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

ABOUT OPUS ENERGY

Opus Energy is an independent supplier of electricity and gas to the UK business sector. Founded in 2002, the company supplies just over 150,000 business sites with energy and purchases renewable power from around 500 small UK generators. From its offices in Northampton and Oxford, Opus Energy employs 450 people. The company's turnover for year to March 2012 was £272 million.

SUMMARY OF RESPONSE

We support the proposed licence requirement for the 'Big Six'[1] to offer fair and reasonable terms, but it is essential that this is open to **all** independent suppliers.

We suggest the cap is altered such that:

- The Big Six have an obligation to offer fair and reasonable trading terms to all independent suppliers who request to trade power in order to hedge an exposure arising from the supply of electricity to end users.
- Each Big Six supplier would only be obliged to trade up to [300,000 Mwhs] per annum per supplier (or supplier group).

Problems with the market structure do not fall away when a supplier reaches 1Twh. So we believe that fair and reasonable trading terms should be offered to all suppliers. Growing suppliers have then just to solve the liquidity issue for marginal volumes over the cap of [300,000 Mwhs] per Big Six participant, rather than come up against a cliff face.

DETAILED RESPONSE

Question 1: *Do you agree with our assessment of market developments?*
Question 2: *Do you agree with our description of the policy and regulatory context affecting liquidity?*
Question 3: *Are there other factors that we have not identified that may be posing a barrier to improvements in liquidity?*

We agree that there has been some increase in day ahead trading volumes and we also agree that there has been no increase in liquidity along the curve.

Although we have been patient on this issue, we have so far seen no evidence that increased short term trading has or will increase liquidity along the curve (whether physical or financial). We do not believe that it has been conclusively demonstrated that it was the lack of a robust short term index which was the underlying cause of low liquidity in the curve.

We consider it likely that the longer term market is illiquid because:

(i) other than the Big Six, there are few actively trading counterparties; and
(ii) rapidly changing environmental policies are creating uncertainty which deter financial players from actively trading in the wholesale UK sector.

[1] 'Big Six' by this we mean the UK's six largest vertically-integrated suppliers

Consolidation has led to a situation where six VIs hold 70% of generation assets and supply over 90% of the market. They have no commercial incentive to share the long term hedge that these assets offer with other suppliers.

There are few financial players in the market place because there are so few materially short players in the market place. Financial players need parties with positions on both sides in order to actively trade.

As well as efforts to stimulate trade, intervention is needed to ensure that the Big Six make their generation assets available to all parties with a short position to hedge arising from supply to end users. This must be not just on a day ahead basis, but as a hedge against future price volatility (ie through long term trades of at least two years forward).

CHAPTER: Two
Question 4: *Do you agree that the Secure and Promote model presented in this document could help to meet our objectives?*
Question 5: *Does our proposed structure for Secure and Promote seem appropriate?*

Independent suppliers rarely have the working capital needed to acquire wholesale product on traded exchanges. Instead they usually purchase power direct from generators or through financial intermediaries who can offer credit solutions and sleeve wholesale trades to the market.

The fall in liquidity levels has caused many financial intermediaries to exit the market. In addition, following consolidation in the sector 70% of the UK's generation assets are now owned by the Big Six.

Whilst historically the Big Six have been reluctant to trade with independent generators, this is now essential. Since they have no commercial incentive to trade (and in fact have a commercial disincentive to trade with companies who are essentially their competitors), it is essential that the Big Six are obliged to offer fair and reasonable trading terms to all independent suppliers. It is the only way in which non Big 6 players will be able to get access to the UK's generation assets and grow to create a competitive market.

The obligation to offer fair and reasonable terms is not a subsidy to small suppliers like the ECO threshold. This is action that is needs to be taken to rectify a market fault. As such, fair and reasonable trading terms should be offered to all suppliers.

Question 6: *Do you think the proposed Secure and Promote model would be a more effective intervention than the Mandatory Auction?*

The proposed Secure and Promote model would only be a more effective intervention than the Mandatory Auction if the obligation to offer "fair and reasonable trading terms" to independent suppliers covers all independent suppliers.

CHAPTER: Three
Question 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" on page 25?*

Credit Terms

Since the Secure and Promote condition would require parties to trade where they are not wanting to trade, it is likely that an overly negative view would be taken on an assessment of credit. To ensure this is not an area of regular dispute, it would be sensible to standardise the methodology to assess credit. This should:

- Use a defined methodology, such as that under the DCUSA to determine the level of credit that should be afforded to a party
- Use a standardised method to convert credit allowance to a MWH trading limit (since the burden of MTM is likely to lead to small supplier failure)
- A clear methodology to define how much collateral is required to trade over and above the credit allowance (up to annual MWh limit).

If credit terms are not defined in this way, it is likely that the Regulator will be asked to field disputes between suppliers over what constitutes "fair and reasonable" credit on a frequent basis.

Scope

Problems with the market structure do not fall away when a supplier reaches 1Twh. So we believe that fair and reasonable trading terms should be offered to all suppliers.

We suggest the cap is altered such that:

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- Each Big Six supplier would only be obliged to trade up to [300,000 Mwhs] per annum per supplier (or supplier group).

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Price

It may also be worth considering whether the guidelines should include guidance on what is "fair and reasonable" with regard to premiums charged for offering non-standard products – ie shape, granularity and additional credit.

CHAPTER: Four

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

We have so far seen no evidence that increased short term trading has or will increase liquidity along the curve (whether physical or financial). We do not believe that it has been conclusively demonstrated that it was the lack of a robust short term index which was the underlying cause of low liquidity in the curve.

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

Yes.

Question 11: *Is market-making the most appropriate intervention option to promote robust reference prices along the curve? What is your view on the trading obligation option that is outlined on page 34?*

We would support large scale mandatory market making and a Self Supply restriction.