Energy for generations

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Dear Phil,

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

The ongoing lack of meaningful liquidity in the GB wholesale power market provides a barrier to entry and participation for independent players. As a developer and operator of independent generation assets, ESB therefore welcomes the opportunity to comment on Ofgem's proposals for improving liquidity through the introduction of a 'Secure and Promote' (S&P) licence condition.

This response provides a brief introduction to ESB, followed by a summary of our views on some of the general issues raised in the consultation. We then provide responses to the specific questions asked by Ofgem in its consultation.

ESB

ESB has been a developer and operator of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for almost 20 years. We own, operate and trade Corby power station and developed the 850MW plant at Marchwood, which was commissioned late in 2009. We are also constructing our latest 860MW development at Carrington which is intended to become operational in 2015. Additionally, we own and operate the 406MW Coolkeeragh plant in Northern Ireland. We are also developing further large-scale CCGT projects at other locations across GB, in particular our 1500MW project at Knottingley, West Yorkshire.

In addition to increasing our conventional generation fleet, we continue to grow our position in the UK wind market. Our operational and development portfolio is in excess of 165MW including the recently commissioned 66MW Fullabrook Wind Farm in Devon which is England's largest onshore wind farm. We are also active in the ocean energy sector.

With increases in physical interconnection, in particular the recent commissioning of the East-West interconnector, coupled with the further development of the regional market, our operations in Ireland will become increasingly linked with the GB market.

Summary of views

ESB has long supported Ofgem's assessment that the GB electricity wholesale market does not have sufficient meaningful liquidity. We have advocated that Ofgem should intervene to improve the situation but have been disappointed with the lack of progress in this regard. Therefore, we strongly support Ofgem's decision to introduce the S&P licence conditions and would urge Ofgem to adhere to the indicative timeline for introduction that it states in its consultation.

Previous responses to Ofgem consultations have stated our preference for obligating the large vertically integrated companies to trade certain volumes in the wholesale market, as we are of the view that this form of intervention would deliver the most significant improvements to liquidity. That said, we believe the obligation to market make, as proposed, has the scope to bring real improvements to the levels of liquidity currently seen in the market. There is a level of detail yet to be developed for the proposals and we would urge Ofgem to develop this as soon as possible to ensure industry is satisfied that the proposals work and do not lead to unintended consequences.

There are a number of aspects of the market making proposal upon which Ofgem seeks views. In particular, is the possibility that there could be an industry-run tender for a single platform to undertake the market making role. Whilst there may be some benefits to the large vertically integrated companies in doing this, we are concerned that the underlying lack of liquidity in the market would limit the number of parties that would come forward to offer such services. The market requires the large vertically integrated companies to bring trades and volume to market irrespective of whether they undertake the market making role, or a third party. If a third party provider was to be used, we believe there would have to be licence conditions on the large vertical integrated companies to provide the necessary market liquidity that will be required to ensure the validity and robustness of the market maker.

In addition, we are concerned that undertaking an industry-run tender would introduce significant delay to the introduction of the market maker. In light of the delays experienced to date and the real need for change, we believe a tendered solution should only be used as a last resort.

We note Ofgem's proposals on improving small supplier access to the wholesale market and think they will aid the participation of those small parties that will be eligible to benefit from the rules. In light of ESB's position as a medium sized independent generator, we have focused our comments mainly on the proposed market making proposals as we believe it is the key aspect to the licence condition that could deliver tangible improvements to liquidity.

Responses to specific questions

Q1. Do you agree with our updated assessment of the wholesale market (set out in this chapter and appendix two)?

We broadly agree with Ofgem's assessment. ESB has not seen any discernible improvement in liquidity over the period covered by Ofgem's assessment. In particular, we note that whilst there may have been a marginal tightening of bid-offer spreads, they remain wide when compared to more liquid markets, particularly for longer dated products. In addition, we have not seen the market developing the near-term liquidity that is apparent, into longer dated products.

Q2. 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?

Yes, we strongly agree that Ofgem should intervene in the market and that the S&P licence condition is an appropriate and proportionate intervention to improve wholesale market liquidity and market access for smaller suppliers.

Q3. Do you agree with our proposed legal approach to S&P?

The approach proposed is reasonable and proportionate.

Q4. Do you agree with our proposals for who should face the obligations under S&P?

Whilst we were surprised to see the inclusion of independent generators in the list of obligated parties under the S&P licence condition, we note that the two independent parties operate significant generation capacity that could usefully provide additional trading options to small independent suppliers. However, Ofgem must ensure that the costs that may be incurred by Drax Power and GdF Suez are not disproportionately greater than those incurred by the vertically integrated players.

Q5. 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 do not have any additional comments to those provided above.

Q6. Are there any further areas that these rules should cover?

No, there are no further areas that we believe require to be covered in the proposals.

Q7. Do you have any comments on our proposed detailed design for the market making obligation, particularly those listed under 'key outstanding design questions'?

We provide comments on each of the detailed aspects of the MMM below.

Nomination of third party – We are not averse to the obligated parties nominating third parties to deliver obligated MMM services. However, a key factor for independent players is having a choice of different routes to market by which they can choose the most appropriate for their trading needs. We therefore agree that only 2 obligated parties should be permitted to use any one platform, thereby limiting the minimum number of platforms to three.

Platform – We agree with Ofgem's proposals as they appear to ensure nominated platforms are accessible to a material number of market participants.

Products – The range of products is appropriate and should encourage liquidity in those areas of the curve that currently have little meaningful liquidity, in particular longer dated baseload and most peak products.

Availability – We welcome Ofgem's intent to ensure that products are available for sufficient market opening to satisfy the needs of independent players. However, we are concerned that requiring MMMs to be open for a minimum of 50% of market opening may actually reduce the effectiveness of the obligation by fragmenting liquidity across the day. We would support the concept that Ofgem has raised previously of obligating 2 one hour trading windows (morning and afternoon) that would focus liquidity and generate more robust reference prices.

Bid-offer spreads – ESB recognises the difficulties in setting spreads at a level that appropriately balances risks, benefits and costs and note the work Ofgem has undertaken in this regard. The spread size is one of the critical aspects that will determine the success of the proposed intervention. Spreads that are as wide as currently seen in the market will not encourage liquidity, we therefore support the levels that Ofgem has deemed more reflective of a liquid market. We feel the tighter spreads that have been specified would provide independent players with opportunities to better hedge their risks and create a wholesale market that is more conducive to market entry and participation.

Obligation to trade – We support the inclusion of an obligation to trade at prices posted, if requested. The requirement to have trading agreements and appropriate credit in place is sensible. We would be concerned if current GTMA and credit requirements were made more onerous following the introduction of the licence conditions, thereby creating a barrier to parties accessing the prices on the MMMs. As such, we believe there is merit in Ofgem monitoring these prerequisites following the implementation of the obligations.

Trade size – Ofgem's proposals are broadly sensible. In order not to unduly complicate the platforms and dilute liquidity, there is merit in determining that only clip sizes of 5MW or 10 MW should be considered in the satisfaction of the MMM obligation.

Reporting – we agree with Ofgem's view that reporting will play a key role in monitoring the success of the intervention. The types and timing of the reports proposed in the consultation appear appropriate.

Q8. Do the detailed elements of the proposed market making obligation appropriately balance costs and risk for the licensees?

We acknowledge that there may be some costs arising from the mandating of trading activity that may not have arisen in the illiquid market that current exists. However, we strongly believe that any additional costs will be outweighed by the benefits that improved liquidity and competition would bring, particularly in the medium to long term.

Q9. 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?

As stated above, ESB is of the view that there are benefits to there being a number of market making options, trading across different types of platform and products. If a tender process is to be used we would seek for it to, as far as possible, provide similar choices to those that would be available when accessing volume on the individual market making platforms.

We have reservations as to the viability of a single tendered platform without improvements to the underlying wholesale liquidity that the platform would rely upon to back-off its market making activities. Irrespective of whether a third party undertakes market making, or the large integrated companies, robust liquidity cannot emerge without those large integrated companies taking a more active role in the wholesale market.

We are also concerned that any tender process would unduly delay the introduction of measures to improve liquidity. Independent players have waited over 4 years for measures to be implemented and we would not want to see a tender process introduce any further delay.

It is therefore our preference for each of the obligated parties to undertake the market making activity themselves or individually tender third parties, as per Ofgem's proposed process with the associated constraints on platform selection.

Q10. Do you agree with our analysis of the costs, risks and benefits of intervening in the near-term market?

Ofgem's analysis of the costs, risks and benefits of intervening in the near-term markets appears sound. Industry is in general agreement that the near-term markets operate with sufficient effective liquidity and that prices are largely robust. Any intervention is likely to incur costs and risks that greatly outweigh any benefits.

Q11. Do you agree that we should not intervene in near-term markets at this stage?

Yes, please see previous answer.

I hope you find these comment of value. Should you wish to further discuss any of the views expressed in this response please do not hesitate to contact me. In the meantime, I look forward to Ofgem taking implementing this critical intervention at the earliest opportunity.

Yours sincerely,

Michael Dodd

GB Regulation Manager, ESB

By e-mail