Monkton Reach, Monkton Hill,
Chippenham, Wiltshire, SN15 1EE
www.goodenergy.co.uk
enquiries@goodenergy.co.uk
0845 6011410

Phil Slarks
Wholesale Markets
Ofgem
9 Milbank
London
SW1P 3GE

15th February 2013

Dear Phil,

Consultation on Wholesale power market liquidity

Thank you for your invitation to respond to the above consultation. As you are aware, Good Energy is a small, licensed electricity supplier of 100% renewable electricity to over 30,000 customers; sourced from a community of around 500 small and decentralised generators across the UK, using the day ahead market to balance its position once forecasted generation output is established. We also supply gas to over 7,000 customers on a tariff which supports the development of renewable heat.

Executive Summary

Good Energy welcomes the proposals set out in this consultation, and believes they are a step forward. However, we feel that there are three areas that require further work. These are collateral, FSA compliance and interaction with other policies, in particular EMR.

Whilst we welcome Ofgem's recognition that collateral is an issue, we believe that further work is required on what is fair and reasonable. For smaller players to trade along the curve, they need comfort that the collateral requirement are fixed, otherwise, collateral tools such as "mark to market" require parties to ensure they have sufficient collateral in reserve to cover the worse mark to market exposure. The further along the curve a trade is, the more uncertain the position. We believe Ofgem should look at standard credit terms such as the CSA used by EFET.

Good Energy is particularly concerned that any solution could have the unintended consequence of pushing smaller suppliers to become FSA accredited in order to get maximum value from the proposed arrangements. If Ofgem could work with the FSA to ensure that any solution will not have this impact, or clearly stated guidelines as to what actions would require FSA accreditation, then this could be resolved.

Finally, as we move forward then we need to get a better grasp of how FIT CFD supported generation is treated when establishing the market price, and the danger of these sites being the price setter, when they are effectively hedged by the mechanism to get their strike price. If Ofgem is planning to propose an enduring solution, then these issues must be considered for unintended consequences.

For your convenience we have answered your questions below, expanding where necessary.

1. **Do you agree with our assessment of market developments?**

Yes. We believe that the day-ahead market is reasonably liquid. However we believe that too much emphasis is placed on churn rate as most small suppliers are trading to balance their portfolio, rather than to trading to make financial margin. We also wonder if the figures include PPA between decentralised generators and suppliers. As the number of decentralised generators increases then one would expect a reduction in churn rates if they were excluded from the dataset.

The issue of credit collateral remains unaddressed, and becomes a greater issue as suppliers move out along the curve and have to accommodate potential liabilities under mark to market arrangements. Over the years, Good Energy has managed this by buying via the NFPA or directly from decentralised renewable generators who do not require collateral as they are not contracted to deliver specific MWs at specific times.

2. Do you agree with our description of the policy and regulatory context affecting liquidity?

Partly. There are two issues under EMR that need to be considered. Firstly, the impact on market prices where the generator's income is hedged against market price fluctuation through a FIT with CFD. Should such plant be included or excluded in setting the market price and what are the implications? Secondly, the issues around collateral requirements for the supplier obligation and the capacity mechanism under EMR should be considered as they may impact the amount of collateral suppliers have available to trade further out along the curve.
The electricity balancing code review should be dropped as it has failed to provide evidence that improving pricing signals will improve balancing decisions made by parties. This would remove an element of uncertainty.

3. Are there other factors that we have not identified that may be posing barriers to improvements in liquidity?

One of the issues not considered is the lack of independent generators willing to trade in the market as they prefer to sign long term PPAs with larger suppliers to mitigate their exposure to imbalance costs amongst other considerations. Proposals for a Green Power Auction Markets based on the NFPA are currently under discussion as a way to deal with this and should be considered as part of the liquidity review, as it could bring independent generators and smaller suppliers together on an equitable arrangement.

4. Do you agree that the Secure and Promote model presented in this document could help to meet our objectives?

We believe that the proposal will help Ofgem achieve the objectives it sets out. However, we are not convinced that the proposals will create an enduring solution that will allow the secure and promote licence condition to be removed unless there is a fundamental shift of market power away from the main vertical integrated companies. The secure and promote model actually increases the market's dependency on them, and could inhibit the growth of trades between independent generation and supply.

5. Does our proposed structure for Secure and Promote seem appropriate?

Yes. In particular we agree that the proposals should only apply to the obligated parties set out, as to impose them on other parties may inhibit competition, especially if it causes them to have to comply with MiFID or become registered by the FSA and the strict regulation this entails.

6. Do you think the proposed Secure and Promote model would be more effective than a mandatory auction?

Yes. The Secure and Promote model is not tied to a particular timetable thus allowing parties to trade as and when they require. A Mandatory Auction would be too restrictive.

7. Do you have any views on the requirements we have set out for trading commitments – in particular those points listed under "outstanding design challenges"?

We are supportive of the requirements as set out, although we believe that more work is required around the "independent assessment" of creditworthiness. We also feel where a party both buys and sells from an obligated party, then this is reflected in the collateral requirements ensuring a net position, we think that the standard credit support Agreement used by the European Federation of Energy Traders (EFET) could be adapted for use.

Whilst supportive of the principle of products, although we believe that given a commitment to 0.1MW clip sizes is too small and 1MW should allow independent parties to build their shape as required.

We support limiting the scope to independent suppliers, but this must reflect that these parties will at times wish to sell products as they adjust their position. Therefore obligated parties should be required to buy as well as sell products.

8. **Do you have any views on our proposed approach to securing existing developments in relation to day ahead auctions – in particular those points listed under "outstanding design challenges?**

We are content with the proposed approach.

9. **Will trading along the curve naturally develop from the near-term market?**

Maybe. One of the biggest obstacles to trading along the curve is the need to post collateral covering the period between the purchase and the delivery of the power. This is often based on a mark to market arrangement which mean suppliers have to be ready to post collateral not just on the trade price, but cover any fall in market price which increases the collateral requirement. These fluctuating collateral requirements over the period between trade and delivery deter smaller suppliers from purchasing along the curve.

If credit and collateral terms were more reasonable, then trading along the curve would increase.

10. **Should Ofgem intervene to ensure that robust reference prices along the curve develop?**

We do not support Ofgem intervening to ensure a robust reference price per se. Ofgem should ensure that the market encourages trading along the curve, which leads to a robust reference price developing. However, we do believe Ofgem should consider the impact of FIT with CFD contracts on the robustness of market prices, and whether a thin market would be open to manipulation by those generators with FIT CFD contracts which are referenced to market prices further out than day ahead.

11. **Is market making the most appropriate intervention option to promote robust reference price along the curve? What are your views on the trading obligation option that is outlined?**

Whilst we can see the merits of a market maker, we are concerned that a regulated market maker may deter the development of market based solutions to trading along the curve. As such we believe that an obligation to trade, would be more beneficial as the obligation should become redundant in time as success would mean that obligated parties trade beyond their obligations naturally. However, the changing nature of the generation portfolio with more intermittent generation needs to be considered when setting any obligation.

12. **Do you have any views on the design of the market making intervention outlined in the document – in particular those points listed under "outstanding design challenges"?**

We are particularly concerned that engaging with any market maker would result in parties being liable to fall under MiFID. For the market maker to be worthwhile, smaller parties wishing to trade with the market maker need to be sure that they would not become embroiled in MiFID or FSA compliance.

13. **Do you have any views on the MA design issues discussed in this chapter?**

No. We still remain unconvinced that a mandatory auction will achieve the stated objectives.

14. **Do you believe that a hub approach to pool liquidity across multiple MA platforms is a viable option?**

We would require more detail on the operation of the hub to make that assessment, but are concerned about the costs of such approach.

I hope you find these responses useful, if you would like to discuss any of the points we have raised further, please contact me.

Kind regards,

Chris Welby
Policy & Regulatory Affairs Director