

# Liquidity in the Wholesale Electricity Market (Special Condition AA of the electricity generation licence): Draft Guidance

## Guidance

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**Contact:** Leigh Rafferty, Analyst

**Team:** Wholesale Market Performance

**Tel:** 0141 341 3999

**Email:** [gb.markets@ofgem.gov.uk](mailto:gb.markets@ofgem.gov.uk)

### Overview:

This document aims to provide greater clarity on the Secure and Promote licence condition which we are proposing to introduce to improve liquidity. It sets out the policy intent behind each element of the licence condition and establishes the factors that Ofgem will take into account when enforcing the licence condition. It is not legally binding, and is designed to be read in conjunction with, not instead of, the licence condition.

As well as providing clarity on the obligations under the licence condition, this document also provides guidance on the process for small suppliers who wish to have access to the Supplier Market Access rules for Secure and Promote. It also provides the Credit Transparency Form template which must be used by licensees in discussions with eligible suppliers, and report templates to be used by licensees when reporting compliance with the licence condition.

The Guidance is currently in draft form. We welcome any views from respondents on any aspect of this guidance.

## Context

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Ofgem's principal objective is to protect the interests of present and future consumers.<sup>1</sup> 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 Package<sup>2</sup>, Ofgem also has a duty to promote integrated European energy markets. Our view is that improvements to the wholesale power market will support this objective.

The associated notice and statutory consultation represents the latest phase in our liquidity project, through which we have been monitoring the wholesale market and considering interventions that could improve liquidity. This document provides guidance to be read in conjunction with the draft licence condition.

## Associated documents

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- [Wholesale power market liquidity: statutory consultation on the 'Secure and Promote' licence condition](#)
- [Wholesale power market liquidity: statutory consultation on the 'Secure and Promote' licence condition - Impact Assessment](#)
- [Notice under section 11A\(2\) of the Electricity Act 1989](#)

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<sup>1</sup> 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.

<sup>2</sup> 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.

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## Executive Summary

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This document contains guidance on Special Condition AA which we are proposing to insert into generation licences of certain parties. There is a separate statutory consultation document, published alongside this guidance, which sets out our rationale for introducing this special condition, specifies the parties that it applies to, and provides an overview of the policy framework that it is intended to implement.

The guidance in this document accompanies the proposed special condition. The full text of the special condition can be viewed on Ofgem's website. It is attached to a notice under Section 11A(2) of the Electricity Act 1989, published as part of the statutory consultation.

This document provides guidance on:

- the circumstances under which we would consider inserting, removing or partially removing the obligations of the licence condition from individual licensees;
- the interpretation of Schedules A, B and C of the licence condition; and
- the process for applying to become an "Eligible Supplier" under the Supplier Market Access rules.

This guidance is in draft form. There are no specific questions contained in this document, but we welcome any views from respondents. In particular, we welcome views on where the clarity of this guidance might be improved. Any responses should be provided by 18 December 2013. Details on how to respond can be found in Appendix 1.

Subject to responses to the statutory consultation, the Authority intends to issue a decision to modify licences in early 2014. A final version of this guidance will be published alongside the decision to modify licences. It will take account of any responses to the statutory consultation and any submissions relating to this draft version of the guidance.

This guidance may be updated from time to time. However, we will always consult with stakeholders before finalising any changes to it. This will be through Ofgem's normal consultation process.

# 1. Secure and Promote: overall legal structure

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## Purpose of licence condition

1.1. The purpose of special condition AA is to improve the liquidity of the wholesale electricity market by:

- Improving the availability of products that support hedging; and
- Enabling robust reference prices to form along the curve.

1.2. A liquid wholesale electricity market is important as it supports competition in the generation and supply markets, ensuring that they work in the best interests of consumers.

## Structure of Secure and Promote

1.3. Our 'Secure and Promote' (S&P) policy is being introduced through a special condition, inserted into all generation licences held by certain company groups. (For the avoidance of doubt, the obligation only needs to be met once by each group). The initial list of S&P licensees is set out in our statutory consultation document.<sup>3</sup>

1.4. The detail of the obligation is set out in three schedules to the licence condition:

- Schedule A – for the Supplier Market Access (SMA) rules;
- Schedule B – for the Market Making obligation; and
- Schedule C – for the reporting requirements on the S&P licensees.

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<sup>3</sup> Ofgem (2013), Wholesale power market liquidity: statutory consultation on the 'Secure and Promote' licence condition  
[https://www.ofgem.gov.uk/sites/default/files/docs/2013/11/wholesale\\_power\\_market\\_liquidity\\_statutory\\_consultation\\_on\\_the\\_secure\\_and\\_promote\\_licence\\_condition.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/11/wholesale_power_market_liquidity_statutory_consultation_on_the_secure_and_promote_licence_condition.pdf)

1.5. Certain licensees will have all three schedules switched on (by way of a direction from the Authority) in their licences. Others will have only Schedules A and C switched on.

1.6. Any modifications to these schedules would follow the standard statutory process, including consultation phases and opportunities for appeal.

## **Removing this licence condition or adding it to new licences**

1.7. We will review the list of licensees subject to Secure and Promote on an ongoing basis to ensure that it remains appropriate. Any decision to remove, or add, Schedules A, B or C of the licence condition will be based on a combination of the following, non-exhaustive, list of factors:

- i. Any significant and sustained changes in the generation market share or generation output of a company group, taking into account its relative market share and overall size.
- ii. An indication that an existing S&P licensee will face disproportionate costs and risks in continuing to meet the licence condition, or that a potential new S&P licensee could meet the costs and risks proportionately.
- iii. The sustained successful achievement of the objectives of this licence condition.

1.8. Factor i) is intended to reflect circumstances where there is a significant and sustained change in the size of a generation business – for example, as a result of divestment or closure of plant, or acquisition of new plant. We will not necessarily remove or extend the obligation where a licensee experiences gradual changes in their size or market share. However, sustained changes (for example changes that continue for more than one year) may justify a review.

1.9. Factor ii) reflects the ability of the licensee to meet the costs and risks of the obligation. It is our view that the initial set of licensees who are subject to S&P are better placed to meet the requirements of the licence condition at proportionate cost and risk than other market participants. If over time we consider that this has changed, for example as a result of changes to the licensee's business, or wider regulatory change, we may reconsider which parties are best placed to meet the S&P licence condition.

1.10. Factor iii) reflects our intention to keep under review the effectiveness of the licence condition meeting our liquidity objectives (set out in paragraph 1.20 below). We may make changes to the list of relevant licensees if we consider these changes would allow us to meet our objectives more effectively or at a lower cost.

1.11. In addition to the above, when considering whether to remove, or add, Schedule B of the licence condition, we will also consider the following factor:

- iv. Any significant and sustained changes in the domestic supply market share or volume supplied of a party, taking into account its relative domestic market share and overall size.

1.12. Factor iv) is intended to reflect circumstances where there is a significant and sustained change in the size of a domestic supply business. The overall size of the generation and supply businesses will also be considered. We will also consider a firm's market share in the non-domestic market when deciding whether to remove/extend the obligation, although this will not be a key factor in our decision. A firm without a domestic supply business would not normally be subject to Schedule B. We will not necessarily remove or extend the obligation where a licensee experiences gradual changes in its size or market share. However, sustained changes (for example changes that continue for over a year), may justify a review.

1.13. Taken together, factors i) and iv) are intended to reflect circumstances where there is a fundamental change in the structure of a business, which may impact upon the ability of a licensee to meet the requirements of schedule B.

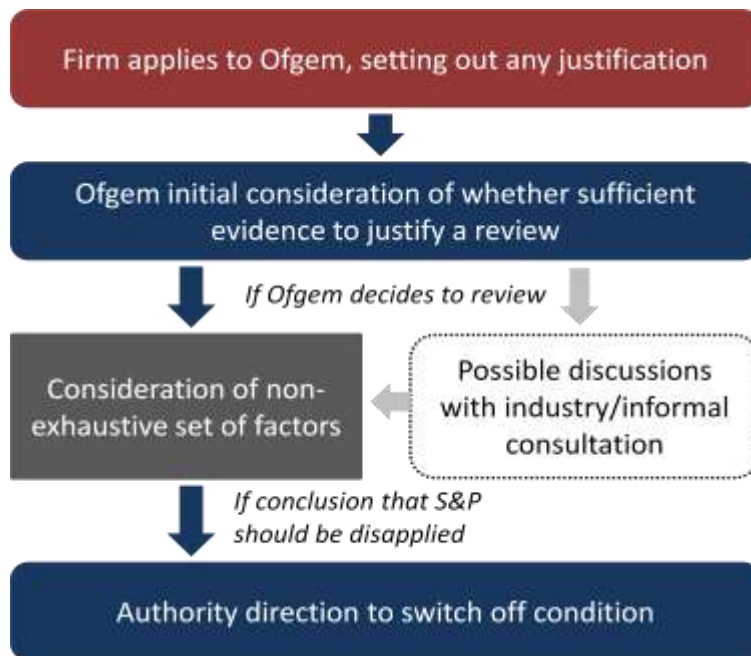
### **Outline of process for removing licence condition**

1.13. Any S&P licensee that considers that it should have all, or part of the obligation lifted may apply to the Authority in writing to request a review. We would expect supporting evidence to be provided.

1.14. Figure 1 below provides an indication of the process we expect to follow when deciding whether the licence condition should be removed for a particular company group. It is worth highlighting the importance of the initial consideration stage – we would only move to a full review if presented with clear evidence that this was justifiable.



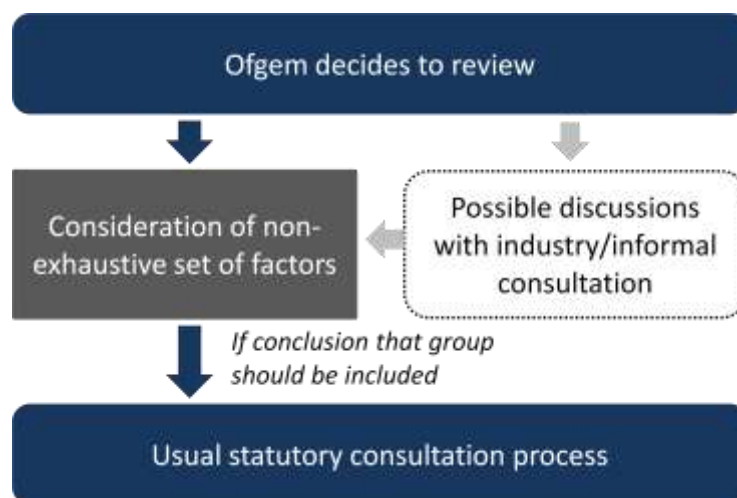
**Figure 1 – Outline of process for removing licence condition**



### Application to new firms

1.15. The Authority will follow the usual statutory consultation process if seeking to introduce this licence condition for other parties, as outlined in figure 2, below.

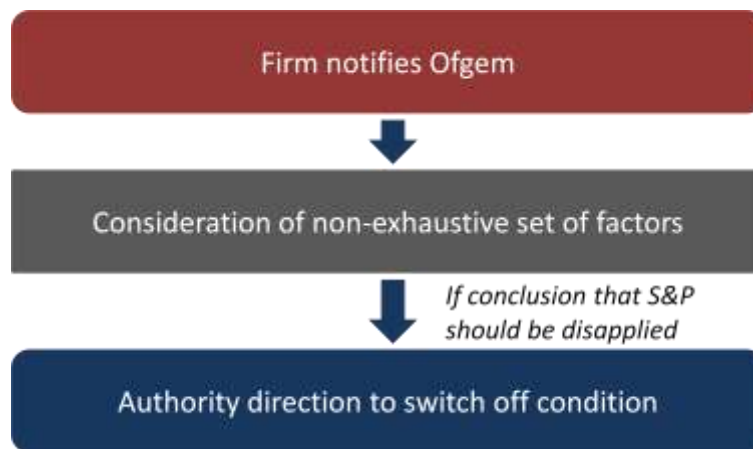
**Figure 2 – Application to new firms**



## Transfer of licences

1.16. Secure and Promote is intended to reflect the characteristics of company groups and being subject to the obligation is based on assessments of company groups. On that basis, where an S&P licensee sells a specific asset<sup>4</sup> including the associated generation licence with an S&P licence condition to a non-S&P licensee, we will normally disapply the S&P licence condition through a direction from the Authority. In straightforward cases, this process should be relatively quick.

**Figure 3 – Sale of an asset (with attached licence) to a non-S&P licensee**



1.17. The same principle also applies between the different categories of S&P licensee: in circumstances where an S&P licensee subject to Schedule B transfers a licence to a licensee subject solely to Schedules A and C, Schedule B will normally be disapplied for the party acquiring the licence.

1.18. This principle will also be applied when an S&P licensee (or an affiliate) is granted a new generation licence. The S&P licence condition (with the appropriate Schedules for that company group) will normally be inserted into the licence.

1.19. The exception to this principle is where the divestment of a licence and its associated assets significantly reduces the market share of a firm. If, in such circumstances, the firm considers it should have its obligations lifted, it should apply to the Authority for a review via the process set out in figure 1 above.

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<sup>4</sup> This does not apply where a whole business group, or the majority of its assets and associated licence(s), changes ownership. In such cases the obligation would normally remain in the licence(s) and transfer to the new owner.

## Success criteria for this licence condition

1.20. Secure and Promote aims to improve liquidity and meet our three objectives for a well functioning wholesale electricity market:

- Availability of products which support hedging
- Robust reference prices along the curve
- Effective near-term markets

1.21. It is difficult to set simple quantitative targets for improvements to liquidity – there is no one answer to what level of liquidity is sufficient. To measure the success of S&P we will monitor a range of indicators in order to build a clear picture of the progress of the market and the contribution of S&P to liquidity. This will include metrics generated from our ongoing market monitoring activities, information received from S&P licensees in their quarterly reports<sup>5</sup>, and qualitative feedback from market participants on the success of S&P and conditions in the wholesale market.

1.22. If our assessment of the market suggests that our liquidity objectives could be met while removing all, or part, of the licence condition from one or more licensees, we will consider doing so. Note, however, that we intend to leave the licence condition in place for a significant period (at least three years) before making fundamental changes.

## Our enforcement guidelines

1.23. We will follow our usual process with regard to the enforcement of this licence condition. We have published guidance which sets out the criteria under which we consider taking enforcement action.<sup>6</sup> We draw attention to chapter three which sets out the criteria for opening an investigation. The criteria set out the two stage process when considering whether enforcement action is appropriate. The first stage considers whether we have the power to act, (ie determining whether a breach has occurred). The second stage considers whether such a breach would meet certain prioritisation criteria. These criteria include (amongst other things) considerations of detriment, whether the breach is ongoing, whether it is a widespread matter, and whether action needs to be taken to deter.

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<sup>5</sup> We would only publish aggregated information from quarterly reports.

<sup>6</sup> Ofgem (2012), Enforcement Guidelines on Complaints and Investigations.

<https://www.ofgem.gov.uk/ofgem-publications/37567/enforcement-guidelines-2012.pdf>

1.24. We have also previously set out our policy in respect of setting financial penalties.<sup>7</sup> We would draw attention in particular to the general criteria. These set out that in considering financial penalties the Authority will consider (amongst other things) whether the breach is trivial and whether the (possibility of a) breach would not have been apparent to a diligent licensee. The Authority would also take into account whether the breach was genuinely accidental or inadvertent. The guidance also sets out factors likely to lead to the Authority imposing stronger penalties.

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<sup>7</sup> Ofgem (2003), Statement of policy with respect to financial penalties.  
<https://www.ofgem.gov.uk/ofgem-publications/74207/utilities-act-statement-policy-respect-financial-penalties.pdf>

## 2. Supplier Market Access rules

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### Chapter Summary

We provide guidance on the Supplier Market Access rules, which are set out in Schedule A of Special Condition AA.

2.1. This chapter relates to Schedule A of the Secure and Promote licence condition. Except where stated, all references are to this Schedule.

### Scope

2.2. As set out in Special Condition AA, Schedule A, paragraph 16(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.*

2.3. We will maintain a list of Eligible Suppliers<sup>8</sup>, which we will publish on our website. This is intended to give clarity on which firms are eligible for treatment under the SMA rules. Licensees are only required to comply with the SMA rules when dealing with firms on this list. However, they are encouraged to follow the best practice set out in the SMA rules with all counterparties in the market. The list of Eligible Suppliers will be monitored and updated monthly to ensure that it is up-to-date.

### Request for trading agreements

2.4. Below we provide some clarity on the application of specific elements of the 'request for trading agreements' requirements.

### Complete trading requests

2.5. As set out in Special Condition AA, Schedule A, paragraph 3:

*The licensee must send a written response to the Eligible Supplier within 20 working days of receipt of a Request. Where a Request is incomplete, the*

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<sup>8</sup> The process for becoming an Eligible Supplier, and the qualifying thresholds, are set out in Chapter 5.

*licensee must specify what information is required for the purposes of completing the Request. The number of working days taken by the Eligible Supplier to complete an incomplete Request will not count towards the 20 working day limit.*

2.6. A complete trading request is one which includes all the pieces of information that the licensee has specified are needed from the Eligible Supplier to allow the licensee to make an offer<sup>9</sup>. If some of this information is missing then the trading request is incomplete and the licensee should inform the Eligible Supplier what is missing. Time that is spent waiting on the Eligible Supplier to provide any missing information will not count towards the 20 working days that the S&P licensee has to send a written response.

### **Offering trading agreements**

2.7. As set out in Special Condition AA, Schedule A, paragraph 4:

*The written 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.*

2.8. Genuine reasons for being unable to trade with a counterparty may include the counterparty failing compliance checks. When fulfilling the requirement set out in paragraph 4(i) we expect licensees to have due regard to other regulations that they are subject to.

### **Request to trade**

2.9. As set out in Special Condition AA, Schedule A, paragraphs 13:

*The licensee's quote shall stipulate the period within which it may be accepted, which shall be a reasonable period based on the licensee's view of prevailing market conditions.*

2.10. For guidance, we consider around three hours to be a reasonable period within which a quote may be accepted. However, we expect S&P licensees to negotiate this

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<sup>9</sup> In accordance with paragraph 11(ii) of the S&P licence condition, the licensee must publish on its website a list of the information needed from an Eligible Supplier in order to process a request for a trading agreement.

with their counterparty. If we have evidence that this rule is being abused then we will review it, with a view to making it more prescriptive.

## Credit terms and collateral arrangements

2.11. This requirement is intended to deliver improvements to fairness of the process that licensees follow when determining the credit and collateral arrangements of an Eligible Supplier. Improving the fairness of the process should improve the fairness of the outcome, resulting in credit and collateral arrangements that are a reasonable reflection of the risk of trading with the counterparty.

### Proper assessment

2.12. As set out in Special Condition AA, Schedule A, paragraph 9:

*The credit terms and collateral arrangements offered by the licensee must be a reasonable reflection of the risks of trading with the Eligible Supplier. For this purpose, the licensee must:*

- i. assess the credit worthiness of the Eligible Supplier by reference to a range of relevant information, including information submitted by the Eligible Supplier;*
- ii. follow an established process for assessing credit worthiness;*
- iii. consider, and where appropriate, discuss a range of credit options with the Eligible Supplier; and*
- iv. ensure that the credit terms and collateral arrangements offered reflect the outcome of the assessment, consideration and discussion under paragraphs i. to iii.*

*and, if required by the Authority, the licensee must demonstrate to the Authority that it has done so.*

2.13. To comply with 9(i) and 9(ii) the licensee must have a process in place for assessing the individual circumstances of the counterparty. The assessment must consider a range of quantitative and qualitative factors. Table 1 provides a non-exhaustive list of the type of factors we would expect to be taken into account when assessing the individual circumstances of the counterparty:

**Table 1 – Quantitative and qualitative assessment factors**

Quantitative Factors	Qualitative Factors
Financial accounts Interim financial statements Profit and loss factors (eg sales, operating profit, financial expenses, net profit) Balance sheet factors (eg total assets, working capital, gross debt, net debt, tangible net worth) External, independent credit ratings / scores Share price performance	Market position Management experience Credit support offered Payment record

2.14. For the avoidance of any doubt, this list is provided as an example of what we mean by ‘a range of quantitative and qualitative factors’. It should not be interpreted as a list of factors that must be considered in order to be compliant with the rule, nor should it be assumed that if all of the factors in the table are considered the licensee is compliant with all aspects of the credit rule.

2.15. We will monitor, via checking information provided on S&P licensees’ websites and details provided on Credit Transparency Forms, whether the factors licensees are considering in their assessments of counterparties are relevant.

2.16. To comply with 9(iii), the licensee should consider and, where appropriate, discuss with the counterparty a range of credit support options. Table 2, below, provides a non-exhaustive list of the type of credit support options the licensee may consider:

**Table 2: Credit support options**

Parent company guarantee	Increased payment frequency
Letter of credit	Margin agreement (including full margin agreement)
Bank guarantee	Allow collateral to be used in settlement
Advance payment	

2.17. For the avoidance of any doubt, this list is provided as an example of what we mean by ‘consider a range of credit options’. It should not be interpreted as a list of factors that must be considered in order to be compliant with the rule, nor should it be assumed that if all of the factors in the table are considered the licensee is compliant with all aspects of the credit rule.

2.18. To comply with 9(iv), the credit terms offered to the counterparty must be derived from the result of the credit assessment. The licensee should be able to demonstrate to Ofgem, if requested, a clear methodology for doing this.



## **Clear communication**

2.19. As set out in Special Condition AA, Schedule A, paragraph 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.*

2.20. A template for the Credit Transparency Form (CTF) can be found in Appendix 2. The licensee must complete, share, and be willing to discuss the CTF with the counterparty. This will include a high-level rationale for the credit terms offered and highlight any changes the Eligible Supplier could make to its request that may improve the credit and collateral terms offered. For example:

- Provision of further information on their balance sheet
- Alternative payment approaches (eg upfront payment)
- Alternative methods of posting credit (eg bank guarantees)

2.21. For the avoidance of any doubt, we do not expect S&P licensees to provide financial advice to Eligible Suppliers. When fulfilling this requirement we expect licensees to have due regard to other regulations that they are subject to.

2.22. We acknowledge that credit assessments are ongoing and may change from time to time. Any review of the credit and collateral arrangements for an Eligible Supplier should follow the requirement set out in paragraphs 9 and 10.

## **Enforcement of the credit rule**

2.23. When determining whether a breach of the credit rule has occurred, we will be interested in the process that S&P licensees have followed when reaching their decision, rather than the decision itself. To be compliant, the licensee must be able to demonstrate that:

- They have followed a process for individually assessing the creditworthiness of the Eligible Supplier, considering a range of relevant information.
- The terms offered are clearly linked to the assessment carried out. This will include, if requested, sharing their methodology for this with Ofgem.
- They have clearly communicated with the eligible supplier, including completing, sharing and discussing the Credit Transparency Form.

## Our role

2.24. Our role will be in ensuring the compliance with the credit rule and enforcing when breaches have occurred. We are concerned with the process through which the outcome was derived and how it was communicated to the Eligible Supplier rather than the outcome itself. We will not act as a mediator between parties, a forum for disputes, or take a view on the fairness of the outcome.

2.25. Given this, S&P licensees and their counterparties should discuss and negotiate these terms with the view to reaching a mutually satisfactory commercial agreement. Parties must take all reasonable steps to resolve disputes prior to involving Ofgem. For example, this may include third party mediation, or the S&P licensee conducting an independent internal review of the terms offered. If a complaint is raised with us parties should keep in mind the limits of our role we have set out.

## Trade size

2.26. As set out in Special Condition AA, Schedule A, paragraph 12:

*A qualifying request to trade is a request from an Eligible Supplier to buy or sell any Product in a volume of 0.5 MW or any integral multiple thereof not exceeding 10 MW.*

2.27. The licensee is only required to trade clip sizes in increments of 0.5MW between 0.5MW and 10MW. The licensee is free to trade in smaller clip sizes or increments if it chooses, however it will not be obligated to do so. For example, a licensee is free to trade a clip size of 0.2MW or 6.7MW if it chooses, but would not be obligated to.

2.28. For the avoidance of any doubt, "trade" includes both buying and selling the Products listed in Schedule A.

## Product Range

2.29. As set out in Special Condition AA, Schedule A, paragraph 16(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):

<i>Baseload</i>	<i>Week+1</i> <i>Month +1</i> <i>Month +2</i> <i>Quarter +1</i> <i>Season +1</i> <i>Season +2</i> <i>Season +3</i> <i>Season +4</i>
<i>Peak</i>	<i>Week+1</i> <i>Month +1</i> <i>Month +2</i> <i>Quarter +1</i> <i>Season +1</i> <i>Season +2</i> <i>Season +3</i>

*In the table above, Peak, Baseload, Week, Month, Quarter and Season have their generally accepted meanings as applicable in the market at the relevant time.*

2.30. For the avoidance of any doubt:

- "Week+1" refers to the weekly product for delivery starting the week following the current week. So if the request to trade occurs in Week 39, the licensee must be willing to trade Week 40 if requested by an eligible company.
- "Month+1" is the month following the current month. So if the request to trade occurs in April, the licensee must be willing to trade May.
- "Month+2" is the month starting two months following the current month. So if the request to trade occurs in April, the licensee must be willing to trade June.
- "Quarter+1" is the quarter following the current quarter. So if the request to trade occurs in quarter one, the licensee must be willing to trade quarter two.

- “Season+1” is the season starting the current season. So if the request to trade occurs in Summer 14, the licensee must be willing to trade Winter 14.
- “Season+2” is the season starting two seasons following the current season. So if the request to trade occurs in Summer 14, the licensee must be willing to trade Summer 15.
- “Season+3” is the season starting three seasons following the current season. So if the request to trade occurs in Summer 14, the licensee must be willing to trade Winter 15.
- “Season+4” is the season starting four seasons following the current season. So if the request to trade occurs in Summer 14, the licensee must be willing to trade Summer 16.

2.31. The licensee will be expected to trade products according to the trading calendar prevailing in the market (eg either EFA calendar or Gregorian calendar products).

## Pricing

2.32. As set out in Special Condition AA, Schedule A, paragraph 15:

*The licensee's quote must be as good as the best price that is available to the licensee in the market for the relevant Product at the relevant time; provided that the quote may include (but where included, must itemise separately):*

- a. an objectively justifiable risk premium to reflect the risk (if any) to the licensee of trading in volumes smaller than those available to the licensee in the wholesale electricity market; and*
- b. at cost any wholesale market trading fees incurred by the licensee in trading the relevant product.*

*The licensee may not include any administrative charge or any other internal costs incurred as a result of trading with the Eligible Supplier.*

2.33. For the avoidance of any doubt:

- The licensee will not be expected to price on more attractive terms than the relevant market price (eg the market offer price when the Eligible Supplier requests a quote to buy);

- The licensee will not be expected to quote the market price if it is not available to them (eg because they do not have a GTMA in place with the counterparty posting that price). Instead they should offer the best price that they are able to trade.

2.34. We accept that there is some risk incurred by trading small clip sizes which cannot immediately be backed out in the market. As long as it can be objectively justified (and itemised), a premium may be added to the price quoted to reflect this risk. We do not expect these risk premiums to be excessive or to vary greatly between S&P licensees. If we feel that this rule is being abused we will review it and may make it more prescriptive or remove it.

2.35. To be clear, the licensee is permitted to pass on the wholesale market trading fees incurred in executing the trade – it is not permitted to pass on a portion of any fixed fees it occurs from being a member of the platform that the trade is conducted on. The wholesale market trading fees incurred in executing the trade should be passed on at cost, on a pro-rata per MWh basis.

## 3. Market Making obligation

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### Chapter Summary

We set out guidance on the Market Making obligation set out in Schedule B of Special Condition AA.

### Introduction

3.1. This chapter relates to Schedule B of Special Condition AA. Except where stated, all references are to this Schedule.

### Nominee to discharge requirements

3.2. As set out in Special Condition AA, Schedule B, paragraph 4(a):

*Subject to paragraphs 4(b) and (c), 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.*

3.3. If a licensee nominates a third party, the ultimate responsibility for meeting the obligation remains with the licensee. Failure by the third party to comply with any aspect of the obligation will be treated as a licence breach by the licensee in the normal way.

### Qualifying platforms

3.4. As set out in Special Condition AA, Schedule B, paragraph 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) the platform must be operationally independent from the licensee;*
- (c) the licensee must have a reasonable expectation that the relevant Product(s) will be traded on the platform; and*
- (d) the operator of the platform must provide trading data relating to the licensee (or Nominee) to the Authority when requested for the purpose of monitoring the licensee's compliance with this Schedule B.*

3.5. In general, we want to leave licensees flexibility about where to market make, so as to avoid distorting the market for trading platforms. However, we have included a platform rule to prevent licensees from market making on platforms which (due to their location, rules, fees or any other factors) are likely to severely hinder access to the market making activity, and hence to significantly reduce the effectiveness of the intervention.

3.6. Our policy intention is that independent generators and suppliers should be able to access products offered by market makers. We expect licensees to market make on platforms which are accessible. If we see licensees choosing platforms with very limited accessibility we will consider changes to the licence condition to introduce more prescriptive rules about where the licensees can carry out their market making activity. We believe such an approach would be undesirable. We therefore urge licensees to market make on platforms that are consistent with Ofgem's objectives for the liquidity project.

3.7. When deciding whether a platform meets the 'reasonable expectation' test (paragraph 5(c)), we may refer to:

- The number of firms who have made the necessary arrangements to trade on that platform
- The volume of trading in the products on the platform
- For a new entrant platform, the time since entry, and trends in membership and volumes
- Any other factor which the Authority may consider is relevant to take into account in the achievement of the objective of this condition

3.8. For the requirement on a platform operator to provide trading data to the Authority (paragraph 5(d)), we will allow a reasonable amount of time for the provision of such data, which shall be no less than one week.

3.9. For the avoidance of doubt, the eligibility of a platform does not depend on its classification under European financial legislation.

## Availability of prices

3.10. As set out in Special Condition AA, Schedule B, paragraph 6(b):

*Where a bid or offer posted by the licensee for a particular Product is accepted, the licensee must post a new bid and offer for the Product within five minutes after the acceptance of the first bid or offer.*

3.11. The five minute reloading period runs from the point at which the first bid or offer is accepted (removed from the screen). It is an upper limit on the time that the licensee is excused from its usual obligation to post prices.

## Suspension of obligation

3.12. As set out in Special Condition AA, Schedule B, paragraph 7:

- (a) *If, at any time in a trading window, a Product has been traded (on any qualifying platform) at a price which is more than 1.04 or less than 0.96 times the price at which the Product was first so traded within that trading window, the licensee may decide to cease posting bids and offers for that Product (as required by this Schedule B) for the remainder of that trading window. Such trades may have been made by the same or different persons and on the same or different qualifying platforms.*
- (b) *Where the licensee decides to cease posting bids and offers for a Product (as required by this Schedule B) in a trading window under paragraph 7(a), it must:*
  - (i) *record such decision at the time it is taken, together with details of the trades referred to in that paragraph; and*
  - (ii) *report the time and date at which it ceased to post bids and offers for such Product (as required by this Schedule B) in its quarterly report to the Authority.*
- (c) *The licensee's duty to post bids and offers for the relevant Product (as required by this Schedule B) resumes at the next trading window.*

3.13. The fast market rule is intended to provide protection for licensees against extreme volatility. As with commercial fast market clauses, it is intended to be used sparingly.

3.14. For the avoidance of doubt, Ofgem would not be applying discretion about when a fast market is called, and would not be notifying licensees about when a fast market is in operation.

3.15. Under paragraph 7(b) we would expect the licensee to report the price of the first trade and the trade triggering the fast market, the approximate time of these trades, and the platform on which each of these trades occurred.

## Volume cap

3.16. As set out in Special Condition AA, Schedule B, paragraph 10:

- (a) *If at any time in a trading window the difference between the licensee's traded bid volume and traded offer volume in respect of a Product exceeds 30MW, the licensee may decide to cease posting bids*



*and offers for that Product (as required by this Schedule B) for the remainder of that trading window.*

(b) *For the purposes of paragraph (a):*

(i) *the traded bid volume and traded offer volume in a trading window are the total volumes of a Product for which the licensee's offers respectively to buy and to sell, on any one or more qualifying platforms, have been accepted in the trading window;*

(ii) *where the volume for which an offer to buy or sell is accepted exceeds the maximum required volume under paragraph 9, the volume in excess of such maximum will not be counted towards the total traded bid volume or traded offer volume.*

3.17. The licensee will be required to report on the windows and products for which volume caps have been applied in its quarterly report to Ofgem.

3.18. For the avoidance of doubt, the licensee's obligation will resume in full at the start of the next window.

## Definitions

### Products

3.19. As set out in Special Condition AA, Schedule B, paragraph 12:

**"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)

<i>Baseload</i>	<i>Month +1</i> <i>Month +2</i> <i>Quarter +1</i> <i>Season +1</i> <i>Season +2</i> <i>Season +3</i> <i>Season +4</i>
<i>Peak</i>	<i>Month +1</i> <i>Month +2</i> <i>Quarter +1</i> <i>Season +1</i> <i>Season +2</i> <i>Season +3</i>

3.20. For the products included in this Schedule, the same definitions apply as set out in chapter two.

3.21. The licensee will be expected to trade products according to the trading calendar prevailing in the market for that product. (Either the EFA calendar or the Gregorian calendar).

## 4. Reporting requirements

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### Chapter Summary

We set out guidance on the reporting requirements set out in Schedule C of Special Condition AA.

4.1. This chapter relates to Schedule C of the Secure and Promote licence condition. Except where stated, all references are to this Schedule.

### Reporting on compliance with Schedule A

4.2. In order to demonstrate compliance with Schedule A, the licensee will have to submit to Ofgem a quarterly report providing details on their Supplier Market Access activity. A draft template of the format of this report can be found at Appendix 3.

4.3. The information the S&P licensee must provide is set out in the table in Schedule C. If they wish to submit additional information to demonstrate their efforts in complying with Schedule A then they are free to do so in an annex to the quarterly report.

4.4. As stated in Special Condition AA, Schedule C, S&P licensees will be required to submit a statement confirming:

1. *the licensee has complied with all the requirements in Schedule A; or*
2. *if the licensee has not complied, giving details of such failure to comply.*

4.5. We will on occasion conduct checks to verify this statement. It is the licensee's responsibility to ensure that it has evidence it can provide upon request to demonstrate how it has complied with these rules or, in cases where it has not been able to do so, that illustrates any factors it proposes to cite in mitigation. This evidence should be kept for three years from the date of submitting the quarterly report.

4.6. Credit Transparency Forms do not need to be submitted along with quarterly reports, however should also be kept for three years from the date of submitting the quarterly report and provided to us upon request. A draft template for the Credit Transparency Form is in Appendix 2.

### Reporting on compliance with Schedule B

4.7. In order to demonstrate compliance with Schedule B, the licensee or their nominated third party will have to submit to Ofgem a quarterly report providing

details on their market making activity. A draft template of the format of this report can be found at Appendix 4.

4.8. The information the S&P licensee must provide is set out in the table in Schedule C. If they wish to submit additional information to demonstrate their efforts in complying with Schedule B then they are free to do so in an annex to the quarterly report.

4.9. As stated in Special Condition AA, Schedule C, S&P licensees will be required to submit a statement confirming that:

1. *the licensee complied with all the requirements of Schedule B; or*
2. *if the licensee has not complied, giving details of such failure to comply.*

4.10. We will on occasion conduct checks to verify this statement. It is the licensee's responsibility to ensure that it has evidence it can provide upon request to demonstrate compliance with these rules. This information should include:

- Time-stamped bid and offer data;
- Time-stamped trade data (indicating whether a trade was a buy or sell); and
- The platform(s) that market making was conducted on during the window in question

4.11. This evidence should be kept for three years from the date of submitting the quarterly report.

4.12. We may verify information provided by licensees against information provided by platforms. A platform is only eligible as a platform for meeting the market making obligation if it provides such information when requested by Ofgem.

## **Reporting on compliance: the near-term market**

4.13. To assist with existing monitoring of near-term markets all S&P licensees will have to provide us with a quarterly report detailing the volumes bought and sold through day-ahead auctions in each month of the quarter. A draft template for the format of this report can be found at Appendix 5.

4.14. The S&P licensee must submit the information set out in the table in Schedule C. If they wish to submit additional information to demonstrate their efforts in supporting the effective functioning of near-term markets then they are free to do so in an annex to the report.

## 5. Becoming an 'Eligible Supplier' for the Supplier Market Access rules

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### Chapter Summary

We set out the process for applying to be an Eligible Supplier and how we will deal with applications.

### Rationale for our approach

5.1. In order to ease compliance with the SMA rules for the licensees, we want to maximise the clarity over which firms are eligible for treatment under the rules. We consider this is best achieved by establishing a simple administrative process whereby we will make available a list of parties eligible for treatment under the rules. This will provide an easy one-stop reference for licensees when determining if a counterparty is an Eligible Supplier. At the same time we want the process to be quick and simple for small suppliers seeking to become Eligible Suppliers under the SMA rules.

5.2. We will publish, and regularly update, the list of Eligible Suppliers on our website. We will include a link to the list in the final version of this guidance document.

### Process for becoming an 'Eligible Supplier'

#### Criteria

5.3. As set out in our June 2013 consultation, a supplier is an 'Eligible Supplier' for treatment under the SMA rules if they meet the following criteria:

- They hold a valid GB electricity supply licence;
- They and their affiliates have supplied less than 5TWh in the 12 months ending the month before the last full calendar month<sup>10</sup> (calculated on a group basis); and

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<sup>10</sup> So if an application is made on 14 May 2014, the relevant period will be 1 April 2013 to 31 March 2014.

- They and their affiliates have generated less than 1TWh in the 12 months ending the month before the last full calendar month (calculated on a group basis).

5.4. We will consider applications from any suppliers who meet these criteria. However, in exceptional circumstance we retain the right to refuse applications from firms – or to remove firms from the list – even if they meet the criteria. Situations in which we might refuse a firm’s admission to the list (or remove a firm from the list) that otherwise meets the criteria include:

- Firms who have previously been Eligible Suppliers but have engaged in behaviour outside the spirit of the SMA rules – for example, through vexatious behaviour in negotiations with S&P licensees.
- Firms where we believe the true nature of the business is not within the intended scope of the SMA rules. For example, if a large financial firm holding a supply licence sought treatment under the rules.

5.5. We are keen that the SMA rules are effective in supporting the participation of smaller players in the market and facilitating competition, so we would only expect to exercise this right to refuse admission to the list in rare circumstances.

### **Process for admission to the list of Eligible Suppliers**

5.6. In order to become an Eligible Supplier, firms should write a letter<sup>11</sup> to Ofgem stating:

- That they wish to become an Eligible Supplier for the purposes of the SMA rules
- That they hold a valid current GB electricity supply licence
- Their total supply volumes for the 12 months ending the month before the last complete calendar month (calculated on a group basis)
- Their total generation volumes for the 12 months ending the month before the last complete calendar month (calculated on a group basis)

5.7. This letter should be signed by a director of the firm. We will check the information provided against sources of data we hold internally. Provided there are no significant differences with the statements made in the letter, the supplier will be added to the list of Eligible Suppliers, published on the Ofgem website. We will write to the Eligible Supplier formally notifying them of their eligibility and noting the date on which their eligibility will expire (see below).

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<sup>11</sup> Letters may be submitted electronically.

### **Timetable for processing requests**

5.8. We want to give applicant firms certainty over their status as quickly as possible. We aim to process all applications to become an Eligible Supplier, and update the list, within one calendar month.

### **Expiration of Eligible Supplier status**

5.9. Once added to the list of Eligible Suppliers, firms will remain on it for one year. For example, if a firm becomes an eligible supplier on 14 May 2014, they will remain an Eligible Supplier up to and including the 13 May 2015. Their eligibility will expire at 5pm on 13 May 2015. In order to remain an Eligible Supplier, firms must repeat the process set out above.

5.10. It is the responsibility of the Eligible Supplier to ensure that it reapplies in time to remain on the list.

5.11. A firm will remain an Eligible Supplier even if, following admission to the list of Eligible Suppliers, in a subsequent month they would fail to meet the criteria set out above<sup>12</sup>. We will not undertake reassessments of eligibility between applications to be added to the list of Eligible Suppliers.

### **Feedback on this process**

5.12. We are keen that this process minimises administrative burdens for both applicant firms and S&P licensees. We therefore welcome feedback on this process and are prepared to consider revisions to it in response to feedback from stakeholders.

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<sup>12</sup> Except in cases where they have been removed from the list for vexatious behaviour.

## Appendices

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## Appendix 1 - Responses

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1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. There are no specific questions relating to the content of this document. However, we welcome the views of respondents on any part of this draft guidance. In particular we welcome any suggestions on how we can make the guidance clearer.

1.2. Responses should be received by 18 December and should be sent by email to:

Leigh Rafferty  
[gb.markets@ofgem.gov.uk](mailto:gb.markets@ofgem.gov.uk)  
0141 341 3999

1.3. Hard copies of responses can be addressed to Leigh Rafferty at:

3rd Floor,  
Cornerstone,  
107 West Regent Street,  
Glasgow, G2 2BA

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](http://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. Any questions on this document should, in the first instance, be directed to Leigh Rafferty, through the above contact details.

## Appendix 2 – Draft Credit Transparency Form

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2.1 Please note that we do not expect licensees to stick to a one-page limit when completing this form. We welcome feedback on all aspects of the draft Credit Transparency Form.

### Draft Credit Transparency Form

#### Company details

<b>Date</b>	
<b>Contractual counterparty</b>	
<b>Credit support provider</b>	
<b>Agreement under negotiation</b>	eg GTMA

#### Information requested (as published on website)

Information requested	Received	Notes

#### Credit review: factors taken into account

Quantitative factors	Qualitative factors

#### Credit review: outcome

<b>Unsecured limit offered</b>	Yes / No
<b>Value of unsecured limit</b>	
<b>Credit support received</b>	
<b>Other relevant information</b>	
<b>Actions that could improve / diminish terms</b>	For example: alternative method of credit support, management stability

## Appendix 3 – Draft Reporting Template: Supplier Market Access rules

3.1 Please note that we do not expect licensees to stick to a specific page limits when completing this report. We welcome feedback on the draft reporting template for the SMA rules.

### Draft Compliance Report Template: Supplier Market Access

#### Reporting period:

#### Information on activity with Eligible Suppliers

Link to where Eligible Suppliers can find contact details and information needed when submitting a trading request:

I confirm that the information obtained at the above link is accurate and up-to-date.

Trading agreements in place	Trading agreements signed this quarter	Trading agreements under negotiation
Enter names of counterparties	Enter names of counterparties	Enter names of counterparties

Abandoned negotiations / unable to offer agreement	
Enter names of counterparties	Enter reasons for abandonment / being unable to offer an agreement

#### Trading activity:

Names of Eligible Suppliers traded with this quarter

Product	Gross volume (MWh)	Number of trades	Product	Gross volume (MWh)	Number of trades
BL W+1			PK W+1		
BL M+1			PK M+1		
BL M+2			PK M+2		
BL Q+1			PK Q+1		
BL S+1			PK S+1		
BL S+2			PK S+2		
BL S+3			PK S+3		
BL S+4					

**Confirmation of compliance with SMA rules**

I confirm that [LICENSEE NAME] has complied with all aspects of Schedule A of the Secure and Promote licence condition this quarter, or that attached to this report are details of any failure to comply

I understand that Ofgem may carry out checks to confirm compliance with Schedule A, or investigate any occasion where [LICENSEE NAME] has failed to comply, and agree to provide evidence to demonstrate this within five working days of the request.

Signed:

Date:

## Appendix 4 – Draft Reporting Template: Market Making obligation

4.1 Please note that we do not expect licensees to stick to a specific page limits when completing this report. We welcome feedback on the draft reporting template for the Market Making obligation.

### Draft Compliance Report Template: Market Making

#### Reporting period:

#### Details of nominee (if used)

<b>Name of nominee</b>	
<b>Number of market participants nominee is set up to trade with</b>	

#### Platforms used this quarter

Platform name

#### Withdrawal from market making activities this quarter

Date	Window	Reason (evidence should also be submitted)
		Eg volume cap or fast market

#### Trading activities as a market maker this quarter

Product	Gross volume (MWh)	Number of trades	Product	Gross volume (MWh)	Number of trades
BL M+1			PK M+1		
BL M+2			PK M+2		
BL Q+1			PK Q+1		
BL S+1			PK S+1		
BL S+2			PK S+2		
BL S+3			PK S+3		
BL S+4					

**Confirmation of compliance with Market Making rules**

I confirm that [LICENSEE NAME] has complied with all aspects of Schedule B of the Secure and Promote licence condition this quarter, or that attached to this report are details of any failure to comply.

I understand that Ofgem may carry out checks to confirm compliance with Schedule B, or investigate any occasion where [LICENSEE NAME] has failed to comply, and agree to provide evidence to demonstrate this within five working days of the request.

Signed:

Date:



## Appendix 5 – Reporting Template: Near-term market

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5.1 We welcome feedback on the draft reporting template for the near-term market.

### **Draft Report Template: Near term-market**

**Reporting period:**

**Gross volume bought and sold through day-ahead auctions each month**

Month	Volume (MWh)

Signed:

Date:

## Appendix 6 - Feedback Questionnaire

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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:

**Andrew MacFaul**  
Consultation Co-ordinator  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
andrew.macfaul@ofgem.gov.uk