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9<sup>th</sup> August 2013  
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**The Renewable Energy Company (Ecotricity) Consultation Response to  
The Retail Market Review: Liquidity Proposals**

Dear Phil Slarks,

Ecotricity is an independent renewable energy supplier and generator with around 75,000 customers – domestic and non-domestic combined.

We welcome Ofgem's plans to improve liquidity in the wholesale energy market. This is an issue that we have long been concerned about and have been actively engaged with Ofgem on for the past 3 years. We believe that the current proposals for a Secure and Promote licence condition strike a relatively good balance between the needs of the industry and the competitive position of the various market participants. Nevertheless, we maintain our concerns over certain aspects of the proposed intervention options, in particular in relation to the Market Making Obligation; and recommend that Ofgem carefully consider the details of the proposal.

Moreover, we believe that the implementation of the Secure & Promote licence condition will give rise to the need for complex and costly monitoring mechanisms in order to ensure compliance with all of the proposed elements.

## **Answers and Questions**

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

We agree with Ofgem's assessments that churn, and therefore liquidity continued to decline over 2012-13. In particular, we are satisfied by Ofgem's assessment of the churn in the forward 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?***

Ecotricity has previously expressed concerns over the details of the Secure and Promote (S&P) licence condition proposals, in particular with regard to the Market Making Obligation (MMO) being implemented as a singular intervention. In our February response, we argued that the mechanism would not necessarily guarantee that prices would be reflective of the market, and in particular of small suppliers' needs. We highlighted the high potential for price setting and stressed that there would be little guarantee that the prices posted would be attractive to independent suppliers. For example, we raised concerns over the risk that obligated parties would ensure narrow spreads by purchasing at the high prices that they themselves set.

However, we are pleased that Ofgem has now clarified some of these issues. For example, we are broadly satisfied with the argument that, by extending the MMO to multiple licensees, the potential for price setting and market manipulation would decrease. We also believe that the proposal to have Ofgem establish the bid-offer spread limits is a positive development; although we would like to understand how this would be monitored in practice. Moreover, this does not mean that the Big 6 suppliers would be unable to post uncompetitive prices, as the proposed rules do not eliminate the option of internal trading. We would be interested in obtaining some clarity over how Ofgem intends to address this issue.

We welcome the introduction of Supplier Market Access (SMA) rules as part of the S&P condition. We are pleased that Ofgem has decided to introduce a set of rules that specifically target trading arrangements between generators and small suppliers. If the two elements of the S&P are properly interlinked, we believe that Ofgem's proposal could go relatively far in addressing the liquidity issue. However, we welcome further clarifications from Ofgem on the precise interactions between the two. For example, under the MMO rules, Ofgem requires licensees to trade at the prices they set, if requested to do so. However, a clip size of 5MW, which is the minimum Ofgem proposes for these trades, is far too large for small suppliers; suggesting that they won't have the opportunity to partake in these types of trades. It is not clear how this interacts with the SMA rule whereby small suppliers can request trades for minimum clip sizes of 0.5MW. We would like to highlight that, if this link is not carefully considered by Ofgem, then the MMO prices cannot be truly reflective of the needs of the entire energy market.



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

We agree that the introduction of the S&P as a standard license condition would be beneficial, in that it would allow Ofgem to employ the usual processes in terms of consultations on amendments and enforcement.

We would like to question the necessity of paragraph X1, which states that the S&P licence condition will cease to have effect in relation to one or more obligated licensee when the Authority so deems. We assume that the reason for this is to give the Authority more discretion in revoking the obligation than it would otherwise have. We object to this and believe that any removal of this requirement from one or more licensee should be subject to the standard process that accompanies licence condition changes.

We also have concerns with X3, which states that schedule 2 will only apply with the consent of the licensee. It is not clear what Ofgem means by this, but it is important that the MMO be imposed on all relevant suppliers, not simply those that consent.

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

Yes. We believe that Ofgem has selected the correct market participants to be licensees to the S&P condition. As mentioned above, we are particularly pleased that Ofgem has decided to proceed with the option to have multiple licensees under the MMO. This is more likely to reduce the concentration of power and the potential for manipulation.

We would like clarification over whether Ofgem intends for the obligation to be on all licensees over a given size, or whether it will apply only to licensees specified at the outset.

**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'?*

We are satisfied with Ofgem's approach to ensuring transparency (A1) under the SMA rules; as well as the scope (A2) of the rules. With regard to the arrangements for responding to trading requests (A3), we encourage Ofgem to clarify that the requirement to respond within 3 hours of receipt implies that generators are required to maintain the price that was live at the time when the request was made. Otherwise, a 3 hour time lag between when the request is made and when the generator responds can have an impact on the supplier's ability to trade efficiently.

We believe that the rules proposed by Ofgem to ensure fair credit and collateral arrangements (A4) are reasonable. We are pleased that these encourage assessments to be made based on the individual circumstances of the counterparty and the risks associated with the specific trade. We strongly support the proposal for a transparency mechanism, which clarifies the factors and information taken into consideration by generators when establishing credit terms. We would encourage Ofgem to leave no room for interpretation and vagueness when designing the Credit Transparency Form. We would also suggest that, looking forward, Ofgem place a considerable amount of focus on monitoring the effectiveness of this SMA rule; as it is a key determinant of market liquidity and of small



suppliers' ability to trade; and consider strengthening the requirement if this becomes necessary.

In our February response, Ecotricity stressed the importance of having clip sizes (A5) as small as 0.1MW. It is not clear to us why Ofgem has now moved from this initial proposal to the lower granularity of 0.5MW that it now proposes. In the January consultation, it was recognised that clip sizes as small as 0.1MW are most likely to reflect volume needs of small players, as they would allow them to create their own shape along the curve. We encourage Ofgem to reconsider this proposal.

In relation to the product ranges (A6) covered by the SMA rules, it would be preferable to add a little more flexibility in the product range outlined in the consultation. For example, it would be practical to have a Month+3 and Quarter +2 available; and to split up seasons for both peak and baseload products. It would be reasonable to have a Season+4 product available for peaks if this exists for baseload.

Finally, we suggest that Ofgem provide some indication of how it ensures that trading prices (A7) are 'reflective of the market price'; in particular how it will define, monitor and enforce this requirement. As mentioned above, this is where interactions between the SMA rules and the MMO become significant; and more clarity is required from Ofgem's proposals.

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

No, we believe that Ofgem has covered all of the elements that are relevant to small suppliers' trading arrangements with large generators.

**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'?*

We maintain our position that a single platform (B2) would be more suitable for the purposes of the MMO. This approach would limit collateral requirements, increase transparency and make reference prices more robust. If this platform were selected through a robust tender process, it would also eliminate any concerns over its effect on the competition in the market for platforms.

With regard to product range (B3), we suggest that Ofgem consider the same amendments as those highlighted above for the SMA rules. As already mentioned, these additions would be more reflective of the market's needs and would allow more flexibility, for the reasons outlined above in response to Question 5.

We would also encourage Ofgem to provide more clarity over what the intention of its proposed availability rule (B4) is. It is not clear to us how this would work in practice; and how Ofgem intends to ensure continuous market making if it would allow licensees to withdraw from the market 50% of the time over the course of a month.

We would be interested in understanding how Ofgem has reached the bid-spread offer values that it proposes (B5). We believe that the difference between peak and baseload spreads is questionable; in our experience, this tends to be proportionate to the difference



in price between baseload and peak prices. For example, if peak prices were 25% higher than the baseload prices, then this should be reflected in the difference between the respective bid-offer spreads.

Finally, we are pleased with the proposal to oblige the MMO licensees to trade at the prices posted (B6). We believe that this goes some way in keeping incentives for market manipulation to a relative minimum. However, we would like to express our concern with the decision to set the minimum clip size for this obligation at 5 MW (B7). As explained above in response to Question 2, this suggests that small suppliers will not have the option to utilise their rights under the SMA rules to request market makers to trade at the prices they post. We strongly advise that Ofgem reconsider this and provide more clarity over the practical interactions between the two requirements.

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

We are agnostic in relation to whether this is the case.

***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?***

We believe there can be positive outcomes derived from a tender process and we think a trial of this option would be beneficial. We agree with the issues identified by Ofgem, in particular in relation to how many firms would be allowed to bid and what type of businesses these firms would be. Furthermore, it is worth noting that, if funding the tender process would result in additional costs to market participants; then the benefits that this option would bring over the existing MMO proposals must be carefully assessed. It is also important to ensure that the prices that would arise through this process would be reflective of demand and supply; otherwise the impact on consumers would be major, and questionable from an ethical point of view.

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

We are agnostic in relation to the cost-benefit analysis provided by Ofgem.

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

We agree that Ofgem's efforts to improve liquidity in the wholesale market should initially focus on the long-term markets; and that the near term market is already sufficiently liquid to not require intervention. We believe, however, that the near-term market must be carefully monitored; and would encourage Ofgem to ensure that the high volume which is currently being traded in near-term exchanges is not erroneously accepted as the sole indicator of a liquid market. As highlighted in our previous responses, it is churn that is the most important indicator of market liquidity.

## **Conclusion and Summary**

Overall Ecotricity strongly supports the move to improve liquidity in the wholesale market and believe it is imperative that changes be implemented as soon as possible.

We believe that the current structure of the S&P licence condition goes some way in clarifying Ofgem's previous proposals. In particular, the introduction of SMA rules for small suppliers is a positive development. However, we encourage Ofgem to provide some clarity in relation to how the various elements of the licence condition would interact in practice; and to ensure that small suppliers are able to yield the benefits of both the SMA rules and the MMO arrangements.

Ecotricity are grateful for the opportunity to comment on this consultation on the RMR liquidity proposals and we look forward to your response and next steps.

We also welcome any further contact in response to this letter. Please contact Holly Tomlinson on 01453 769301 or [holly.tomlinson@ecotricity.co.uk](mailto:holly.tomlinson@ecotricity.co.uk).

Yours sincerely



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