renewableUK
The voice of wind & marine energy

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

RenewableUK is the leading UK renewable energy trade body, representing more than 650 members in the wind, wave and tidal stream sectors. Members include suppliers, generators, manufacturers, etc. These industries will provide the majority of the renewable electricity required to meet the UK's 2020 emissions reductions targets, create thousands of jobs across the supply chain, revitalise the economy and stabilise consumer energy bills.

RenewableUK appreciates the opportunity to respond to Ofgem's *Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition* and wider liquidity work. Our membership agrees with the Ofgem assessment that the market has in certain areas improved and become more responsive. Evidence presented in the consultation shows that churn has fallen in the first three quarters of 2012, from the 2011 level, however, it is still over three times the generation volume. Bid-offer spreads remain wide (wider than in 2011) and are wide compared to gas. We support the principal objective of supporting effective competition, delivering benefits in terms of lower bills, greater choice and better service. The bottom line is that poor liquidity prevents growth from new players and imposes costs on consumers. RenewableUK therefore believes it is important to increase liquidity to ensure healthy competition, resulting in stable electricity costs for consumers.

In the interests of efficiency and consumer value, it is important that efficient solutions to further enhance liquidity are found. Any poorly designed mandating arrangements will not only be costly to implement, but could distort the very price signals that Ofgem is seeking to enhance.

It would be helpful if Ofgem clearly outlined what it considers as a success in this area. From our point of view, success would be the entry of new PPA providers, who would be able to offer long-term deals as there would be a liquid market over a sufficiently long horizon for them to manage the risks involved. This criterion would focus on liquidity as a means to an end, not an end in itself. Success may also be a market where participants have the ability to open or close a position quickly and efficiently – i.e. trade away a long or short position at the time they want. There are two fairly easy ways to measure this, including a higher churn level (it is currently around 3 times the generation volume) or tight bid-offer spreads along the curve. Before Ofgem moves forward with its final assessment, recommendations and minded-to position it would be helpful to better understand how it intends to measure success.

Secure and Promote as described in the consultation could be a viable option, but a number of details are unknown as currently presented, including whether it adequately supports the needs of independent generators. The Mandatory Market Maker option will be caught by the imminent MIFID regulations, unless an exemption is made. This would create significant burdens for existing players in the market and we would therefore suggest Ofgem looks at a Third Party Market Maker model, where Ofgem issues an Invitation to Tender on operation of a market maker. Possible alternatives could be to require suppliers to trade a percentage of either their generation or supply on the market, or a real self-supply restriction with a ban on the transfer of power between generation and supply arms of vertically integrated companies. Ofgem has said the design and implementation of such a solution could be complex; however, any solution will have its share of difficulties.

In general, the issue of liquidity must be seen in the context of a market with high levels of vertical integration. Even if it is not certain that vertical integration is the root cause of illiquidity, it is certainly the perception of many outside the Big Six that this is the case. Ofgem will have to work hard to show that real gains in liquidity, giving tangible benefits to independent players, can be made under the current market structure or there will be continued calls for stronger action, including for DECC to use the powers it is taking under the Energy Bill currently before Parliament.

CHAPTER: One

- **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?**

Yes, we broadly agree with Ofgem's assessment of market developments in addition to the policy and regulatory context affecting liquidity. In order to ensure robust reference prices it is essential that all market participants have confidence that the prices in the market reflect underlying supply and demand conditions and that small players have the same visibility as larger players. While tight bid-offer spreads are preferable to wider spreads the key issue is that all participants have the confidence that they are accessing the same bid-offer spread. Provided that there is transparency in the OTC market and that all market participants can access the same products at the same prices, we believe Ofgem's objectives in this area can be met.

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

Yes, the Secure and Promote model presented could help to meet the objective and seems appropriate, but it also depends on many details that have not yet been worked out. The regulatory model should be where companies are encouraged to meet a requirement on a voluntary basis, followed up, if necessary, by a formal obligation. This would enable companies to find the most efficient way of meeting the objective, subject to normal competitive pressures. It is essential that all market participants can have the confidence that market-led developments that have improved wholesale market liquidity and access to date will continue and can be relied on. The ability of Ofgem to lock in advances should there be a threat of withdrawal of commitments would ensure that benefits are maintained.

The Secure and Promote model seems to be a better approach than the Mandatory Auction as it builds on what currently works well in the market rather than risking market distortion through the imposition of a previously untried market intervention.

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?**
- **Question 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" on page 28?**

Whether or not secure and promote is achieved through a licence obligation, a trading code or through voluntary commitments, it will be necessary to recognise the different requirements from different market participants in relation to each of the objectives. The proposed structure envisages a Trading Requirements Document setting out the detailed requirements that parties would face, and it is recognised that this document will need to evolve and adapt over time to reflect the needs of the market. The Requirements Document will be key to the success of intervention rather than the proposed licence condition itself and therefore it is essential that this reflects the needs of the market before there is an obligation to comply with the requirements. After Ofgem outlines what success looks like it may be necessary for the liquidity review to be broadened.

CHAPTER: Four

- **Question 9: Will trading along the curve naturally develop from the near-term market?**
- **Question 10: Should Ofgem intervene to ensure that robust reference prices along the curve develop?**
- **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?**
- **Question 12: Do you have any views on the design of the market making intervention outlined in this document – in particular those points listed under "outstanding design challenges" on page 33?**

It is uncertain whether trading along the curve will naturally develop from the near-term market. Ofgem should be in the position to intervene to ensure robust reference prices along the curve if it is deemed to be necessary.

More trading in both physical and financial products along the curve would be beneficial. While Ofgem has noted an increase in the number of firms registered to trade financial products, we believe it is also important to encourage more trading in physical products along the curve. Ofgem has noted that some independent players may be indifferent between hedging through physical or financial products. We believe that more transparency in OTC physical trading prices combined with increased day-ahead liquidity may encourage increased trading along the curve.

CHAPTER: Five

- **Question 13: Do you have any views on the MA design issues discussed in this chapter?**
- **Question 14: Do you believe that a hub approach to pool liquidity across multiple MA platforms is a viable option?**

The MA design is not the preferred option as it is currently presented, many issues need to be resolved and the details worked through, but it should not be entirely ruled out.

The MA option is the most risky of the options under consideration and may not improve access for independent suppliers. An MA is likely to require market participants to put up more working capital to cover both initial margin and regulatory capital requirements, potentially acting as a barrier to smaller participants.

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