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Phil Slarks,
Wholesale Markets
Ofgem
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Friday 9th August 2013

Dear Phil,

Consultation on proposals for a secure & promote licence condition

Thank you for the opportunity to provide comment on the above consultation. As you are aware Good Energy is a licensed electricity supplier supplying over 34,000 customers with electricity sourced primarily from decentralised renewable generators.

Executive Summary

We welcome this consultation, in particular the recognition that credit collateral is an issue in the market, but we are disappointed that Ofgem has chosen to take a soft line on this issue in merely requiring obligated parties to offer bespoke rather than generic terms.

One of our chief concerns is that Ofgem appear to be solving yesterday's problem with a regulatory solution rather than helping the market develop effectively for the future where intermittent generation becomes more prevalent, and thus more trading will occur in the near term market.

That said we are supportive of the SMA proposals in general, but still believe that it is credit and collateral that prevents smaller suppliers trading along the curve rather than actual willingness of larger players to trade.

However, we believe the market maker proposals are designed to exclude smaller market players with their large clip size and focus on standard shapes. This is concerning as it means that the market reference price for PPA arrangements under the SMA will be dictated by the obligated parties alone. Even more concerning is that it provides an opportunity to game the market reference price used in EMR for FIT CFD contracts, which we believe needs serious consideration.

We have answered your specific questions below, expanding where necessary.

Q1. Do you agree with our updated assessment of the wholesale market?

Partly. We agree with the market indicators, but would raise the following points which may be influencing the market which are not covered.

Firstly, the structure of EMR support favours vertical integration as a risk reduction strategy. This will have an impact on liquidity in the forward curve if parties find that market design does not favour independent generation and supply.

Secondly, the trend is towards more intermittent generation. By its nature, intermittent generation will be traded in the near term market once its availability is confirmed. As the proportion of generation increases in the near term market, then the market is likely to move further away from longer term trading.

Finally, any assessment of the market should include consideration of the credit terms available, as these will impact parties' ability to trade out along the curve.

Q2. Do you agree with our conclusion that we should intervene in the market in the form of the 'Secure & Promote' licence condition set out in this document?

No. We believe that the secure & promote solution fails on two fronts. Firstly is that it is backwards looking and trying to solve the market of yesterday, rather than the market that we are facing tomorrow. The impact of EMR, European target model and a changing generation mix are not being sufficiently factored into the solution. Secondly, the solution is a regulatory fix rather than a market solution. We feel that any solution should result in the market becoming more liquid rather than parties being artificially forced to create liquidity. Whilst the impact is likely to work, it cannot be enduring and in itself will distort the market to prevent it working properly based on market fundamentals.

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

We are broadly supportive of the legal approach, but suggest that a draft of the guidance should be made available earlier than the statutory consultation. We also believe that the guidance should have a process of consultation on any changes that are required to it.

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

Yes, but believe that on any subsequent review a generators mix of base load and intermittent generation should be considered given this proposal is about being able to offer firm contracts along the curve rather than the near term market.

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 believe that final proposals are reasonable, but add the following comments:

Transparency – We are not convinced that a named individual on an obscure part of one of several websites that a party can have is the best solution on transparency. It may be better that this list is kept by Ofgem along side the list of eligible suppliers.

Credit & Collateral – This is the key issue for small suppliers and whilst we welcome the requirement to set credit & collateral terms based on an individual's risk profile we still believe this will remain a significant barrier to entry. We believe if the market was working effectively, smaller suppliers would trade with the obligated party offering the best collateral terms, and force a race to the bottom. We urge Ofgem to monitor terms to ensure that competitive and reasonable terms are offered rather than all obligated parties offering similar terms to all based on the risk profile of a 'generic smaller supplier'.

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

Although it is implied, we believe that the rules should explicitly state that small suppliers require access to buy or sell power. This will give small suppliers confidence to buy from independent generators, or suppliers in advance knowing that they can sell on any surplus power at a later date should the need arise.

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

Our major concern with the market making obligation is that it seems designed to exclude smaller suppliers from participating, thus trading in this area will be limited to the obligated parties and any potential pure market trader. For example, the minimum clip size of 5MW, contradicts the arguments made in the SMA for a clip size of 0.5MW. Also the potential for the trading to take place on several different platforms means that the cost of joining all platforms, and the associated credit terms to participate in them will be prohibitive. Small suppliers will therefore be restricted to the near term market, (assuming the Market making obligation does not reduce availability in the near term market), and the SMA PPA market.

If the market making is controlled by a relatively small number of parties, and these prices are then used to bench mark PPAs under the SMA arrangements, then the market will not be functioning effectively for smaller suppliers or generators as it will be dominated by trades between larger parties.

One must also question if this limited number of players fulfils the liquid market requirements under FiT with CFD, especially as all players are likely to be significant participants in that market also.

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

We believe that clip sizes of 5MW are not suitable for smaller suppliers or generators to participate. Also, the cost to suppliers of maintaining a presence on multiple platforms will also increase costs. As a result we do not feel that the 1st bullet point in 4.3 on the document is met, as it restricts the market to the obligated parties. We therefore believe that clip size should be reduced to 0.5MW as a minimum and trading to be on a single platform, or on multiple platforms but with pooled access to the traded volume as per the pending ‘Virtual Hub’ arrangement.

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 a view on how we can solve the practical challenges we have identified?

We support the principle of a single platform, but believe that a market maker should be a short term solution to improve liquidity in the market. If a commercial market maker was appointed then it would want the role to be enduring, whereas setting the obligations on parties encourages them to deliver liquidity such that the obligation can be withdrawn in the future.

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

We broadly agree, but feel the market should be kept under review, especially if enforced liquidity along the curve reduces liquidity in the near term market.

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

Yes.

I hope you find this response useful. If you wish to discuss any of the above further, please do not hesitate to contact me.

Kind regards,

Chris Welby

Chris Welby
Policy & Regulatory Affairs Director.