



Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition

Consultation

Reference: 88/13
Publication date: 12 June 2013
Response deadline: 9 August 2013

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Overview:

Ofgem's liquidity project seeks to ensure that the wholesale electricity market supports effective competition, delivering benefits to consumers in terms of downward pressure on bills, greater choice and better service. Ofgem is concerned that poor liquidity in the wholesale electricity market is posing a barrier to effective competition, thereby preventing consumers from fully realising the benefits of competition. While we have seen some recent improvements, particularly in near-term markets, this progress has been insufficient. We therefore intend to intervene in the market to improve liquidity.

This document sets out our final proposals for a 'Secure and Promote' licence condition. This aims to improve the access of small suppliers to the wholesale market and to ensure that the market provides the products and price signals that all firms need to compete effectively. We have refined the design of Secure and Promote following our previous consultation, which was launched in December 2012.

We are keen to hear feedback from stakeholders on the proposals set out in this document. **The deadline for responses to this consultation is 9 August 2013.** Following this consultation, the Authority will take a decision on whether to launch a statutory consultation on implementing the Secure and Promote licence condition in Autumn 2013.

Context

Ofgem's principal objective is to protect the interests of present and future consumers.¹ In accordance with this objective, we want to ensure that liquidity in the GB wholesale power market is sufficient to underpin well-functioning, competitive generation and supply markets.

Under the Third Package², Ofgem also has a duty to promote integrated European energy markets. Ofgem's view is that improvements to the wholesale power market will support this objective and has taken into account the need to promote integration in the consideration of intervention mechanisms.

This consultation represents the latest phase in Ofgem's liquidity project, through which we have been monitoring the wholesale market and considering interventions that could improve liquidity. Alongside the Retail Market Review, it forms part of Ofgem's efforts to ensure that consumers get the best possible deal from energy markets. We have previously maintained that we would prefer to see industry initiatives deliver improvements. However, because such initiatives have not delivered the improvements we need to see, we now intend to intervene.

Associated documents

- Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition - Draft Impact Assessment
<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Liquidity%20draft%20IA%20120613.pdf>
- Retail Market Review: final domestic proposals, 27 March 2013, Reference 40/13
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr>
- Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition, 5 December 2012, Reference: 163/12
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=324&refer=Markets/RetMkts/rmr>

¹ This includes the interests of consumers in the fulfilment by Ofgem, when carrying out its functions as designated regulatory authority for Great Britain, of the objectives set out in Article 40(a) to (h) of the Gas Directive and Article 36(a) to (h) of the Electricity Directive.

² The term "Third Package" refers to Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 (Gas Directive) and Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 (Gas Directive) and Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 (Electricity Directive), concerning common rules for the internal market in natural gas and electricity respectively.

Contents

Executive Summary	4
1. The rationale for our intervention	6
Why liquidity in energy wholesale markets is important	6
Our updated view of the market	7
Our conclusion	9
Messages from the previous consultation	11
Final proposals on S&P	12
2. The legal structure of S&P	14
Legal approach to S&P	14
Implementation of S&P	18
3. Detailed design of the Supplier Market Access rules	19
Supplier Market Access rules	19
Detailed design of the SMA rules	20
Key outstanding design issues	26
4. Detailed design of the market making obligation	28
The market making obligation	29
Key outstanding design issues	33
5. Near-term markets	37
Progress against our objective for the near-term market	37
Our future approach to the near-term market	39
6. Next steps	40
We are seeking your feedback on S&P	40
Appendices	41
Appendix 1 – Consultation Response and Questions	42
Appendix 2 – Update on key liquidity metrics and the policy context	44
Appendix 3 – Illustrative draft Secure and Promote licence condition	51
Appendix 4 – Glossary	60
Appendix 5 – Feedback Questionnaire	66

Executive Summary

Poor liquidity imposes costs on consumers

Ofgem's liquidity project aims to identify and remove barriers to competition in the wholesale energy markets. Alongside the Retail Market Review, it is a key part of Ofgem's work to ensure that consumers get the best possible deal from energy markets.

We are concerned that the wholesale electricity market is still not delivering the products and price signals that are needed to facilitate competition. This means market participants – particularly independent market participants – may struggle to enter the market and compete effectively. Poor liquidity therefore prevents consumers from fully realising the benefits that competition can deliver in terms of downward pressure on bills, better service and greater choice.

Our final proposals: Secure and Promote

We intend to intervene to improve liquidity

Our preference has been for market-led solutions to poor liquidity and we have been urging market participants to identify such solutions for several years. However, we have not seen sufficient progress, or a clear plan that would deliver such progress, particularly in forward markets. As a result, **we intend to intervene in the market through a 'Secure and Promote' (S&P) licence condition.** We believe that S&P will meet our objectives more successfully and at lower cost and risk than any alternative intervention.

We have set out our final proposals for S&P

This document sets out our final proposals for S&P for consultation. These proposals take into account helpful responses from stakeholders to our previous consultation, including on the interactions with European financial legislation and the costs and benefits of intervening in near-term markets. The proposals are also based on further detailed work, especially in some key areas. For example, we have given further careful thought to the licensees who should undertake the S&P obligations. We have also paid attention to the legal structure of S&P, to ensure that there is a robust and fair process for changes to the licence condition. As a result of our further analysis, we are confident that S&P is an effective and proportionate route to meeting our objectives.

The table below summarises our final proposals in relation to each of our three liquidity objectives:

	Objective	Proposed intervention under S&P	Licensees subject to obligation
1	Availability of products that support hedging	Supplier Market Access Rules – Rules to ensure small suppliers can access the wholesale market products they need	Centrica, Drax Power, E.ON UK, EDF Energy, GDF Suez, RWE Npower, ScottishPower, SSE
2	Robust reference prices along the curve	Market Making Obligation – Licensees must post bid and offer prices in the market, supporting price discovery and ensuring regular opportunities to trade	Centrica, E.ON UK, EDF Energy, RWE Npower, ScottishPower, SSE
3	Effective near-term market	Reporting requirements – Monitoring of near-term to ensure it remains liquid. We stand ready to intervene if necessary	Centrica, Drax Power, E.ON UK, EDF Energy, GDF Suez, RWE Npower, ScottishPower, SSE

Some stakeholders have proposed alternative mechanisms for intervening to improve liquidity, including the self-supply restriction (SSR). Our view is that an SSR would not be as successful in meeting our objectives as S&P. Depending on its design it could either be ineffective or impose significant costs. We have also chosen not to proceed with our proposals for a Mandatory Auction (MA). We note stakeholders' concerns that the MA would not provide continuous opportunities to trade and could be costly to access.

We are keen to have further discussions on the detail of our S&P proposals

While we intend to proceed with S&P, there is still scope for further discussion in a number of areas on the detail of the intervention. We therefore encourage stakeholders to engage with our work to ensure S&P is as effective as possible.

One area where we particularly welcome feedback is on the delivery of market making. Our starting point is that market making would be delivered through licence obligations. However, some stakeholders have suggested that an industry tender process may be preferable. We believe there are practical challenges to an industry tendered approach. However, if stakeholders are able to propose a credible, practical plan for the timely implementation of market making through an industry tender process, we will consider it as an alternative to the market making obligation.

Next steps

Following this consultation, the Authority will decide whether to proceed to statutory consultation on the S&P licence condition. Our intention would then be to issue the formal direction to amend licences before the end of 2013, ensuring that the licence condition comes into effect in early 2014. An industry tender approach for market makers would need to be completed without further delay to this timetable.

1. The rationale for our intervention

Chapter Summary

Ofgem's liquidity project is concerned with ensuring the wholesale energy markets function effectively and promote competition. We have been concerned that poor liquidity in the electricity wholesale market inhibits competition and imposes costs on consumers. Our updated assessment suggests that the market is still not meeting the needs of market participants. Based on this assessment, relevant policy workstreams and responses to our previous consultation, we now intend to introduce a 'Secure and Promote' licence condition to improve liquidity.

Question 1: Do you agree with our updated assessment of the wholesale market (set out in this chapter and appendix two)?

Question 2: Do you agree with our conclusion that we should intervene in the market in the form of the 'Secure and Promote' licence condition set out in this document?

Why liquidity in energy wholesale markets is important

Effective wholesale energy markets can deliver benefits to consumers

1.1. Consumers can benefit from competitive energy markets through downward pressure on bills, better service and greater choice. Ofgem's liquidity project is driven by the concern that poor liquidity in the wholesale electricity market means it does not effectively support competition in the generation and supply markets.

1.2. Liquidity is the ability to quickly buy and sell a commodity without a significant change in its price and without incurring significant transaction costs.³ A lack of liquidity can prevent consumers from fully realising the benefits of competitive markets through a number of channels:

- **Deterring entry and growth of players in the market** – Poor liquidity limits the ability of entrants and small firms to buy and sell electricity in the wholesale market. This may prevent them from selling their output or sourcing energy to supply to their customers. This barrier to entry and growth in the market removes a competitive threat to incumbent firms.
- **Inhibiting competition between existing players in the market** – Poor liquidity in the electricity wholesale market limits opportunities to

³ Chapter one of the draft Impact Assessment includes a more extensive discussion of what liquidity is and why it is important. See also Ofgem (2009) 'Liquidity Proposals for the Great Britain (GB) wholesale electricity market', paragraphs 1.7 to 1.12.

trade, acting as a barrier to firms seeking to increase their market share and reducing the scope to identify optimal hedging strategies that provide customers with the best possible deal. It could also encourage business models that reduce the need to trade in the wholesale market, such as vertical integration and long-term contracts. Poor liquidity therefore inhibits competition between incumbent players in the market.

- **Weakening price signals that help to ensure security of electricity supplies** - In order to make decisions about investment in new generating plant and about when to carry out maintenance, generators need robust and transparent forward market prices. Poor liquidity may obscure or weaken these price signals, potentially having a negative impact on the security of consumers' electricity supplies.

1.3. It is therefore vital that we ensure that wholesale markets are liquid, so that consumers can be confident that they are getting the best possible deal.

Regulatory intervention can deliver improved liquidity

1.4. Poor liquidity can be self-reinforcing. Poor availability of products and price signals can deter firms from trading in the market, which then further reduces the availability of products and prices. The market therefore becomes locked in a low-liquidity equilibrium. There may be insufficient incentives for individual firms to break free from this equilibrium. However, an external shock – such as a regulatory intervention – can set liquidity on an upward path. As firms become confident that products will be available at robust prices, they will increase their participation in the market, further improving liquidity. A more detailed discussion on the effects of poor liquidity and the scope for regulatory intervention to improve liquidity can be found in chapter one of the draft impact assessment.

Our updated view of the market







Analysis of key liquidity metrics

1.5. To assess liquidity in the market, we monitor a range of key wholesale market metrics. We have used this analysis to chart progress against our three liquidity objectives. These objectives reflect key characteristics that the wholesale market should demonstrate in order to effectively support competition:

- 1) Availability of products that support hedging
- 2) Robust reference prices along the curve
- 3) An effective near-term market.

1.6. We have seen some progress towards our objectives, particularly in near-term markets. However, our analysis, coupled with feedback from stakeholders, suggests that forward market liquidity remains poor. Figure 1 summarises the key findings from our latest analysis of the market. More detail can be found in appendix two.

Figure 1 – Summary of wholesale market developments

Objective	Metric	Updated analysis	Progress to date
Overall market liquidity	Churn	Churn remains around 3 in 2013 to date, and is marginally lower than during the same period in 2012.	
Objective 1 – availability of products that support hedging	OTC trading in forward products	The proportion of the market traded more than 13 months ahead of delivery has increased for baseload products so far in 2013. However, trading in peak products more than 13 months ahead has declined to the lowest level since 2008, to around 3 per cent of peak trading.	
	Independents' ability to trade	Continued anecdotal evidence that some large firms are more willing to enter into agreements to trade OTC with independent suppliers, although feedback from independent suppliers remains mixed.	
Objective 2 – robust reference prices	Bid-offer spreads	So far in 2013 we have seen a narrowing of spreads – they are currently at their lowest since 2010. This is likely to be driven to some extent by underlying seasonal trading patterns (see appendix two). Spreads are still markedly higher than in the GB gas market.	
	Trading in financial products	The significant increases in trading in financial products during 2012 have been reversed in 2013 to date. Trading in financial products made up 0.3 per cent of overall traded volumes in Q1 2013 compared to 4 per cent in Q1 2012.	
Objective 3 – effective near-term market	Near-term exchange trading	Since Autumn 2012 volumes traded on near-term exchanges have remained broadly constant. This follows a 12 month period of strong growth.	

Source: ICIS Heren, APX, N2EX, ICE, Digest of UK Energy Statistics (DUKES), Nasdaq OMX

Policy developments

1.7. Alongside developments in the market, there are a number of key policy workstreams that have helped to shape our view of how liquidity is likely to evolve and the detailed design of our proposals. These workstreams are summarised below and examined in more detail in appendix two:

- **Ofgem's Retail Market Review (RMR)** – The RMR aims to make energy retail markets simpler, clearer and fairer, making it radically easier for consumers to choose their energy supplier. Low engagement in retail markets and poor liquidity in wholesale markets can have mutually reinforcing effects. The RMR and the liquidity project are therefore complementary aspects of Ofgem's work to break this cycle and ensure that the markets work effectively in the interests of consumers.
- **Electricity Market Reform (EMR) and the Energy Bill** – There are a number of interactions between liquidity and the EMR programme – for example, the reference prices for the FiT-CfD for low-carbon generation. The Energy Bill, which provides the legislative underpinning for EMR, also includes backstop powers for the Secretary of State to act to promote liquidity if Ofgem's liquidity project does not fully meet the Government's objectives. The Government have stated that Ofgem's liquidity project remains the primary vehicle for improving liquidity and has encouraged stakeholders to engage constructively with Ofgem's process.
- **European financial legislation** – A number of reforms to European financial regulation are currently under development, including revisions to the Markets in Financial Instruments Directive (MiFID II) and the European Market Infrastructure Regulation (EMIR). These have implications for trading in energy wholesale markets, as well as for the design of our proposals (see chapter four for more detail).
- **European target model** – The European Target Model sets out a vision for a single European market in electricity by 2014 through 'market coupling'. To facilitate market coupling at the day-ahead stage, a virtual hub is being developed to create a single day-ahead price for the GB price zone. This will pool liquidity across the two existing day-ahead auction platforms, potentially providing a spur to liquidity in this part of the market (see chapter five for more detail).

Our conclusion

We intend to intervene through the 'Secure and Promote' licence condition

1.8. Based on the developments discussed above, our further engagement with stakeholders and our own further policy development, **we believe there is a clear rationale for intervention in the market to improve liquidity**. Our analysis suggests that there have not been sufficient progress against our objectives,

particularly in forward markets. Though we recognise that some market participants have put significant efforts into identifying routes to meeting our objectives, overall we have not seen the improvements needed.

1.9. Following the previous consultation and our further policy work, we believe that **the S&P licence condition is the most effective intervention to improve liquidity**. We believe it will do so at lower cost and risk than any alternative intervention options.

Rationale for not pursuing other intervention options

1.10. We have considered a range of other intervention options during the course of the liquidity project. Our reasons for not pursuing the key alternative options are set out below:

- **Mandatory Auction** – We previously consulted on a Mandatory Auction (MA), which would require parties to auction 25 per cent of their generation in a specified range of products each month. A MA could provide regular opportunities to trade and robust reference prices along the curve. However, stakeholders expressed concerns over the lack of continuous trading provided by the MA, and the potential costs of trading on a cleared platform.
- **Self-supply restriction (SSR)** – A number of stakeholders highlighted an SSR as an alternative approach to improving liquidity. There are various potential designs for an SSR. These range from 'light' versions, featuring restrictions on the level of intra-group transfer of energy between different parts of vertically integrated companies; to 'heavy' versions, which could involve the complete operational separation of the generation and supply businesses of vertically integrated players.

Light versions of SSR are likely to be relatively low impact: they may even have no marginal impact on liquidity. In contrast, heavy versions may deliver some increase in traded volume, but would probably impose high costs on industry (and therefore consumers). Either version of SSR would fall short of meeting our objectives: for example they do not ensure an increase in liquidity along the curve and would do nothing to ensure that smaller players can get access to the products they need.

- **Obligation to trade** – This would require firms to trade a minimum volume in the market. This approach was proposed by some stakeholders during the previous consultation. Unlike the SSR, an obligation to trade could ensure an increase in volumes traded along the curve since it would be possible to specify which products the licensees would have to trade. However, in having to meet this obligation, there is a risk that these firms would have to trade at uneconomic prices, becoming distressed buyers or sellers. This would introduce distortions into the market price.

1.11. Summary impact assessments for each of these alternative intervention options can be found in appendix two of the draft Impact Assessment.

Messages from the previous consultation

1.12. In December 2012, we launched a consultation on our 'straw man' Secure and Promote (S&P) proposals. This consultation yielded helpful feedback from stakeholders on the design of our S&P proposals as well as a range of other issues. Figure 2 below summarises the key messages from the consultation. These views have played a central role in our further policy development.

Figure 2 – Key messages from previous consultation

Topic	Headline messages
Progress of the market towards our objectives	<ul style="list-style-type: none"> • Many respondents agree with our evaluation that our liquidity objectives remain unmet • Few respondents thought that curve liquidity would develop naturally from the near-term
Structure of S&P	<ul style="list-style-type: none"> • Overall view of S&P package fairly positive, with most respondents saying that it could help to meet our objectives • Although many respondents agreed with the structure of S&P, there were some disagreement on the legal approach, especially the role played by the Trading Requirements Document and the choice of licensees
'Fair and reasonable' trading terms	<ul style="list-style-type: none"> • Our proposals on trading agreements received support, although there was also a clear message that more needs to be done to refine the detailed design, particularly in relation to credit and pricing
Improving liquidity and reference prices along the curve	<ul style="list-style-type: none"> • Support for the view that market making could help to improve liquidity along the curve, although concerns raised in relation to European financial regulation • Alternative intervention options discussed, but little consensus as respondents supported a range of proposals
Day-ahead auctions	<ul style="list-style-type: none"> • Mixed views about whether intervention in relation to day-ahead auctions is worthwhile or desirable
Mandatory Auction	<ul style="list-style-type: none"> • A clear majority of respondents thought that S&P would be a more effective intervention than the MA

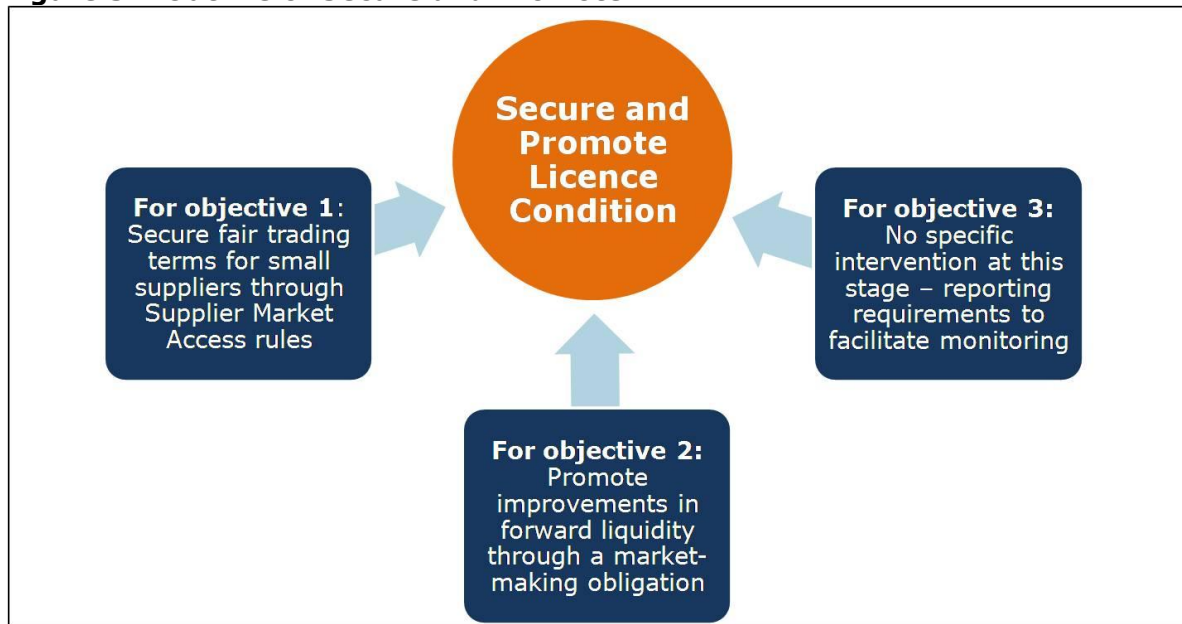
1.13. We also issued a Request for Information (RFI) to the proposed licensees on the costs of meeting the S&P obligations. This information has been central to the preparation of the draft Impact Assessment published alongside this document.

Overall it has contributed to our view that the costs of S&P will be lower than the benefits that it could deliver to consumers.

Final proposals on S&P

1.14. Based on these messages, as well as our further policy analysis, we have refined the design of S&P. Figure 3 below summarises our final proposals for S&P:

Figure 3 – Outline of Secure and Promote



1.15. The most significant changes to the design of S&P since the December 2012 consultation are:

- **We propose a market making obligation to meet objective two, with the option of nominating a third party to undertake the obligation** – Our previous consultation noted that, if we did decide to proceed with intervention in relation to objective two, our lead option would be to introduce market making. We now confirm our view that market making is the intervention most likely to improve liquidity and reference prices along the curve. However, due to the interactions with European financial regulation, we propose that licensees will be able to nominate a third party to undertake market making on their behalf if they choose. Chapter four sets out the detailed design of our proposed market making obligation.
- **No intervention in near-term markets at this stage, but reporting requirements** – In our December 2012 consultation, we proposed locking in the growth in volumes on day-ahead auction platforms, through licence obligations. Informed by responses to the previous

consultation, we have given further thought to the costs and benefits of this approach. We no longer propose to intervene in near-term markets at this stage. Instead, S&P includes reporting requirements to ensure that we can monitor liquidity in near-term markets effectively. However, we stand ready to intervene in future if we believe that it would be beneficial.

- **Greater detail across all intervention options** – We recognise that, in order to properly evaluate our proposals, stakeholders need to see as much detail as possible. For this reason, in chapters three, four and five we set out our S&P proposals and the thinking behind them in a greater level of detail than previously. We have also included an illustrative draft licence condition in appendix three, to enable stakeholders to see how S&P will be given legal effect.
- **Further analysis on the licensees who are subject to the obligations under S&P** – We have given careful further thought to the question of which firms should face the obligations under S&P. This work has considered the current structure of the market, the ability of firms to meet our obligations at reasonable cost and risk and the need to ensure that the intervention is effective. As a result of this analysis, we are now proposing different lists of licensees for the Supplier Market Access rules and the Market Making obligation. We believe our proposals for who should face the obligations under S&P ensure that it can be delivered effectively and at reasonable cost and risk to licensees.
- **Changes to the legal structure of S&P to ensure a fair and robust change process** – During the previous consultation, stakeholders noted that the process for making changes to S&P needs to be fair and robust. As a result, under our final proposals, the detailed obligations of S&P will be implemented through schedules to the licence condition. This approach means that modifications to those schedules would follow the standard statutory process, including consultation phases and opportunities for appeal.

We want stakeholders' feedback on the detailed design of our S&P proposals

1.16. Although we are clear about the overall shape of the intervention we intend to pursue, there remains significant scope for further discussion on the detail of S&P. In some areas, it may be that our proposals can be improved. The remainder of this document sets out our proposed detailed design and invites stakeholders to comment on all aspects of it.

1.17. Following this consultation, we intend to amend licence conditions and implement S&P as quickly as possible to limit the costs imposed on consumers by poor liquidity. Our initial view is that S&P can be fully implemented early in the first quarter of 2014.

2. The legal structure of S&P

Chapter Summary

We have developed our S&P proposals based on responses to the previous consultation and our further work. In particular, we have revised the proposed approach to codifying the legal structure of the obligation and given careful consideration to the question of who should face the obligation. We believe our final proposals deal with the most significant concerns expressed by stakeholders and ensure that S&P is underpinned by a robust legal framework.

Question 3: Do you agree with our proposed legal approach to S&P?

Question 4: Do you agree with our proposals for who should face the obligations under S&P?

Legal approach to S&P

Codifying the obligation

2.1. S&P will be introduced through a special licence condition in the generation licence. Some of the relevant activities under S&P may be carried out by another part of the firm's business (for example, a separate trading business). Where this is the case, the generation licensee will still be responsible for ensuring that the obligation is met by its affiliates.

2.2. We previously proposed that the detail of S&P would be in a separate document to the licence condition (referred to as the 'Trading Requirements Document'). Several stakeholders expressed the view that the detail of S&P should instead be included in the licence condition itself, to ensure a robust process for modifications. In response to this, we now propose to include the detail of the S&P obligation in three schedules to the licence condition: schedule A for the Supplier Market Access rules, schedule B for the Market Making obligation and schedule C, which sets out the reporting requirements for the licensees. Modifications to those schedules would follow the standard statutory process, including consultation phases and opportunities for appeal. Indicative drafts of these schedules are included at appendix three. We will also publish guidance to provide further clarity on the actions licensees are expected to perform. We intend to publish a draft of this guidance as part of the statutory consultation.

2.3. We believe that this is a robust approach which responds to stakeholders' concerns about the legal approach to S&P. However, it is important to note that maintaining flexibility within S&P would be valuable, as it would allow the obligation to quickly adjust to the needs of market participants. We would therefore welcome feedback on how flexibility can be maintained within this framework.

Enduring monitoring and enforcement

2.4. The S&P licence condition will be subject to the normal enforcement processes applicable to generation and supply licences, set out in Ofgem's Enforcement Guidelines on complaints and investigations.⁴ We will actively monitor compliance based on our wholesale market monitoring, information collected from the licensees, broader consultation with other market participants, and any complaints that we may receive. More detail on the information we intend to collect to support the monitoring of S&P is set out at the end of chapters three and four.

2.5. As with all licence conditions, any decision to investigate a potential breach of S&P would be made in accordance with the Enforcement Guidelines and would take the facts of the case into account. Factors considered before investigating a potential infringement include (but are not limited to) the extent of the potential harm to consumers and whether the licensee takes steps to address the situation.

S&P Licensees

2.6. We have given careful thought to the question of which licensees should face the S&P obligation. There are a number of factors that we have considered, including:

- the structure of the generation and supply markets
- the key players in the market
- licensees' capability to meet the obligations at proportionate cost and risk
- the need to ensure that the intervention is effective

2.7. Based on this assessment, we have updated our view of which parties should face the S&P obligation. In our final proposals, the list of licensees is different for the two obligations. The proposed licensees are set out in Figure 4 below:

Figure 4 – S&P licensees

Supplier Market Access rules		Market Making obligation	
Centrica	GDF Suez	Centrica	RWE Npower
Drax Power	RWE Npower	EDF Energy	ScottishPower
EDF Energy	ScottishPower	E.ON UK	SSE Generation
E.ON UK	SSE Generation		

⁴ Ofgem (2012), Enforcement guidelines on complaints and investigations: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=39&refer=Aboutus/enforcement>

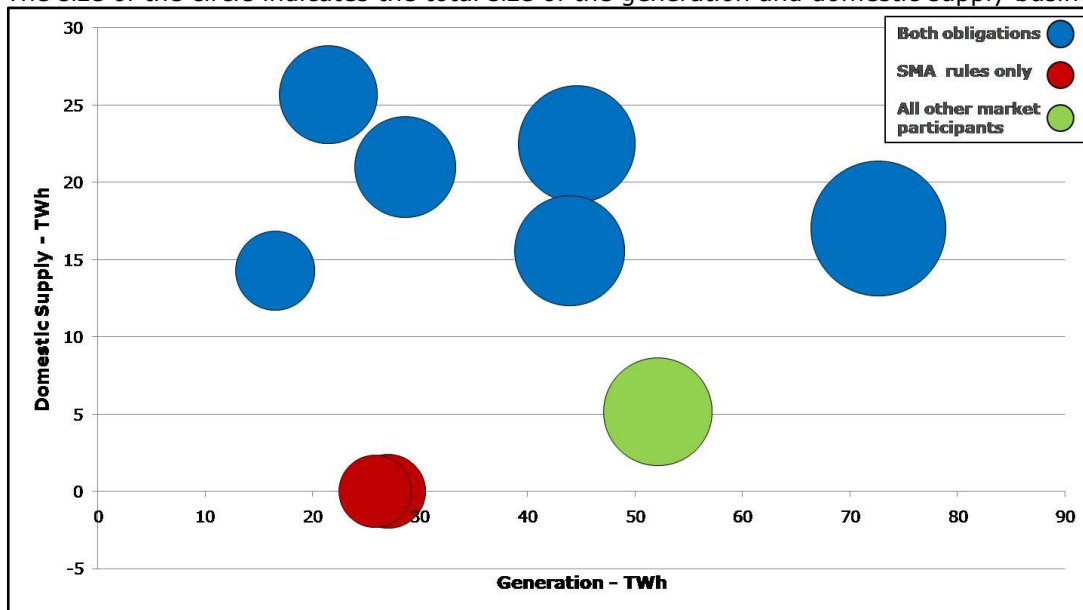
Rationale for licensees who face the market making obligation

2.8. Our rationale for the firms who will face the market making obligation is as follows:

- **The domestic supply market** – the firms subject to the market making obligation control around 98 per cent of the domestic supply market⁵, and hold broadly stable shares of this market.⁶ The domestic supply market has characteristics that may reduce suppliers' incentives to trade in the wholesale market. Domestic customers are 'sticky': nearly two thirds have never switched their supplier.⁷ As a result, the need for suppliers to trade in response to changes in customer numbers is reduced. They will also have less need to compete to identify the optimal hedging strategy in order to provide the best possible price offer to their customers.⁸ This intervention will ensure that the firms with large domestic supply businesses are required to fully engage in the wholesale market and contribute to liquidity.

Figure 5 – Generation and domestic supply market share (2012)

The size of the circle indicates the total size of the generation and domestic supply business.



Source: Datamonitor

⁵ Ofgem (2013) Retail Market Review: Final Domestic Proposals, p19: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr>

⁶ Ofgem (2013) Retail Market Review – Updated Domestic Proposals, p 35: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf>

⁷ Ofgem (2013) Retail Market Review: Final Domestic Proposals, p18

⁸ This contrasts to some extent with the non-domestic market, where consumers tend to be more active and suppliers may have a greater need to trade in response to changes in customer numbers and to offer the best prices.

- **Vertical integration** – As can be seen from Figure 5, the parties subject to the market making obligation have a substantial presence in both generation and domestic supply markets. Vertical integration provides an alternative to wholesale market trading that is not available to independent players. While the proposed licensees do participate in the wholesale market, they have a continuous option to source energy from their affiliate business as an alternative. This option may be particularly valuable when liquidity is poor and their participation would be particularly beneficial. This intervention will ensure the licensees are present in the wholesale market on a relatively continuous basis.
- **Trading capabilities** – These firms are the six largest players in the generation and supply market considered as a whole. Because of their size and vertical integration, they regularly take both long and short positions and have the capabilities to take a sophisticated view of market prices. This ensures they are able to market make at reasonable cost and risk. Their size is also likely to mean that the costs of meeting the obligation are likely to be small in comparison to their existing businesses.
- **Effectiveness of the intervention** – The market making intervention can be delivered successfully with the licensees we have identified. The benefit of additional market makers might be limited, but the costs would be higher.⁹ We believe our proposed list of licensees provides the best balance of costs and benefits to consumers.

2.9. Our analysis has considered the factors above collectively. No one factor has determined our conclusion. While there are other firms that may have some of the above characteristics, the factors above mean that these six firms are a distinctive subset of the market. For example, we have considered the case for bringing the other two largest generators within the scope of the market making obligation. We have decided against this due to the significant differences between these two firms and the six licensees subject to the market making obligation. For example, they are not present in the domestic supply market. In addition, as noted above, we believe that six is a sufficient number of market makers. Bringing other firms within this obligation would impose additional cost on the industry without countervailing benefits.

Rationale for who faces the Supplier Market Access rules

2.10. The main purpose of the SMA rules is to ensure that suppliers can get access to power in the wholesale market. The firms in the market best placed to provide this power are the larger generators. We therefore propose that the eight largest generators should face the SMA rules. Together these players make up more than 80 per cent of the generation market. Extending the obligation to eight licensees (rather than the six who face the market making obligation) ensures that small suppliers can

⁹ The draft Impact Assessment estimates that for each licensee, the set-up cost of market making would be £300,000, and the ongoing cost would be £1.6m per year.

access a broad range of counterparties with diverse generation sets. It also spreads the burden of the obligation to some extent.

2.11. There are other market participants – particularly independent generators – who could also be subject to the SMA rules. However, we do not believe it would be cost-effective to broaden the obligation beyond the eight companies we have identified: it would impose costs on these businesses while not proportionately improving the effectiveness of the intervention. Considering their smaller size compared to the proposed licensees (the next largest generator generates around half the output of the smallest S&P licensee), the costs imposed by the obligation could be more significant in the context of these generators' existing businesses.

Changes to the S&P licensees

2.12. Over time, the characteristics of market participants may change such that the list of licensees should change. We will therefore keep the list under review. For example, if a large independent generator gained a sizeable share of the domestic supply market, we would consider whether the licence should apply to them. Similarly, if the activities of an existing S&P licensee changed significantly – for example, if they exited the domestic supply market – we would consider whether their obligations should be removed. Any amendments to the list of S&P licensees would need to be justified in relation either to the effectiveness of the obligation or the fair treatment of different parties within the market.

Implementation of S&P

2.13. Providing no fundamental obstacles to S&P are identified, following this consultation, the Authority will decide whether to launch a statutory consultation on S&P in Autumn 2013. We would then intend to issue a decision to modify licences before the end of the year. Following this, we may allow a short implementation period before S&P takes effect. However, we want to see our intervention implemented quickly, to limit the costs imposed on consumers by poor liquidity. Our current view is that the licensees could be compliant with S&P before the end of the first quarter of 2014. We are keen to hear stakeholders' views on this timetable.

Post-implementation review

2.14. To minimise uncertainty for market participants, we would intend to leave S&P in place for a defined period (for example, three years) before making fundamental changes. After this period, we would expect to conduct a review of whether S&P remains appropriate.

3. Detailed design of the Supplier Market Access rules

Chapter Summary

Objective 1 requires that all market participants can successfully gain access to the wholesale market products they need to compete effectively. S&P includes a series of 'Supplier Market Access rules' to ensure that small suppliers can get access to the products they need in the wholesale market. Based on consultation responses and our own further analysis (including advice from industry experts), we have set out our final proposals for these rules and seek views from stakeholders on them.

Question 5: Do you have any views on our final proposals for the Supplier Market Access rules, particularly those aspects listed under 'key outstanding design questions'?

Question 6: Are there any further areas that these rules should cover?

3.1. Our proposals for objective 1 (availability of products that support hedging) aim to ensure that smaller independent suppliers can gain access to the wholesale market on reasonable terms. We have heard repeated concerns that independent suppliers have problems setting up trading agreements through which to access the wholesale market. This inhibits their ability to grow to become viable competitors to the large vertically integrated suppliers. This is particularly evident in the domestic supply market, where the six large suppliers control more than 98 per cent of the market.¹⁰

3.2. It is important to recognise that some market participants have already made efforts to improve their approach to trading with independent suppliers. We welcome these efforts. We hope to build on them through this intervention and ensure they become common practice across all the larger players in the industry.

Supplier Market Access rules

The aim of the Supplier Market Access (SMA) rules

3.3. The SMA rules set out the minimum standards that small suppliers should expect when negotiating trading agreements with the large players. They are designed to address the specific issues faced by small suppliers.

¹⁰ Ofgem (2013) Retail Market Review: Final Domestic Proposals, p19: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr>

3.4. The SMA rules seek to:

- **Ensure that negotiating trading agreements with small suppliers is not treated as a low priority.** While it may be commercially rational for a player to prioritise trading with larger counterparties over smaller ones, it is potentially a barrier to competition and therefore may not be the right outcome for consumers over the long-term. The SMA rules will ensure that requests from small suppliers are not ignored or delayed.
- **Enable smaller market participants to access the products that meet their hedging needs,** in volumes that are appropriate for their size, and at fair prices. This will help small suppliers to manage their price risk, meaning they can provide an improved price offer to their customers and can compete more effectively with larger players.
- **Ensure the fairness and transparency of credit and collateral terms.** While credit and collateral play an important role in the wholesale market, small suppliers should have confidence that their individual circumstances have been considered, and that the terms they are offered are a reasonable reflection of the risks associated with trading with them.

3.5. It is also important to note what the SMA rules do not intend to do. Firstly, they are not intended to cover every aspect of trading agreements. They do not aim to prevent parties from innovating and pursuing approaches beyond the rules we have set out.

3.6. Secondly, these rules do not aim to increase the level of counterparty risk in the market. We recognise that credit requirements are one of the main barriers to the wholesale market for smaller market participants and the SMA rules aim to mitigate the effects of this barrier. However, credit requirements play an important role in maintaining the stability of the market. It is in the interests of consumers to ensure that these terms remain robust. The SMA rules aim to ensure that the credit terms offered appropriately reflect the risks of trading and that the reasons for the terms offered to small suppliers are communicated transparently.

Detailed design of the SMA rules

Detailed requirements

3.7. Our further policy work and responses to the previous consultation have enabled us to refine our final proposals for the SMA rules. Figure 6 below sets out our proposals. The subsequent sections examine each proposed rule in more detail. We are keen to have feedback from stakeholders on all aspects of these rules.

Figure 6: Supplier Market Access – detailed rules

Element	Requirements
A1 – Transparency	<p>Licensee must provide a named contact on its website for requests for trading agreements.</p> <p>Licensee must provide on its website a list of the information that is required from a potential counterparty in order to process a request for a trading agreement. Licensees may only request information that is relevant to this request.</p>
A2 – Scope	<p>Licensees must follow these rules in trading with all suppliers whose affiliated parties supplied less than 5TWh and generated less than 1TWh in the previous year, up to a limit of 0.5TWh per counterparty. Ofgem will publish a list of eligible suppliers. If a group has multiple generation and/or supply licences, eligibility will be considered on a group basis.</p>
A3 – Response to trading requests	<p>Licensee must respond in a timely manner, by fulfilling the steps below:</p> <ol style="list-style-type: none"> 1. Licensee must acknowledge a written request for a trading agreement within 2 working days. The acknowledgement must state whether necessary information has been received, or specify the further information that is required. If the request is resubmitted with further information, the licensee must acknowledge the subsequent request within 2 days. 2. The licensee must send a written response to the request within 15 working days after receipt of a complete trading request. This response must include: a formal offer of a trading agreement including all relevant terms and conditions; or if the licensee cannot trade with the counterparty for legitimate reasons, the reasons for this position. 3. Licensee must ensure that any subsequent negotiations proceed in a timely manner. The licensee will not be held responsible for delays due to its counterparty. 4. If no agreement has been reached within 60 working days from the receipt of a complete trading request, the licensee must write to the counterparty within 5 working days, noting the outstanding areas of disagreement, and offering a face-to-face meeting within 20 working days from the date of writing to discuss these areas. 5. Following the meeting, if no agreement is reached, the licensee must continue to negotiate in good faith until such a time as agreement is reached or both parties agree to cease discussions. 6. Small suppliers are expected to negotiate in good faith. Ofgem reserves the right to remove them from the list of eligible suppliers in the event that they act in bad faith eg through vexatious requests for a trading agreement. <p>Requests to trade</p> <p>Once a trading agreement is in place, the licensee must respond to requests to trade within 3 hours of receipt. If the request is received on a non-working day, or less than three hours before the end of a working day, a response must be provided by 11.00 am on the next working day.</p>

Figure 6: Supplier Market Access – detailed rules (cont.)

<p>A4 – Credit and Collateral</p>	<p>Licensee must offer proportionate credit and collateral arrangements.</p> <p>Credit terms will be considered to be proportionate when the following conditions are met:</p> <ul style="list-style-type: none"> • In reaching its decision, the licensee follows a process which takes into account the individual circumstances of a counterparty, through consideration of a range of relevant information • The credit terms are a reasonable reflection of the risks of trading with the counterparty <p>Licensee must also clearly explain the rationale for credit decisions.</p> <p>When responding to a request for a trading agreement, the licensee must complete a Credit Transparency Form which justifies its credit decision. This must set out:</p> <ul style="list-style-type: none"> • The credit terms and collateral arrangements offered • The quantitative and qualitative factors and information taken into account in making this assessment • Any steps the counterparty could take which could result in a material improvement in the credit terms offered. <p>The licensee must share the Credit Transparency Form with the counterparty and be prepared to discuss it. These credit forms should be held on file for Ofgem audit for three years.</p>
<p>A5 – Clip Size</p>	<p>If requested, licensee must trade clip sizes as small as 0.5MW, and in minimum increments of 0.5MW above that.</p>
<p>A6 – Product Range</p>	<p>If requested, the licensee must be willing to trade at least the following standard products:</p> <p>Baseload: Week+1, Month+1, Month+2, Quarter+1, Season+1, Season+2, Season+3, Season+4</p> <p>Peak: Week+1, Month+1, Month+2, Quarter+1, Season+1, Season+2, Season+3</p>
<p>A7 – Fair and Transparent Pricing</p>	<p>Licensee must provide quotes for products reflective of the market price.</p> <p>Any added fees (for example trading fees) charged by external platforms should be itemised and justifiable</p> <p>The licensee should not include any administration costs in the price quoted.</p>

A1 – Transparency

3.8. Licensees will have to make publicly available (for example, on their website) an individual to be the first point of contact for trading requests from small suppliers. To ensure that small suppliers submit all of the relevant information necessary to process a trading request, licensees must also publish a list of the required information. It is then the small suppliers' responsibility to ensure that they provide the required information. This rule will help to speed up the process for small suppliers seeking to make contact and begin negotiations on a trading agreement.

A2 – Scope of the Supplier Market Access rules

3.9. In our December 2012 consultation document¹¹ we suggested that the SMA rules¹² should be targeted at independent suppliers who supplied less than 1TWh in the previous year. During the consultation period a number of parties questioned this threshold. Some suggested that the 1TWh threshold for independent suppliers could create a 'cliff edge' which would increase uncertainty both for licensees and for small suppliers. Other stakeholders suggested that the rules should be market-wide and should apply to trading with all market participants.

3.10. We remain convinced that it is appropriate for the SMA rules to be accessible only to small suppliers without a substantial affiliated generation business. Our reasoning for this is:

- Targeting the rules means they are able to be more specific and focus on the particular needs of these firms. While other market participants (such as independent generators) do face barriers to the wholesale market, the characteristics of these firms mean that some of these barriers are less severe than those faced by smaller suppliers.¹³
- As noted in the draft Impact Assessment, many of the costs associated with the SMA rules would increase with take-up. Increasing the scope beyond small suppliers would therefore increase costs to obligated firms.

3.11. However, we have amended the proposed design in response to feedback in several important ways. We have increased the threshold up to which suppliers will be eligible for treatment under the rules to 5TWh and have limited the volume they are guaranteed to have access to from each licensee to 0.5TWh.

¹¹ Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition, p24

¹² Previously referred to as 'trading commitments'

¹³ For example, independent generators own valuable fixed assets in the form of generating plant. Generally speaking, these assets lessen the severity of barriers such as the need to post credit and collateral.

3.12. In order to provide certainty to licensees on which suppliers are eligible to access the SMA rules, Ofgem will publish a list of eligible suppliers. Suppliers who meet the criteria would apply to Ofgem to be added to the list. To mitigate the 'cliff edge' effects, we propose that once a supplier has been declared eligible, they will remain eligible for 12 months, even if they subsequently cease to qualify. Our final proposal for the scope of the obligation is summarised in Figure 7:

Figure 7 – Scope of the SMA rules

<u>Scope</u>	<u>Rationale</u>
<p>All suppliers whose affiliated parties:</p> <ul style="list-style-type: none"> i) supplied less than 5TWh ii) generated less than 1TWh <p>In the previous 12 months...</p>	<p>Targets the intervention on those who face the largest barriers.</p> <p>Assessed on a group basis to ensure that a larger supplier cannot access the rules by establishing multiple supply licences.</p>
<p>...up to a limit of 0.5TWh per counterparty, per year.</p>	<p>Limits the cost for licensees. If a small supplier is able to negotiate two trading agreements this would give them access to enough electricity to supply around 250,000 domestic customers per year¹⁴.</p>
<p>Ofgem will maintain a list of eligible suppliers on their website. Suppliers will apply to be on the list and will remain eligible for 12 months, after which they will need to reapply.</p>	<p>Provides clarity for licensees on who is eligible for treatment under the rules and minimises cliff edge effects.</p>

A3 – Responding to trading requests

3.13. These rules aim to ensure that small suppliers are not treated as a low priority. Feedback from our last consultation highlighted that the process of signing a GTMA can involve several stages, and that it may take some time for both parties to reach agreement. We have therefore set out a series of milestones to ensure that negotiations move along in a timely manner.

3.14. Eventually, the process for negotiating a trading agreement will come down to whether commercial terms can be agreed. To ensure that the communication channels remain open, the licensee is required to offer a meeting 60 working days after receipt of a complete trading request. This meeting will identify the outstanding barriers to an agreement and explore the potential solutions to them. If an agreement is still not reached then negotiations should continue until an agreement is reached, or both counterparties agree to terminate discussions.

¹⁴ Based on average domestic consumption of 3,330kWh per year

3.15. Throughout this process we expect small suppliers to act in good faith and to take clear steps to resolve any problems. This includes agreeing to terminate negotiations when it is clear that no agreement can be reached for good commercial reasons. Small suppliers who behave in a vexatious manner (for example, by prolonging negotiations beyond the point where there is any chance of agreement) could be removed from the list of eligible small suppliers and lose their access to the SMA rules.

A4 – Credit and Collateral

3.16. Our rules in relation to credit seek to improve the fairness and transparency of the credit terms offered to small suppliers. The rules outlined in Figure 6 above aim to ensure that the credit terms offered to small suppliers reflect the risks of trading with them. They also aim to improve transparency for small suppliers over the rationale for the credit terms they are offered, and may assist them to identify ways to improve these terms.

3.17. Key to this will be the Credit Transparency Form. This will be a pro forma template provided by Ofgem which must be filled in by the licensee when providing a credit offer. The form will clearly set out: the terms offered; the factors that have been taken into account in deriving that offer; and any actions that could be taken by the small supplier to improve the terms on offer. This form will be shared with the small supplier and held on file for a period of three years for Ofgem audit.

3.18. We would also like to ensure that licensees' systems and processes do not impose costs on small suppliers. For example, it would be desirable for licensees to return collateral posted by the small supplier as soon as possible. This could be done by offsetting collateral posted by the small supplier against their payment for energy delivered. This approach would mitigate the cash flow burden faced by small suppliers at no extra cost to the licensee. We will consider including this as a requirement within the SMA rules and welcome feedback on the costs, benefits and risks of doing so.

3.19. As noted above, it is in consumers' interests for credit arrangements in the wholesale market to be robust. Under the SMA rules, licensees remain free to pursue their own individual credit policies. Evaluations of counterparty risk will inevitably vary in line with these policies. Consequently, Ofgem will not become involved in fine judgements about whether credit terms offered are objectively appropriate. Instead, we will expect to see that a sound process has been carried out that fully considers the particular characteristics of the small supplier in question.

A5 – Clip Size

3.20. Because of the size of their business, small suppliers often need to trade in smaller volumes than are typically seen in the wholesale market. This rule is therefore designed to enable small suppliers to access products in clip sizes that reflect their volume needs. This will help them to effectively hedge their price risk and minimise their need to trade further to refine their position closer to delivery.

3.21. In our previous consultation we suggested that licensees should be required to trade in clip sizes as small as 0.1MW. Following feedback from stakeholders, we have increased the minimum clip size to 0.5MW with minimum increments of 0.5MW above that. The increased clip size aims to make it easier for licensees to manage their exposure, as it reduces the number of trades they must do with small suppliers before they can trade in the wholesale market to manage the resulting position.

A6 – Product Range

3.22. The product list has been selected to reflect a range of products we consider to be necessary to enable a small supplier to effectively hedge their position. Licensees are free to offer other products if they choose to do so.

3.23. We have decided not to include shaped products in the list. Shaped products are bespoke in nature. It is therefore difficult to apply the same general rules that we propose in relation to standard products. We believe that the product range we have set out should be sufficient for suppliers to manage the majority of their price risk, with further shaping done through more granular products closer to delivery.

A7 – Fair Pricing

3.24. We want to ensure that small suppliers face prices that reflect the wholesale market price at the time the quote is requested. We would expect prices to be widely available in the market (for example on trading screens or those published by price reporters) for the products we have set out. This will be supported by the fact that the majority of products are included in the market making obligation (see chapter four).

3.25. In meeting this obligation, any external platform fees incurred as a result of sourcing the power in a wholesale market may be added to the price quoted; these fees should be separately itemised from the wholesale power price. These fees are equivalent to those that the small supplier would have faced had they accessed the market directly.

Key outstanding design issues

3.26. We welcome views on all aspects of the design we set out in this chapter. There are some areas where we would particularly welcome further feedback:

- **Scope** – do you think the scope of the obligation that we have set out above is appropriate?
- **Credit and collateral** – does our suggested approach deliver benefits to small suppliers without imposing disproportionate costs and risks on the licensees?

- **Response to trading requests** – are the timetables we have proposed for negotiations on trading agreements clear and achievable?

Costs

3.27. Chapter five of the draft impact assessment provides an initial estimate of the costs of complying with the SMA rules. Our estimate at this stage is that the measure will have set up costs of around £2m and ongoing costs of around £4m a year across the industry. We will work to refine these estimates during the next consultation phase and welcome any further evidence on costs that stakeholders can provide.

Reporting

3.28. Licensees will be required to provide evidence that they are compliant with the SMA rules. This will include a brief quarterly update and a more detailed annual report. Figure 8 below sets out the information we would require at each stage:

Figure 8 – Reporting requirements for SMA rules

Quarterly progress update	Annual report
<p>High-level indicators of trading activities with small suppliers:</p> <ul style="list-style-type: none"> • number of independent suppliers with whom the licensee has traded with this quarter • number of trading agreements signed in this quarter • number of formal requests received in this quarter for which: <ul style="list-style-type: none"> ○ a formal offer has been made and negotiations are ongoing ○ a formal response has been sent outlining why licensee is unable to trade with the counterparty • Total volume traded this quarter with small suppliers • Total number of trades this quarter 	<p>Detailed information on trading activities with independent suppliers:</p> <ul style="list-style-type: none"> • names of suppliers with whom a new agreement has been signed • names of independent suppliers: <ul style="list-style-type: none"> ○ with whom licensees are currently negotiating ○ with whom licensees have failed to reach a trading agreement following negotiations ○ to whom licensees have been unable to make an offer (eg due to compliance checks) • total volume traded • total number of trades • Credit transparency forms will not be submitted to Ofgem, but should be kept on file for 3 years and made available to Ofgem upon request

3.29. We believe that the information above, allied to our wider market monitoring and feedback from market participants, will enable us to effectively monitor compliance with the SMA rules. However, we are keen to hear feedback from stakeholders on this approach.

4. Detailed design of the market making obligation

Chapter Summary

Objective 2 aims to ensure that the wholesale market delivers the necessary forward market products and price signals that generators and suppliers need to manage their businesses and compete effectively. To achieve this objective, S&P features a market making obligation. We have amended our proposed design on the basis of further policy development and stakeholder views from the previous consultation, including in relation to the interaction with European financial legislation.

Question 7: Do you have any comments on our proposed detailed design for the market making obligation, particularly those listed under 'key outstanding design questions'?

Question 8: Do the detailed elements of the proposed market making obligation appropriately balance costs and risk for the licensees?

Question 9: Do you believe that an industry-run tender process could more successfully deliver our proposals for a market maker? If so, do you have views on how we can solve the practical challenges we have identified?

4.1. Our December 2012 consultation document on S&P set out two options for the second liquidity objective:

- **Option A** – no specific intervention to meet objective 2, on the basis that liquidity along the curve would evolve from the near-term market
- **Option B** – introduce one of a range of intervention options to ensure objective 2 is met, with market making proposed as a lead option.

4.2. As noted in chapter one, responses to the previous consultation and our further analysis have not given us sufficient confidence that liquidity will develop along the curve in the absence of intervention. We therefore intend to intervene to ensure objective 2 is met through a market making obligation. While we have considered other intervention options for achieving objective 2 – in particular an obligation to trade – we believe that market making is the intervention most likely to successfully achieve our objectives at proportionate costs and risk.

The market making obligation

Aims of the market making obligation

- 4.3. The market making obligation aims to meet objective 2, by:
- providing regular opportunities to trade for all market participants, enabling them to meet their wholesale market needs and compete more effectively
 - enabling the development of a series of robust prices along the curve, which can inform a range of commercial decisions, including prices offered to customers, investment in new generation and the scheduling of plant maintenance. This will facilitate competition in both the generation and supply markets and will support security of consumers' supplies
 - encouraging competition between incumbent players in the market (particularly the domestic supply market), by increasing the scope for firms to compete to identify the best hedging strategy in order to provide the best possible price offer to their customers.

4.4. We also expect that market making could lead to increases in traded volumes in the forward market. As bid-offer spreads narrow it is likely to improve the availability of opportunities to trade sufficiently that we see a substantial increase in traded volumes. However, an increase in traded volumes may not be necessary for this objective to be met. As long as all companies have the opportunity to trade and robust price information is available in the market along the curve, the market will be functioning sufficiently well to support competition.

Detailed requirements

4.5. Our further policy work and responses to the previous consultation have enabled us to refine the detailed design of the market making intervention. This is set out in Figure 9 below and reviewed in more detail in the subsequent sections of this chapter. We welcome feedback from stakeholders on all aspects of this design.

Figure 9: Market Making Obligation – detailed rules

B1 – Nominating a third party	Licensee may nominate a third party to undertake their obligation on the same basis set out in this licence condition (unless otherwise specified). The licensee must not nominate any party delivering more than one other licensee’s obligation. The third party must be set up to trade with 10 generation and/or supply licensees.																						
B2 – Platform	The licensee is required to market make on any GB wholesale electricity market trading platform which can be accessed by a significant number (eg 10) of generation and/or supply licensees																						
B3 – Products	The licensee must post bids and offer prices in the following products: Baseload: Month+1, Month+2, Quarter+1, Season+1, Season+2, Season+3, Season+4 Peak: Month+1, Month+2, Quarter+1, Season+1, Season+2, Season+3.																						
B4 – Availability	For each of the listed products the licensee must post prices within the bid-offer spread limits specified for more than 50 per cent of the market opening time in any given calendar month. If a third party meets the obligation of two firms: the third party must post prices within the bid-offer spread limits specified for more than 80 per cent of the market opening time in any given calendar month.																						
B5 – Bid-offer spreads	When market making, the licensee must maintain a spread between their bid and offer price narrower than: <table border="1" data-bbox="378 844 1423 1117"> <thead> <tr> <th colspan="2">Baseload</th> <th colspan="2">Peak</th> </tr> </thead> <tbody> <tr> <td>Month+1</td> <td rowspan="3">0.3%</td> <td>Month+1</td> <td rowspan="3">0.7%</td> </tr> <tr> <td>Month+2</td> <td>Month+2</td> </tr> <tr> <td>Quarter+1</td> <td>Quarter+1</td> </tr> <tr> <td>Season+1</td> <td rowspan="4">0.5%</td> <td>Season+1</td> <td rowspan="4">1%</td> </tr> <tr> <td>Season+2</td> <td>Season+2</td> </tr> <tr> <td>Season+3</td> <td>Season+3</td> </tr> <tr> <td>Season+4</td> <td></td> </tr> </tbody> </table>	Baseload		Peak		Month+1	0.3%	Month+1	0.7%	Month+2	Month+2	Quarter+1	Quarter+1	Season+1	0.5%	Season+1	1%	Season+2	Season+2	Season+3	Season+3	Season+4	
Baseload		Peak																					
Month+1	0.3%	Month+1	0.7%																				
Month+2		Month+2																					
Quarter+1		Quarter+1																					
Season+1	0.5%	Season+1	1%																				
Season+2		Season+2																					
Season+3		Season+3																					
Season+4																							
B6 – Obligation to trade	Providing normal prerequisites are in place (eg a GTMA and credit agreement), if requested, the licensee must trade at posted prices.																						
B7 – Trade size	At any particular posted bid or offer price, licensee must be willing to trade in clip sizes of 5MW . The maximum trade size the licensee must execute is 10MW, although they may trade larger volumes if they wish. If a third party is nominated to meet the obligation of two licensees: the maximum trade size multiplies accordingly.																						

B1 – Nominating a third party to meet the obligation

4.6. A key amendment to our proposed design for the market maker has been to enable licensees to nominate a third party to undertake the obligation on their behalf. During the consultation on our initial S&P proposals, a number of stakeholders highlighted that market making could bring licensees within the scope of European financial legislation such as MiFID II and EMIR. This would potentially impose significant costs on these firms. As noted in chapter one and appendix two, this legislation is still under development, meaning the ultimate impacts are uncertain. However, we acknowledge the risks highlighted by stakeholders and the potential associated costs. We are therefore focused on ensuring that S&P does not force licensees within the scope of this legislation if they would not otherwise be within its scope.

4.7. It is primarily for this reason that we have left open the possibility of licensees meeting their obligation through a nominated third party. Each licensee will be able to make an assessment of whether it will be more cost-effective for them to meet the obligation themselves or nominate a third party to do so. This assessment may change over time: for example, before MiFID II is implemented, licensees may wish to meet the obligation themselves, but once MiFID II comes into force may decide to nominate a third party. The licensee may only nominate a party who has trading agreements in place with a significant number of physical market participants – at this stage we suggest that 10 could be an appropriate minimum. This ensures that the prices they post are accessible to a range of other market participants.

4.8. As noted in Figure 9, if the obligation is undertaken by a third party on behalf of two licensees, some aspects of the rules are different. This is to ensure that the intervention continues to meet its objectives even with fewer market makers. It is also important to note that the ultimate responsibility for meeting the obligation remains with the licensee. Failure by a third party to comply with any aspect of the obligation will be treated as a licence breach by the licensee in the normal way.

B2 – Platform

4.9. This rule is designed to provide licensees with the freedom to identify the platform (or platforms) through which they market make. However, at the point a licensee begins to market make on a platform (or platforms), a range of other market participants must be able to trade through that platform – we initially suggest that 10 generation or supply licensees must be set up to trade through the platform. This ensures that licensees are not able to frustrate the aims of the intervention by market making 'in a vacuum' on a platform that is inaccessible to other market participants.

4.10. It has been suggested that we should require market making to occur on cleared platforms. This would encourage trading to move on to these platforms, away from the OTC brokered platforms where most forward market trading occurs at present. We see that clearing has some advantages. For example, it potentially limits the number of trading agreements a party must have in place and allows for efficient use of collateral. However, while cleared platforms may play a substantial role in the market in future, we do not think it would be appropriate to force this change through the liquidity intervention. We would rather that market participants choose the platforms through which they trade.

B3 – Products

4.11. The product list has been chosen to deliver a series of useful hedging products and price signals along the forward curve. It also aims to ensure that participants seeking to hedge are able to access a suitable range of standard products to manage their price risk. This list could be subject to changes. We welcome feedback from market participants on whether the list we have suggested is appropriate.

4.12. In theory, the obligation could be met through either physical or financial products. The message we have heard from market participants is that they are in principle interchangeable.

4.13. However, the market is currently overwhelmingly physical and only a handful of market participants are set up to trade in financial products. Furthermore, we do not believe it would be appropriate to force the market towards trading in financial products through the liquidity intervention. Due to the need to ensure that the market makers' prices are available to a broad range of market participants, financial products are unlikely to be suitable for meeting the obligation in the near-term.

B4 – Availability

4.14. At certain times, the risks associated with market making are increased. For example, when the market is especially volatile it becomes difficult to take a view on the price and post bids and offers to reflect this view. In this scenario, the market maker is at risk of having to trade at a price significantly different from the true market price and is therefore exposed to trading at a loss. To help licensees manage this risk, it is appropriate to give them the opportunity to withdraw from market making at times. The availability requirement we have proposed – 50 per cent over the course of a month – is lower than that set out in most commercial agreements¹⁵. This reflects the mandatory (rather than voluntary) nature of the market making we are proposing. We believe that this requirement ensures regular opportunities to trade while allowing the market maker to manage their risks appropriately.

4.15. If the obligation is undertaken through a third party who is acting on behalf of two licensees, we believe it is appropriate for the availability requirement to be higher. This reflects our view that it is preferable for there to be more than one market maker active in the market at any one time. The presence of more than one market maker brings price discipline to the market makers. Any significant divergence between them will be arbitrated. If a single third party is meeting the obligation of two licensees, they will therefore be required to be available for 80 per cent of market opening time each month.

B5 – Bid-offer spread limit

4.16. This rule seeks to ensure that licensees are not able to frustrate the aims of the intervention by setting wide spreads between their bid and offer price, thereby eliminating opportunities to trade. In our initial S&P proposals, we set out a series of

¹⁵ Commercial agreements are typically in the 75-90% range.

qualitative criteria which would aim to limit the spreads posted. Following further work in this area, we are now proposing fixed percentage limits to the spread. We believe that this will provide greater clarity for licensees about what they must do to comply with the licence condition and will make S&P easier to enforce.

4.17. We recognise that this is a key area of the design of the market making obligation. The indicative spread limits we have proposed have been derived by reviewing the spreads seen in other energy markets as well as our assessment of a sensible aspiration for spreads in the wholesale electricity market. We intend to conduct further analysis on bid-offer spread limits ahead of the final decision to modify licences. We would also welcome detailed feedback (including quantitative evidence) on this point from stakeholders.

B6 – Requirement to trade if requested

4.18. Providing the standard commercial arrangements are in place (for example in relation to credit and collateral) licensees must trade at the prices posted when requested by a market participant with whom they have the appropriate trading agreements in place. This provides the incentive for licensees to post prices that reflect their best assessment of the market price.

B7 – Minimum and maximum trade size

4.19. This requirement is designed to place a lower and upper limit on the size of the trades that the market maker is required to execute under the obligation. Again, this is in order to balance the benefit to other market participants with the cost to the market maker. Our choice of 5MW and 10MW for these limits reflect trade sizes commonly seen in the forward market at present.

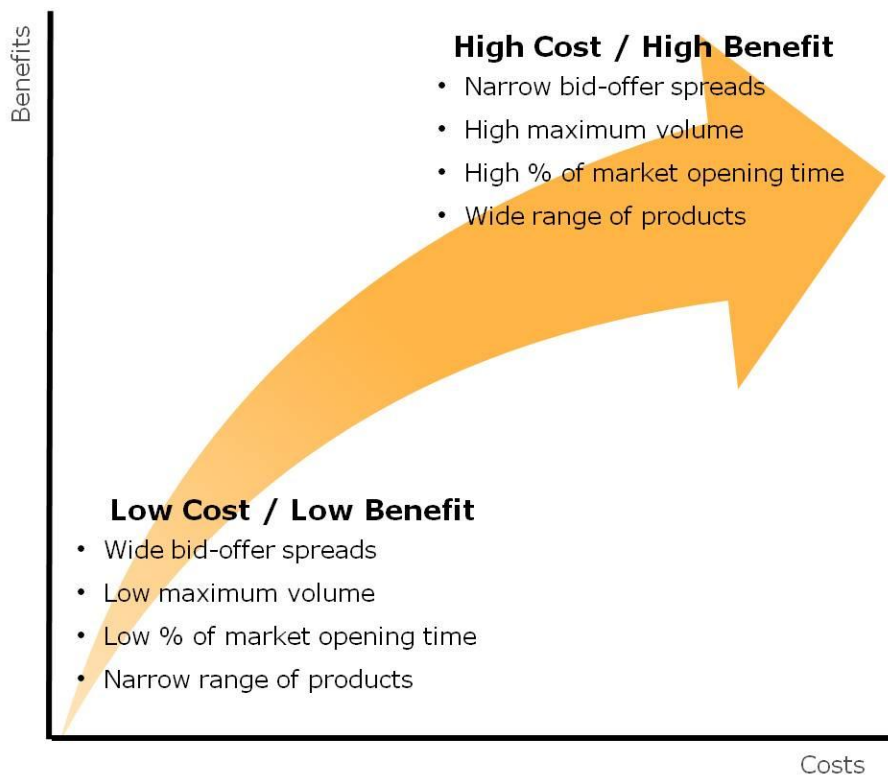
4.20. Where a third party is nominated to market make on behalf of two licensees, the minimum trade size remains the same, while the maximum trade size multiplies accordingly (so the third party must offer trades of 5MW, 10MW, 15MW and 20MW). This ensures the same volume is available to the market in the same granularity as there would have been had the obligation been met directly by the licensees.

Key outstanding design issues

Finding the appropriate balance of costs and benefits

4.21. Our proposed design of the market making obligation aims to balance the benefits to the market with the costs and risks to the licensee. These elements are scalable. As demonstrated by Figure 10, there is a positive relationship between the benefits of the intervention and the cost to licensees:

Figure 10 – Balancing the benefits, costs and risks of the market making obligation



4.22. We have sought to strike an appropriate balance between these costs and benefits. However, we welcome feedback from stakeholders on whether the balance we propose is appropriate.

Setting the bid-offer spread limit

4.23. We intend to do further analysis on bid-offer spread limits. We believe that the limits set out above are a plausible proposal. However, we recognise that it would be possible to propose alternative limits for the bid-offer spread. We welcome feedback from stakeholders on this point.

Alternative delivery mechanisms for market making

4.24. As noted above, our proposed design for the market making obligation gives licensees the choice of individually nominating a third party to meet their obligation. In the previous consultation, some stakeholders highlighted the benefits of a single, industry-run tender process to select parties to fulfil the market maker role. Under this approach, an industry working group, with Ofgem involvement, could run a tender process and select market makers to fulfil the role under a commercial contract. Any fees to be paid to the market maker would be gathered from the industry (or potentially a subset of industry members). Existing industry forums, such as the Power Trading Committee, could play a role in this process.

4.25. We see the attractiveness of this approach: it introduces an element of price discovery in the selection of the market makers, potentially enabling the identification of parties that can fulfil the role at lowest cost. It is also preferable for the activity to be based on a commercial contract rather than a licence condition-based obligation. In principle, if the outcome delivered was the same as that delivered by a licence condition, this could be an appropriate way to meet our objective.

4.26. However, there are a range of practical questions associated with an industry-tendered market maker, including:

- **Tender process** – which parties should be involved in running the tender process? How would this process be governed? What would Ofgem's role be?
- **Procurement risk** – how many firms would bid to become market makers?
- **Timetable** – could the tender process be completed to a reasonable timetable? A substantial delay would not be acceptable.
- **Counterparty to the contract** – who would be the counterparty to the contract with the market makers?
- **Collection of fees** – who would pay any fees charged by the market makers? Through what process would these fees be collected?

4.27. There may be solutions to these challenges. If stakeholders believe an industry tender approach would be preferable then we would be prepared to give it further consideration. However, we would need to see a detailed and credible plan addressing the practical questions above, underpinned by clear commitments from market participants to support successful delivery of the market maker. If we receive such a plan we will consider it as an alternative to introducing the market making obligation.

Costs

4.28. Chapter five of the draft Impact Assessment provides an initial evaluation of the costs of meeting this obligation. Our best estimate is that the market making obligation would have set-up cost of around £2m to the industry, followed by an ongoing cost of around £10m a year. The assumptions behind these cost figures imply a significant increase in liquidity, with potentially significant benefits for consumers. As noted in the Impact Assessment, we welcome further evidence from stakeholders that could help us refine these cost estimates.

Reporting

4.29. As with the SMA rules, we propose that licensees will have to provide evidence that they (or their nominated third party) have met their market making obligation through a quarterly update and then a more comprehensive annual report. We believe that the most efficient way of providing this evidence will be for the licensees to secure a report from their chosen trading platform or platforms. This will detail the amount of time for which the licensee has been meeting their obligation for each business day in the previous year. Any costs incurred in the collection of this data would be met by the licensee.

Figure 11 – Reporting requirements for Market Making

Quarterly update	Annual report
<ul style="list-style-type: none"> • Name of platform(s) used to meet the obligation • If third party is nominated to meet obligation: name of third party • Percentage of market opening hours for which prices were posted, for each product, in each calendar month • Volumes traded (and number of trades) through the market maker in each product 	<p>Same items as quarterly reports, plus:</p> <ul style="list-style-type: none"> • Statement from platform(s) detailing length of time for which market making was performed on each trading day over the course of the year

4.30. We believe that the above information will enable us to successfully monitor compliance with the market making obligation. We are keen to hear feedback on our proposed approach to monitoring compliance, including from trading platforms who may be the source of the data we are requiring.

5. Near-term markets

Chapter Summary

Objective 3 aims to ensure that near-term markets function effectively and enable market participants to match their contracted position with their physical position. Following feedback from the previous consultation, we are not proposing an intervention in support of this objective at this stage. This is due to our updated assessment of the costs and benefits of intervention in this area. However, we will continue to monitor this part of the market and will be prepared to intervene if necessary.

Question 10: Do you agree with our analysis of the costs, risks and benefits of intervening in the near-term market?

Question 11: Do you agree that we should not intervene in near-term markets at this stage?

Progress against our objective for the near-term market

5.1. Our third liquidity objective is “effective near-term markets.” Near-term markets are important for enabling firms to match their contracted position with their physical position as they approach delivery. This allows them to avoid imbalance charges. As noted in chapter one, we have seen encouraging progress against this objective in recent years. In particular, we have seen strong growth in volumes traded on the two day-ahead auctions (see graph in appendix two). More generally, most market participants have consistently told us that the near-term market meets their needs.

5.2. In our December 2012 consultation document, we suggested that S&P could include measures to lock in the progress we have seen on day-ahead auctions, by requiring licensees to trade a specified volume through a day-ahead auction platform. This would ensure that the near-term market continues to be liquid. We also noted that it could have underpin a reliable near-term reference price, which could lead to improvements in liquidity along the curve.

5.3. As noted in chapter one, our final S&P proposals do not feature intervention in the near-term markets at this stage. This is because of our evolving view of the costs and benefits of such an intervention.

The near-term market is likely to continue to be liquid

5.4. As highlighted in our previous consultation, a number of developments in the market should help to ensure that the volumes seen on day-ahead auction platforms remain regardless of regulatory intervention:

- **Market coupling** – As part of market coupling under the European Target Model, trading on the two day-ahead auction platforms in GB will be brought together through the virtual ‘GB hub’, due to be implemented towards the end of 2013. Parties trading on either of the day-ahead auction platforms will be able to access this single pool of liquidity. The process of market coupling will also make the day-ahead auction an attractive trading

route for European parties, potentially attracting new players to the GB market.

- **Intermittent CfDs under EMR** – the Government has suggested that the Feed-in Tariff with Contracts for Difference (FiT-CfD) for intermittent generation could be based on a reference price taken from the day-ahead auctions.¹⁶ This will give CfD generators an incentive to trade their generation in the auction to minimise their basis risk.¹⁷ It also provides an incentive for suppliers to trade a portion of their supply in the auction, to manage the risk they face in the magnitude of their contribution to the CfD.

5.5. These factors may further improve a day-ahead market that is already meeting the needs of market participants to a large extent. More generally, through the Electricity Balancing Significant Code Review, Ofgem is considering reforms to cash-out which could also have a positive impact on near-term liquidity (see appendix two for more detail). In this context, the potential 'benefits' case of intervention to improve liquidity in near-term markets may be limited.

There may be costs or unintended consequences of intervention

5.6. In response to our previous consultation on S&P, a number of stakeholders highlighted the risks of intervening in the near-term market through the mechanism we proposed. In general, these risks related to the impact the intervention could have on competition between near-term trading platforms. It was noted that by securing developments in this area, we could unintentionally lock in the existing market structure, limiting competition between trading platforms. This would potentially impose costs on market participants (and therefore consumers) as downward pressure on costs such as trading fees is reduced.

5.7. It was also suggested that the focus on securing the progress we have seen to date could lessen the impetus for achieving further market-led improvements – for example, by encouraging a wider range of parties to participate in the auctions. All near-term platforms have a commercial incentive to continue improving liquidity and take proactive steps to do so. We would not want to introduce an intervention that limited the appetite for such improvements among market participants.

5.8. More generally, we are mindful that the detailed wording of the licence condition could introduce unintended distortions and inefficiencies to the behaviour of licensees and to the wider market. When the case for the intervention is so finely balanced, it is important to take the possible impacts of 'unknown unknowns' into account.

¹⁶ DECC (2012) Feed-in Tariffs with Contracts for Difference: Operational Framework, p52: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/65635/7077-electricity-market-reform-annex-a.pdf

¹⁷ Basis risk is the risk that the price an individual generator receives for their output is different to the reference price which determines the generators' payment under the CfD.

It is not clear that there is a cost-benefit case for intervention at this stage

5.9. The above analysis sets out our view that: the benefits of intervention in the near-term market may be limited, as there are factors that should ensure near-term markets continue to be liquid; and the costs may be comparatively high, due to the risks and potential unintended consequences of intervention. This view should also be seen in the context of the 'better regulation' principle that, due to the costs and burdens for businesses, new regulations should only be imposed where there is a clear case for protection.¹⁸ On balance, our current view is that this case is not evident.

5.10. We welcome feedback from stakeholders on the analysis set out above and whether our proposal not to intervene in near-term markets is appropriate.

Our future approach to the near-term market

We will continue to monitor the near-term markets and stand ready to intervene if necessary

5.11. It is important to note that we remain focused on liquidity in near-term markets. We will continue to monitor these markets closely to track progress. If we believe that near-term liquidity is deteriorating and that intervention would be beneficial, we will be prepared to act. To improve the quality of our monitoring, schedule C of the S&P licence condition includes reporting requirements in relation to the volumes that licensees trade through day-ahead auction platforms. We will also give thought to whether it might be beneficial for market participants to publish data on their trading in the near-term market, to provide a greater degree of transparency.

5.12. One factor that would further reduce the need for Ofgem to intervene in this area in the future would be for market participants to make additional voluntary commitments to support improvements in near-term markets. These commitments would preferably be made publicly, to improve transparency and trust in this part of the market. We are keen to hear from stakeholders on the scope for such voluntary commitments.

¹⁸ Better Regulation Delivery Office: <http://www.bis.gov.uk/brdo/resources/knowledge/better-regulation-principles>

6. Next steps

We are seeking your feedback on S&P

6.1. This document sets out our intention to intervene in the wholesale electricity market through the S&P licence condition. We believe it is the best available mechanism for securing improvements to liquidity and meeting our objectives for the market at lowest cost and risk. We have set out our final proposals for S&P based on our further policy development and responses to our previous consultation.

6.2. In this phase of the liquidity project, we are particularly keen to have feedback from stakeholders on the detailed design we have proposed: there are likely to be areas where the design can be improved as a result of this feedback. While we recognise that some have a preference for alternative mechanisms, we encourage stakeholders to fully engage with the proposals set out in this document: it is important that we get the details right.

6.3. To this end, we intend to hold a stakeholder roundtable that will focus on the detail of the proposals. Stakeholders should contact us if they would like to attend this session. As ever, we would also strongly encourage stakeholders to provide written responses to the consultation and to contact us to arrange bilateral meetings.

6.4. We also welcome feedback on the draft impact assessment that we have published alongside this document. If you have any comments on this impact assessment (for example, if you have any evidence that could enable us to improve our understanding of the costs and benefits of our intervention) then we would be keen to hear them.

Our forward timetable

6.5. Now we have set out our intention to intervene, as well as our final proposals for the shape of that intervention, we intend to move as quickly as possible towards putting licence conditions in place and implementing S&P. Providing this consultation does not identify any 'roadblocks' to S&P, the Authority will take a decision on whether to launch a statutory consultation on the licence condition in Autumn 2013. Following this, changes to licence conditions would be made before the end of the year.

6.6. Following introduction of the licence conditions, we are likely to allow a period for licensees to ensure they are compliant with the obligation. However, we do not expect this to be a long period. As noted in chapter two, our initial expectation is that S&P will be fully implemented early in 2014.

Appendices

Index

Appendix	Name of Appendix	Page Number
1	Consultation response and questions	42
2	Update on key liquidity metrics and policy context	44
3	Illustrative draft Secure and Promote licence condition	51
4	Glossary	60
5	Feedback questionnaire	66

Appendix 1 – Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 9 August 2013 and should be sent to:

Phil Slarks
Wholesale Markets
Ofgem
9 Millbank
London
0207 901 7000
gb.markets@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem will consider whether to proceed to a statutory consultation on licence changes in Autumn 2013. Any questions on this document should, in the first instance, be directed to Phil Slarks, Martin Bell or Leigh Rafferty at the contact details above.

Chapter one

Question 1: Do you agree with our updated assessment of the wholesale market?

Question 2: Do you agree with our conclusion that we should intervene in the market in the form of the 'Secure and Promote' licence condition set out in this document?

Chapter two

Question 3: Do you agree with our proposed legal approach to S&P?

Question 4: Do you agree with our proposals for who should face the obligations under S&P?

Chapter three

Question 5: Do you have any views on our final proposals for the Supplier Market Access rules, particularly those aspects listed under 'key outstanding design questions'?

Question 6: Are there any further areas that these rules should cover?

Chapter four

Question 7: Do you have any comments on our proposed detailed design for the market making obligation, particularly those listed under 'key outstanding design questions'?

Question 8: Do the detailed elements of the proposed market making obligation appropriately balance costs and risk for the licensees?

Question 9: Do you believe that an industry-run tender process could more successfully deliver our proposals for a market maker? If so, do you have views on how we can solve the practical challenges we have identified?

Chapter five

Question 10: Do you agree with our analysis of the costs, risks and benefits of intervening in the near-term market?

Question 11: Do you agree that we should not intervene in near-term markets at this stage?

Appendix 2 – Update on key liquidity metrics and the policy context

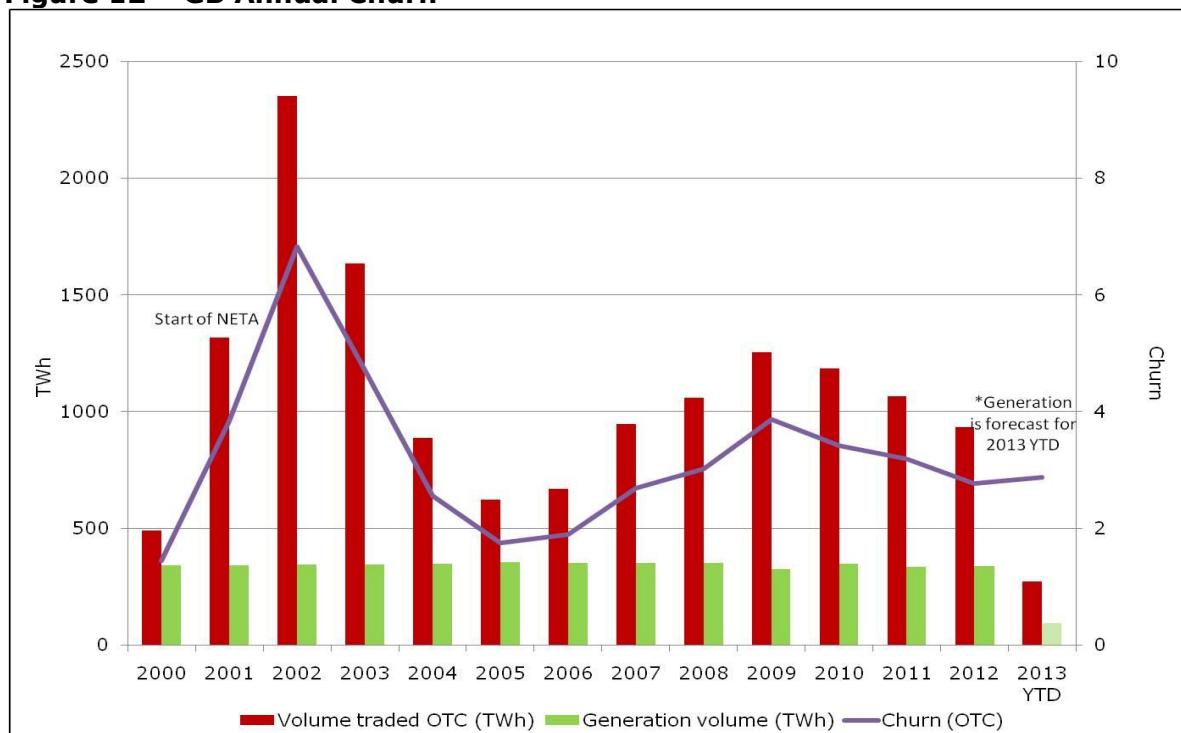
2.1. This appendix updates our assessment of our liquidity metrics. These form a key part of the evidence base we use to assess progress towards our liquidity objectives, and to evaluate the need for intervention in the wholesale electricity market. All metrics are updated to the end of March 2013. It also outlines the various policy workstreams which have the potential to impact on liquidity and which have therefore been considered as part of our policy development.

Liquidity metrics

Churn

2.2. Churn measures the number of times a unit of generation is traded before it is delivered to the final customer. It is a useful high-level indicator of the level of overall liquidity in a market. Figure 12, below, shows that, since 2009, churn in the GB power market has been on a downward trend. There has been a slight increase in churn so far in 2013 (a churn of 2.9 compared to a churn of 2.8 in 2012). However this increase is may partly be a result of seasonal effects: trading is typically higher during the first quarter. When Q1 2013 is compared to Q1 2012, churn has fallen from 3.2 to 2.9.

Figure 12 – GB Annual Churn



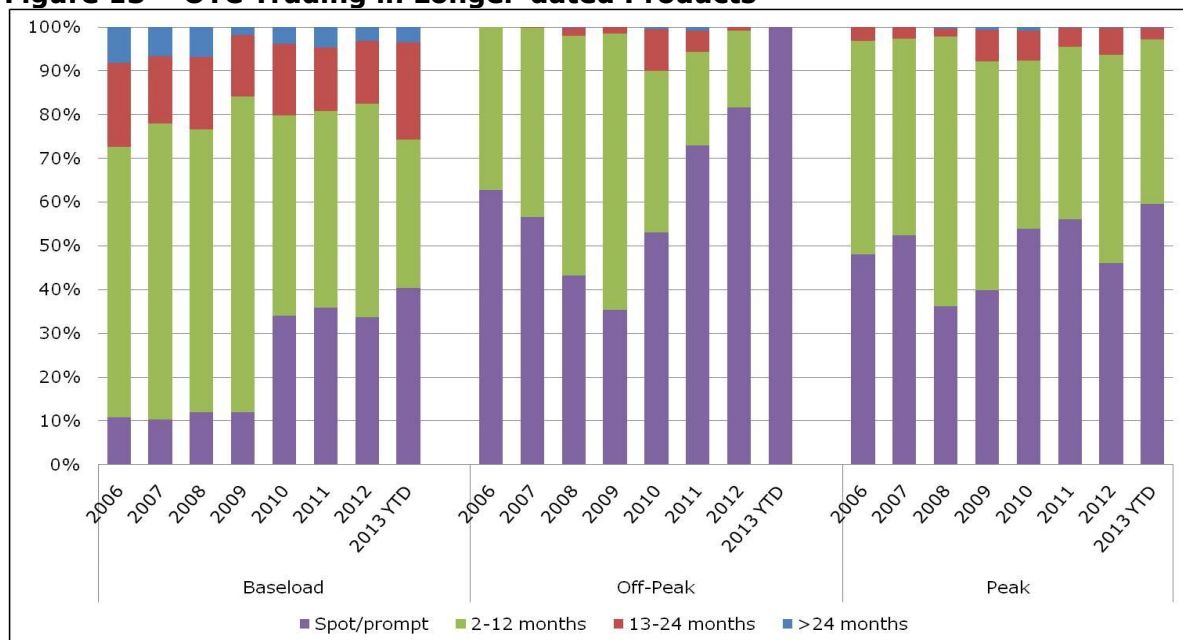
Source: ICIS Heren, APX, N2EX, ICE, DUKES

Access to products which support hedging

2.3. To support effective competition, market participants need to be able to access forward products which allow them to hedge against movements in the wholesale price. One indicator of market participants' ability to hedge is the proportion of the OTC market that is traded months and years ahead of delivery.

2.4. Figure 13, below, shows that, to date in 2013, there has been a decline in trading along the curve for peak and off-peak products. In particular, only 40 per cent of peak products traded in 2013 to date are for delivery more than two months out, and only three per cent are for delivery more than 12 months out. Trading in baseload products more than a year ahead of delivery has increased, as has the proportion of baseload traded less than two months ahead. As a result, the proportion of baseload contracts traded in 'medium-term' products (2-12 months ahead of delivery) has declined. It is possible that these trends are in part due to seasonal trading patterns.

Figure 13 – OTC Trading in Longer-dated Products



Source: ICIS Heren

Robust reference prices along the curve

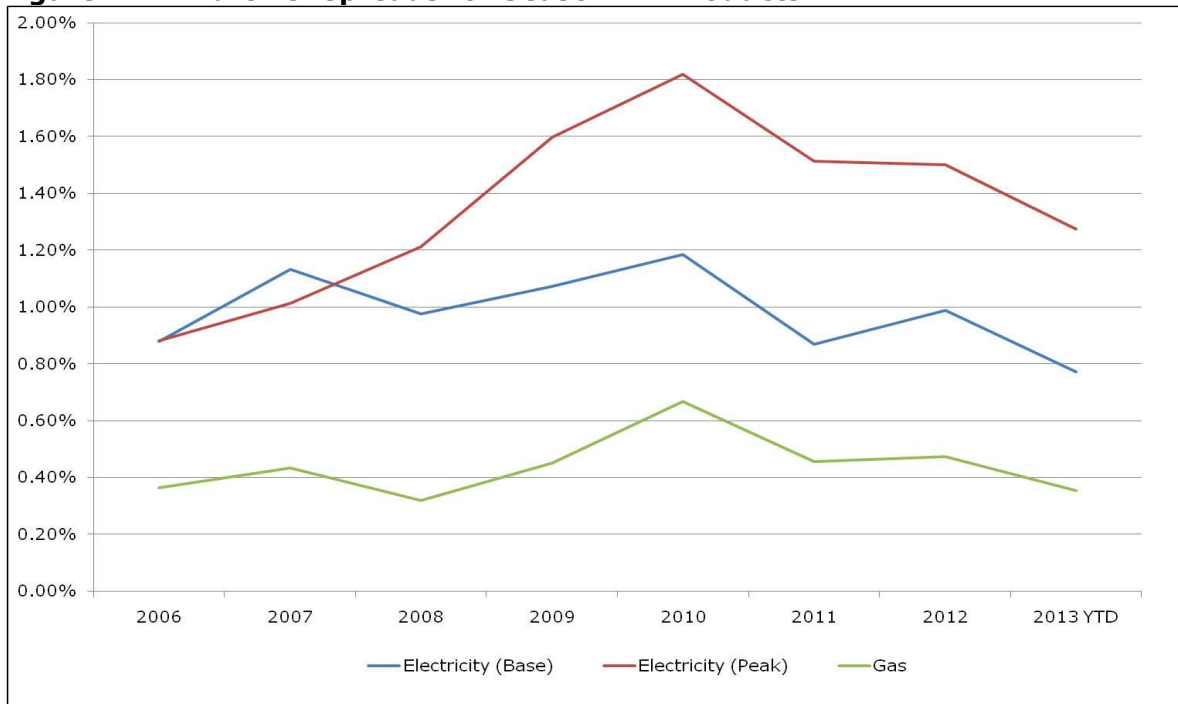
2.5. The bid-offer spread is an indicator of the degree of consensus around views of the market price. A tight spread suggests that opportunities for arbitrage are being exhausted. When the spread is tight, it gives market participants confidence that they can buy and sell without incurring significant transaction costs.

2.6. Our updated analysis shows a tightening of spreads across a range of forward products so far in 2013 (for example, see Season+4 products in Figure 14, below). Normally a tighter spread is a sign of increased traded volumes and improved liquidity, and indeed traded volumes in Q1 2013 have increased compared to Q4 2012. However, as noted above, seasonality may be playing a role here: traded volumes tend to be

highest in the first quarter (and lowest in the last quarter). This is likely to impact the width of the bid-offer spread.

2.7. The fall in the spread is therefore likely be partially driven by these trading patterns and has the potential to increase again over the course of the year. It is also likely to be driven by the falls in the gas spread over the same period, particularly bearing in mind the tight correlation between the two prices.

Figure 14 – Bid-offer spreads for Season +4 Products

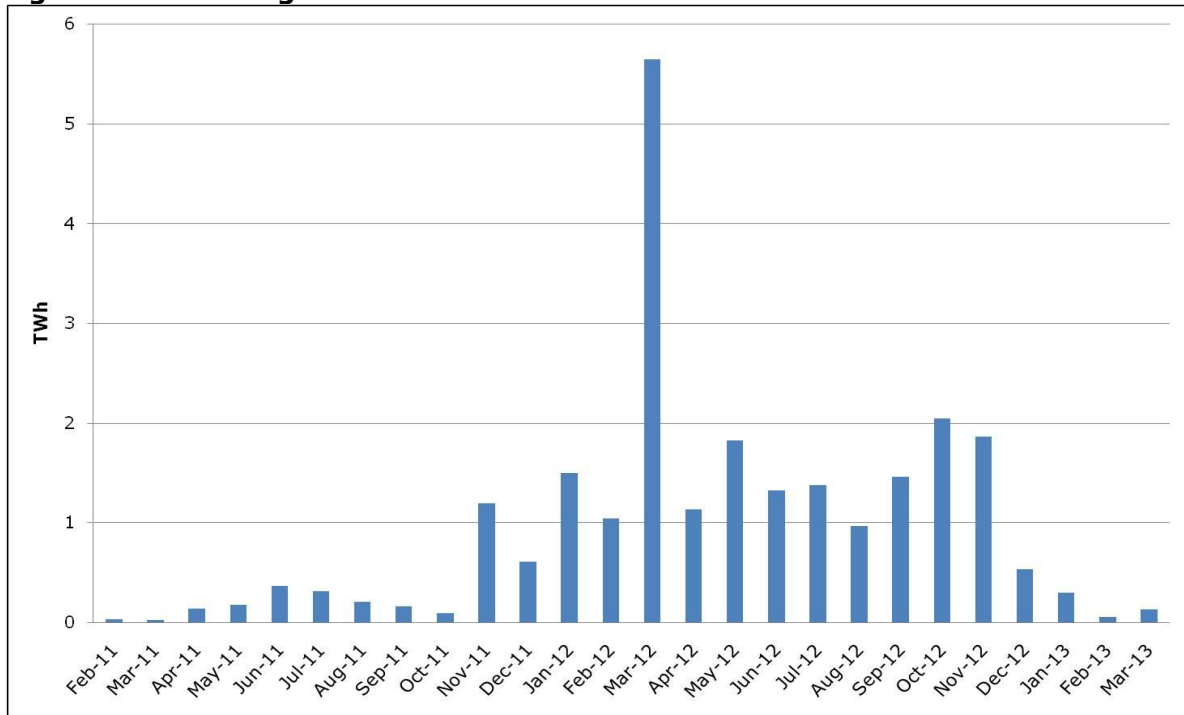


Source: ICIS Heren

Financial products

2.8. Financial products can provide an alternative hedging tool for market participants. They do not require firms to take a physical position, which can ease access for financial players. The presence of financial players in a market may increase overall trading and liquidity in the market. Increases in the volume of financial products seen in 2012 have been lost in the first quarter of 2013 (see Figure 15, below). Trading in financial products now make up only 0.3 per cent of volumes traded in the wholesale market so far in 2013 (compared to around 2 per cent in 2012).

Figure 15 – Trading in Financial Products



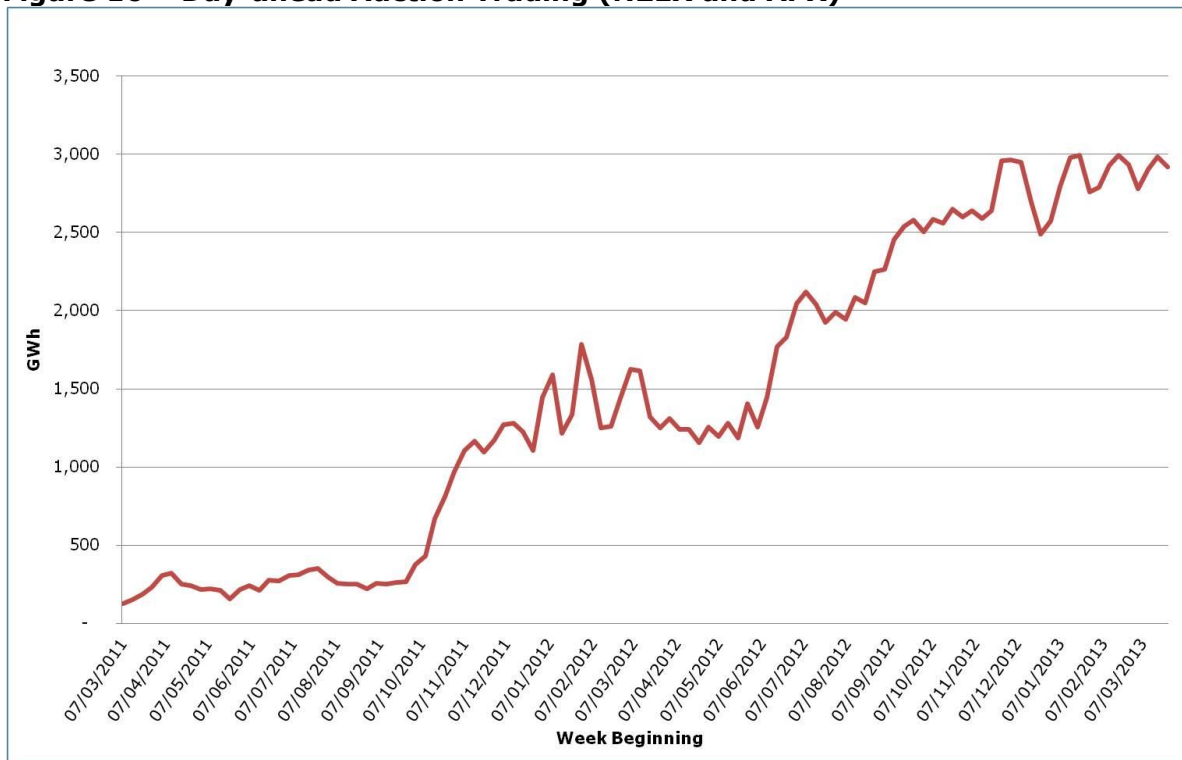
Source: Nasdaq OMX

An effective near-term market

2.9. An effective near-term market ensures that market participants can shape their position close to delivery to manage their imbalance risk. An indicator of how well near-term markets are functioning is the volume traded on near-term exchange platforms.

2.10. As noted in previous consultations, since Autumn 2011, there has been significant growth in volumes traded on near-term exchanges. This has to a large extent been driven by gross-bidding agreements between the six large vertically integrated players and N2EX. Over the last 4 months, growth in these day-ahead auction volumes has levelled off but remains between 2.5 and 3TWh a week (see Figure 16 below).

Figure 16 – Day-ahead Auction Trading (N2EX and APX)



Source: N2EX, APX

Key related policy workstreams

2.11. A number of policy workstreams have the potential to impact on liquidity and the intervention options we have been considering. These workstreams have played an important part in our assessment of the market and the need for intervention. These workstreams are addressed in turn below.

Retail Market Review

2.12. In March 2012, Ofgem published the final proposals of the Retail Market Review (RMR). We proposed a new set of rules for energy retail markets to make them simpler, clearer and fairer, and to make it radically easier for consumers to choose their electricity and gas supplier. The new rules will enable consumers to more easily engage with the retail energy markets and decide which offer is best for them, increasing the competitive pressure on energy suppliers to deliver good customer service at efficient cost. A final decision on the first elements of the RMR package is likely to be taken by early July 2013. If we decide to modify the licence to introduce our proposals, we expect the initial RMR reforms to take effect in August 2013, with other reforms to follow.

2.13. There is a causal link between effective wholesale markets and competitive retail markets that works in both directions. Consumer engagement and switching in the retail market increases the need for suppliers to trade in the wholesale market in response to changes in customer numbers, thereby boosting liquidity. At the same time, an effective wholesale market enables firms to compete to identify the best hedging strategy so they

can make the best possible price offer to attract new customers, increasing the effectiveness of competition in the retail market.

2.14. These two effects can be mutually reinforcing. However, the effect can work in the opposite direction: low switching in the retail market dampens liquidity and low liquidity lessens the scope for firms to identify the best wholesale market strategy. Ofgem's analysis has suggested that this is the situation in the GB wholesale and retail markets at present. The liquidity project and RMR are complimentary aspects of Ofgem's work to break this cycle and ensure that consumers get the best possible deal from energy markets.

EMR and the Energy Bill

2.15. The Energy Bill is currently going through Parliament. The Bill contains the legislative provisions underpinning the Electricity Market Reform (EMR) programme. EMR has important interactions with liquidity. For example, the FiT-CfD for low-carbon generation requires liquid markets on which to base reference prices. The choice of reference price is itself likely to have an impact on liquidity once in place, as market participants trade in order to capture the reference price. DECC intend to publish further detail on their intended design for the FiT-CfD in the coming months. We will continue to work with DECC to consider the interactions between the FiT-CfD and liquidity as they develop the design.

2.16. As noted in chapter one, the Energy Bill also contains backstop powers to enable the Government to act to promote liquidity in the event that Ofgem's liquidity project does not fully meet the Government's objectives. DECC have made it clear that Ofgem's liquidity project remains the primary vehicle for achieving improvements to liquidity. We are working closely with DECC to align our work on liquidity and minimise uncertainty for market participants.

European financial regulation

2.17. A range of European legislation is currently being developed that could have significant implications for wholesale electricity market liquidity. In particular, a revised version of the Markets in Financial Instruments Directive (MiFID II) is currently being negotiated. This directive defines which products and firms fall within European financial regulation, and sets the scope of other pieces of financial legislation. The Council is currently developing its position on MiFID II – this will be followed by 'trialogue' negotiations, the timing for which is currently uncertain. In addition, the European Market Infrastructure Regulation (EMIR) is in the process of implementation. A key aspect of EMIR is the requirement for clearing of eligible OTC derivatives, which will come into force from 2014.¹⁹ Becoming subject to European financial regulation could have cost impacts on energy firms, and might impact their trading activities. Such costs could have an impact on liquidity in commodity markets, including power. In addition, European financial regulation could affect the costs for firms of complying with a liquidity obligation.

¹⁹ Although there will be a three year phase-in for non-financial firms exceeding the EMIR clearing threshold.

2.18. Our key conclusion at this stage is that there is considerable uncertainty surrounding the scope and impact of this legislation, which depends particularly on the development of MiFID II. We are unlikely to have full clarity on MiFID II before implementing a liquidity intervention. We therefore intend our intervention to be robust to a range of outcomes regarding MiFID II. Chapter four considers some of the specific interactions between our proposals and this legislation.

European target model

2.19. The European Target Model sets out a vision for a single European market in electricity by 2014 through 'market coupling'. This is to be achieved through Europe-wide, legally-binding network codes. As a National Regulatory Agency, Ofgem has a role in implementing the Target Model. The Target Model for the day-ahead market is European price coupling, which will simultaneously determine volumes and prices for all price zones in Europe. The results of day-ahead power auctions will be combined so that interconnector capacity is allocated according to price signals, ensuring efficient flows between zones.

2.20. A key element of market coupling in GB has been the development of the GB Hub, which will pool liquidity on the two existing GB day-ahead auctions and provide a single price signal for interconnector flows. The GB Hub is currently making progress through the development and testing phases. It is expected to be operational in time for the expected "go-live" of day-ahead market coupling in November 2013. As discussed further in chapter five, we believe that the GB Hub and further integration with other European markets could have positive impacts for liquidity in the GB market, by creating a single pool of liquidity at the day-ahead stage and facilitating the participation of European players in the GB market.

Electricity Balancing Significant Code Review

2.21 Ofgem launched the Electricity Balancing Significant Code Review (EBSCR) in August 2012 to consider the need for reform to the electricity cash-out and balancing arrangements. In February 2013, we signalled our intention to focus on cash-out price formation and incentives to provide flexibility and security of supply.

2.22 Some of the proposals being considered as part of EBSCR could have a positive impact on wholesale market liquidity, particularly in the near-term market. The considerations under the scope of the EBSCR which improve the cash-out price as a signal of scarcity, such as a 'more marginal' cash-out prices, could improve liquidity as incentives to trade ahead of gate closure become greater, in particular at times of system stress. Further, some stakeholders have suggested that a single cash-out price could encourage the development of a more robust spot market reference price and related products that could be more widely traded, which could improve liquidity along the curve.

Appendix 3 – Illustrative draft Secure and Promote licence condition

In order to help stakeholders evaluate our final S&P proposals, we have included an indicative version of the licence condition below. It is important to note that, if a decision was taken to proceed with S&P, there would be a statutory consultation on the licence condition according to the standard licence modification process.

We have proposed that some S&P licensees would face both obligations (the SMA rules and the market making obligation), whereas others would face only the SMA rules. Licensees who face only the SMA rules would not have the schedule relating to the market making obligation (schedule B) included in their licence. Schedule C, which includes reporting requirements in relation to S&P, would also be different for licensees who do not face the market making obligation as the reporting requirements for this intervention would be removed.

Electricity Generation Licence Special Condition X: Liquidity in the Wholesale Electricity Market

- X.1 Paragraphs X.2 to X.5 shall cease to have effect in this licence on such date as the Authority may specify in a direction given to the licensee [or to all Relevant Licensees].
- X.2 The licensee shall, with effect from such date or dates as the Authority may specify in a direction given to the Licensee:
- (a) comply with the requirements in Schedule A to this condition;
 - (b) subject to paragraph X.3, comply with the requirements in Schedule B to this condition; and
 - (c) report, in accordance with the requirements in Schedule C to this condition, to the Authority in respect of its compliance with Schedule A and (subject to paragraph X.3) Schedule B and in respect of the other matters specified in Schedule C.
- X.3 If, at the time at which the Licence was modified to include this condition X, the Authority gave notice to the licensee that this paragraph X.3 shall apply in the Licence, a direction to comply with the requirements in Schedule B shall not be given without the consent of the licensee.
- X.4 For the purposes of this condition the "**relevant objective**" is facilitating competition in the generation and supply of electricity, by promoting:
- (a) the availability in the wholesale electricity market of Products which enable persons that supply electricity to hedge their positions into the longer term;

Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition

- (b) the availability of robust reference prices for Products for delivery in the longer term

with a view to the development of liquidity in the wholesale electricity market.

X.5 For the purposes of this condition:

"Product"	in paragraph X3(a) has the meaning given in Schedule A and in paragraph X3(b) has the meaning given in Schedule B;
"Relevant Licensee"	means the holder of a generation licence which includes this condition.

LIQUIDITY LICENCE CONDITION SCHEDULE A

1. The requirements in this Schedule apply with a view to the achievement of the relevant objective in paragraph X.3(a) of this condition.

Request for Trading Agreement

2. The licensee must acknowledge a written request for a Trading Agreement (a **Request**) from an Eligible Supplier within 2 working days after receipt.
3. Where a Request is not complete, the licensee must specify when acknowledging that Request what information is required for the purpose of completing the Request. A Request is complete when it contains all of the information required by the licensee as set out on its website pursuant to paragraph 11.
4. The licensee must send a written response to the Eligible Supplier within 15 working days of receipt of a complete Request. The response must include:
 - i. an offer to enter into a Trading Agreement which shall include all the terms and conditions of such agreement; or
 - ii. an explanation of the reasons why the licensee has determined that it is unable to offer a Trading Agreement to the Eligible Supplier.
5. The licensee shall take all reasonable steps to ensure that any subsequent negotiations on the Trading Agreement with the Eligible Supplier proceed in a timely manner. Where the licensee and the Eligible Supplier fail to reach an agreement within 60 working days from the date of receipt of a complete Request, the licensee shall, within 5 working days after that, write to the Eligible Supplier summarising any unresolved or disputed matters and offering a meeting within 20 working days from the date of writing.
6. The licensee must continue to negotiate with the Eligible Supplier until the Eligible Supplier and the licensee agree that negotiations should no longer continue.
7. The licensee shall retain all information, data, correspondence and the Credit Transparency Form with regards to any Request for a Trading Agreement for three years from the date of the Request for a Trading Agreement.

Credit terms and Collateral arrangements

8. The licensee's offer under paragraph 4(i) must include credit terms and collateral arrangements that are consistent with paragraph 9.
9. The credit terms and collateral arrangements offered by the licensee shall;
 - i. take into account the credit worthiness of the Eligible Supplier as assessed by the licensee, by reference, where applicable, to information submitted by the Eligible Supplier; and
 - ii. be a reasonable reflection of the risks of trading with the Eligible Supplier.

10. The licensee must complete and submit to the Eligible Supplier with its offer a Credit Transparency Form setting out the basis for its credit decision, including but not limited to:

- i. the credit terms and collateral arrangements offered;
- ii. the quantitative and qualitative factors considered;
- iii. identifying any steps the Eligible Supplier could take which could result in a material improvement in the credit terms offered.

Named Contact

11. The licensee shall provide on its website:

- i. a named contact or contacts for the purposes of making a Request for a Trading Agreement; and
- ii. a list or description of all the information required to enable the licensee to make an offer under paragraph 4(i).

Request to trade in Products

12. Where a Trading Agreement is in force between a licensee and an Eligible Supplier, the licensee must provide a quote in response to a request from an Eligible Supplier to buy or sell any one or more Products, with minimum volumes of no more than 0.5MW and rising in increments of 0.5MW. If the request for a quote is received on a day which is not a working day or less than three hours before the end of a working day, the quote must be provided by 11.00 am on the next working day. Otherwise, the quote must be provided within 3 hours of receipt of a request. The quote shall stipulate the period within which it may be accepted, which shall be in accordance with market practice.

13. If the Eligible Supplier accepts the quote within the period stipulated, the licensee shall enter into a transaction with the Eligible Supplier under the Trading Agreement on the basis of the accepted quote.

Pricing

14. The price quoted by a licensee to an Eligible Supplier must be the licensee's assessment of the prevailing market price for the Products at the time the licensee provides the quote.

15. The quote may include at cost any wholesale market trading fees normally incurred in trading the relevant Product. These fees must be itemised in the quote. No additional fees or charges may be added

16. For the purposes of this Schedule A:

(1) "**Credit Transparency Form**" means a form prepared and published by the Authority.

Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition

- (2) The holder of an electricity supply licence is an "**Eligible Supplier**" in any [year] where the Authority has included such holder in a list published for such year of eligible suppliers for the purposes of this condition.
- (3) "**Product**" means each of the products in the table below (where product means a traded electricity product for delivery in Great Britain, including a product settled financially):

Baseload	Week+1 Month +1 Month +2 Quarter +1 Quarter +2 Season +1 Season +2 Season +3 Season +4
Peak	Week+1 Month +1 Month +2 Quarter +1 Quarter +2 Season +1 Season +2 Season +3

- (4) "**Trading Agreement**" means a master agreement for trading electricity.

LIQUIDITY LICENCE CONDITION SCHEDULE B

1. The requirements in this Schedule apply with a view to the achievement of the relevant objective in paragraph X.3(b) of this condition.

Posting prices

2. The licensee shall simultaneously offer to buy and sell each of the Products, by posting on a qualifying platform in accordance with paragraph 4, at times which comply with the requirements of paragraph 6, bid and offer prices which comply with the applicable requirements of paragraph 7, for volumes of such Product which comply with the requirements of paragraph 8.
3. The licensee's bids and offers for a Product at any particular time must be posted on the same qualifying platform; but the licensee may post bids and offers for different Products, or (subject to paragraph 6) for the same Product at different times, on different qualifying platforms.

Nominee to discharge requirements

4. Subject to paragraph 9, the licensee may nominate another person (a "Nominee") to discharge the requirements of this schedule B in relation to any period (comprising a whole number of months), in which case the licensee shall be treated as satisfying such requirements if the requirements are satisfied by the Nominee but not otherwise.

Qualifying platforms

5. A qualifying platform is a trading platform in relation to which the following conditions are satisfied at all relevant times:
 - (a) one or more of the Products may be bought and sold on the platform;
 - (b) at least 10 persons (other than the licensee and any Nominee of the licensee and their affiliates) who are holders of generation or supply licences have made the necessary arrangements to trade Products on the platform.

Availability of prices

6. Bids and offers for each Product must be posted on a qualifying platform for at least:
 - a. fifty percent (50%), or
 - b. where the licensee has nominated a Nominee which at the relevant time is also nominated by another Relevant Licensee, eighty percent (80%),of the time during which the market is assumed to be open in each month. The market is assumed to be open from 8 am to 5 pm Monday to Friday excluding bank holidays in England.

Limits on difference between bid and offer prices

7. The difference between the bid and offer prices at any time for each Product, expressed as a percentage of the [bid] price, may not exceed the percentage in the table below:

	Baseload	Peak
Month+1	0.3%	0.7%
Month+2	0.3%	0.7%
Quarter+1	0.3%	0.7%
Season+1	0.3%	0.7%
Season+2	0.3%	0.7%
Season+3	0.5%	1%
Season+4	0.5%	N/A

Trade volumes

8. The volumes of each Product for which bid and offer prices must be posted are:
- (a) subject to paragraph (b), 5MW and 10MW;
 - (b) if the licensee has nominated a Nominee, 5M, 10MW, 15MW and 20MW.
9. The licensee may not nominate a person as Nominee in relation to a month if that person is also nominated as Nominee in relation to that month:
- (a) by two other Relevant Licensees, or
 - (b) if the Nominee is itself a Relevant Licensee or an affiliate of a Relevant Licensee, by one other Relevant Licensee.
9. For the purposes of this Schedule B:

“**Product**” means each of the products in the table below (where product means a traded electricity product for delivery in Great Britain, including a product settled financially)

Baseload	Month +1 Month +2 Quarter +1 Season +1 Season +2 Season +3 Season +4
Peak	Month +1 Month +2 Quarter +1 Season +1 Season +2 Season +3

**LIQUIDITY LICENCE CONDITION
SCHEDULE C**

1. The licensee must submit a quarterly report to the Authority containing the information set out in the “Quarterly report” row in table 1 below not later than 30 days after the end of each quarter.
2. The licensee must submit an annual report to the Authority containing the information set out in the “Annual report” row in table 1 below not later than 30 days after the end of each year.
3. In the columns entitled Schedule A and Schedule B in the table, terms shall have the meanings given them in Schedule A and B respectively.

Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition

	Schedule A	Schedule B	Additional information
Quarterly report	<p>For each quarter:</p> <ul style="list-style-type: none"> • number of Eligible Suppliers with whom the licensee has traded • number of Trading Agreements signed • number of requests for a Trading Agreement received for which: <ul style="list-style-type: none"> ○ an offer has been made and negotiations are underway ○ a response has been sent outlining why the licensee is unable to trade with the Eligible Supplier • Total volume bought and sold with Eligible Suppliers • Total number of trades 	<ul style="list-style-type: none"> • Name(s) of qualifying platform(s) used to comply with Schedule B • If a Nominee is appointed, the name of the Nominee • Percentage of market opening hours for which prices were posted, for each Product, in each calendar month • Volumes bought and sold (and number of trades) through bids and offers made under Schedule B in each Product 	<ul style="list-style-type: none"> • Volumes bought and sold through day-ahead auctions each month
Annual report	<p>The same information as is required in the quarterly report but covering the whole year, plus:</p> <ul style="list-style-type: none"> • names of Eligible Suppliers with whom a new Trading Agreement has been signed • names of Eligible Suppliers: <ul style="list-style-type: none"> ○ with whom the licensee is currently negotiating a Trading Agreement ○ with whom the licensee has failed to reach a Trading Agreement following negotiations ○ to whom the licensee has been unable to make a former offer • total volume bought and sold this year with Eligible Suppliers • total number of trades this year <p>Credit Transparency Forms will not be submitted to the Authority, but should be kept on file for 3 years and made available to the Authority upon request</p>	<p>The same information as is required in the quarterly reports, plus:</p> <ul style="list-style-type: none"> • Statement from qualifying platform(s) detailing length of time for which the licensee posted bids and offers in each Product on each trading day over the course of the year 	

Appendix 4 – Glossary

A

Agency for the Cooperation of Energy Regulators (ACER)

ACER is a European Union body which cooperates with EU institutions and stakeholders, notably National Regulatory Authorities (NRAs) and European Networks of Transmission System Operators (ENTSOs), to deliver a series of instruments for the completion of a single energy market.

APX

APX owns and operates energy exchange markets in the Netherlands, UK and Belgium. APX provides a power spot exchange service in the UK.

B

Barrier to entry

A factor that may restrict entry into a market.

Baseload product

A product which provides for the delivery of a flat rate of electricity in each hourly period over the period of the contract.

Bid-offer spread

The bid-offer spread shows the difference between the price quoted for an immediate sale (offer) and an immediate purchase (bid) of the same product; it is often used as a measure of liquidity.

Broker

A broker handles and intermediates between orders to buy and sell. For this service, a commission is charged which, depending upon the broker and the size of the transaction, may or may not be negotiated.

C

Carbon Price Floor

A minimum price for carbon released during electricity generation in the UK. The Carbon Price Floor will come into effect from 2013.

Churn rate

Churn is typically measured as the volume traded as a multiple of the underlying consumption or production level of a commodity.

Clearing

The process by which a central organisation acts as an intermediary and assumes the role of a buyer and seller for transactions in order to reconcile orders between transacting parties.

Clip size

The size (usually in MW) of the contract to be traded.

Collateral

A borrower will pledge collateral (securities, cash etc) in order to demonstrate their ability to meet their obligations to repay monies loaned. The collateral serves as protection for a lender against a borrower's risk of default.

Contract for Difference (CfD)

A contract where the payoff is defined as the difference between a pre-agreed 'strike' price and a reference price (determined in relation to an underlying commodity). The Government has proposed the use of CfDs as part of Electricity Market Reform. CfDs under EMR are intended to encourage investment in low-carbon generation by providing greater long-term revenue certainty to investors.

D

Day-ahead market

A form of near-term market where products are traded for delivery in the following day.

Department of Energy and Climate Change (DECC)

The UK Government department responsible for energy and climate change policy.

E

Electricity Market Reform (EMR)

EMR is the Government's approach to reforming the electricity system to ensure the UK's future electricity supply is secure, low-carbon and affordable.

European Target Model

The European Target Model sets out the vision for a single European market in electricity by 2014. The objective of the Target Model is to remove barriers to cross-border trade and encourage harmonisation of European wholesale market arrangements. This is to be achieved through the development of European wide, legally-binding, network codes. As a National Regulatory Agency, Ofgem has a role in implementing the Target Model.

Exchange

A type of platform on which power products are sold. Typically an exchange would allow qualifying members to trade anonymously with other parties and the risks between parties would be managed by a clearing service.

F

Financial Product

A contract that is settled financially at maturity rather than by the delivery of a physical commodity.

Forward Curve

A series of sequential time segments within which it is possible to trade a particular commodity and for which prices are available.

Forward trading

The trading of commodities to be delivered at a future date. Forward products may be physically settled – by delivery – or financially settled.

G

Grid Trade Master Agreement

A Grid Trade Master Agreement (GTMA) is a legal agreement between the two parties in a trade that sets out terms in relation to financially settling the contract and physically delivering the power.

H

[Hedging](#)

Transactions which fix the future price of a good or service, and thereby remove exposure to the daily (or spot) price of a good or service. This enables those purchasing a good or service to reduce the risk of short term price movements.

I

[ICE](#)

Intercontinental Exchange, an American financial company that operates Internet-based marketplaces which trade futures and over-the-counter (OTC) energy and commodity contracts as well as derivative financial products.

[IFA](#)

The electricity interconnector between GB and France.

[Imbalance](#)

The difference between a party's contracted position and metered position measured on a half-hourly basis.

M

[Market Coupling](#)

Market coupling is a method for integrating electricity markets in different areas, applied across a number of European countries.

[Market Maker](#)

A firm which is regularly prepared to buy and sell in a commodities or financial market. Market makers post two-sided (bid and ask) prices on a regular basis, encouraging greater liquidity.

N

[N2EX](#)

The N2 Exchange, a GB electricity market platform, is operated by Nasdaq OMX and Nord Pool Spot AS.

Near-term market

The market in which the products are traded close to delivery (for example, on the day of delivery or day-ahead of delivery).

Nord Pool

Nord Pool, the Nordic Power Exchange, a single power market for Norway, Denmark, Sweden and Finland.

O

Off-peak product

A product which provides for the delivery of a flat rate of electricity for the period of the day when demand is typically lowest for the duration of the contract.

Over the Counter (OTC)

Trading of financial instruments, including commodities, that takes place directly between counterparties. This is in contrast to exchange-based trading where the exchange acts as a counterparty to all trades.

P

Peak product

A product which provides for the delivery of a flat rate of electricity for the period of the day when demand is typically highest for the duration of the contract.

Physical settlement

A contract that, at maturity, results in an exchange of the contracted good for its contracted value.

Product

The type of contract available. Examples include day-ahead, weekly, weekend, block seasonal, year, etc. Standard products are those that are widely traded on well-established terms, so exchanges generally deal in standard products. By contrast, structured products are those where the terms are precisely tailored to match the contract buyer's requirements, and they usually involve variable contract volumes and/or non-standard volumes and durations.

R

Reference price

A price for a product which has been revealed through enough trading for it to be considered reflective of the product's 'true' market value.

Retail Market Review (RMR)

Ofgem's Retail Market Review aims to make the energy market simpler, clearer and fairer for consumers, encouraging and equipping them to engage effectively so that they can get the best deal.

S

Shaped product

A shaped product is a contract which specifies different amounts of electricity to be delivered at different times. A bespoke shaped product with half-hour granularity could specify a different volume for every half-hour period of the contract's duration.

Spot market

Refers to the market in which products traded are delivered at (or close to) delivery.

T

Third Package

The Third Package is EU legislation on European electricity and gas markets that entered into force on the 3rd September 2009. The purpose of the Third Package is to further liberalise European energy markets. DECC is primarily responsible for its transposition in Great Britain and had to do this by 3rd March 2011.

V

Vertical Integration

Where one corporate group owns two or more parts of the energy supply chain. For example, where the same group features both generation and supply businesses.

Appendix 5 – Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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Ofgem
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