collateral considerations

Ofgem found evidence that vertically integrated incumbents might be reluctant to trade with small companies out of credit considerations. However, trading on an exchange or cleared OTC-trading eliminates credit risk and by that could improve trading conditions for independent utilities as well as for vertically integrated incumbents.

Scope of measures

It is our view that liquidity in wholesale electricity markets can be promoted most effectively if a high share of physically oriented utilities and a high number of players takes part in the market. We therefore believe that also independent players should be involved in developing the market, although not to the same extent as big incumbents.

Reciprocity between long-term and short-term markets

Derivative trading can pick up as a result of the improvements seen in spot markets as trading participants will see the need for hedging their activities. In this frame, we consider the gross bidding approach followed by Ofgem as being helpful to secure positive developments in Day-Ahead-Markets and to improve long-term liquidity.

Financial contracts

Financial contracts can help to improve liquidity as they facilitate market access for market participants from the financial industry. However, it is our experience that in a first step, liquidity needs to be provided by physical players. Financial players might be willing to further improve liquidity once a minimum degree of liquidity is available.

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