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Phil Slarks  
Wholesale Markets  
Ofgem  
9 Millbank  
London

Our Ref: GS-000957

2 August 2013

Dear Phil Slarks,

Re: RES Response to Liquidity Consultation

RES is one of the world's leading renewable energy developers working across the globe to develop, construct and operate projects that contribute to our goal of a sustainable future. We have a portfolio of low carbon energy technologies and a range of services which together can meet demand from the industrial, public and commercial sectors on whatever scale.

RES has been an established presence at the forefront of the wind energy industry for over three decades.

Our core activity is the development, design, construction, financing and operation of wind farm projects worldwide. RES has developed or built almost 8GW of wind energy worldwide and we have several thousand megawatts under construction and in development, we continue to play a leading role in what is now the world's fastest growing energy sector. RES is also involved in the dedicated biomass, solar, offshore wind, wave and tidal sectors.

RES welcomes the opportunity to respond to the wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition. We previously responded to Ofgem's original consultation on the 'Secure and Promote' licence condition in February of this year. We attach our response to the specific consultation questions and the key points to note in our response are outlined below:

1. Overall there is a lack of consideration for independent generators, the needs of independent generators are not being met by Ofgem's objectives, assessments and proposals in this consultation. We discussed this in our previous response and we discuss this further in our responses to the specific consultation questions attached.
2. We agree with the conclusion that Ofgem should intervene in the market in the form of the 'Secure and Promote' licence condition but with some amendments to the details of the current proposal.
3. We welcome that Ofgem has taken Option B forward from the previous consultation, to ensure that robust reference prices along the curve develop in the form of the market making obligation.
4. This licence condition should be enacted for five years minimum not the three years currently proposed. A minimum of five years is needed to provide certainty to market participants and encourage new market entrants, maybe even aggregators. However, there are other barriers to aggregators entering the market; it should not be assumed that improved liquidity will automatically lead to independent aggregators being attracted into the market.

5. The Supplier Market Access rules should be not extended to any other independent generators nor should the market making obligation be applied to any other market participants.

RES are grateful for the opportunity to comment and look forward to seeing the formal statutory consultation before the end of the year. We hope you take our comments on board and welcome any further contact in relation to this response, please contact myself on the contact details below.

Yours sincerely,

Sarah Husband

Policy Analyst

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

We agree with the updated assessment of the wholesale market. The evidence continues to show that intervention is necessary. There has been no real improvement in churn, OTC trading in forward products and independents' ability to trade. Additionally, there has been a decline in trading in financial products.

Furthermore, the monitoring of the market which Ofgem currently undertakes should be continued when the 'Secure and Promote' licence condition is implemented.

**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?**

We agree with the conclusion that Ofgem should intervene in the market in the form of the 'Secure and Promote' licence condition but with some amendments to the details of the current proposal. The 'Secure and Promote' licence condition can be implemented quickly and therefore should be, especially given the long delays in the liquidity review which have already occurred. The package of measures approach is a good approach as it is likely to take more than one measure to resolve all liquidity issues in the market. The proposals, if implemented as intended, should make it easier for small suppliers to participate in the market. Small suppliers should be able to trade more easily to balance their position at fairer prices.

We welcome that Ofgem has taken Option B forward from the previous consultation, to ensure that robust reference prices along the curve develop in the form of the market making obligation. We also appreciate the rationale for no longer proposing to require 30% of the Big 6's generation to be traded in the day-ahead market. As we previously stated the requirement for trading 30% of the Big 6's generation in the day-ahead market may not be the best practice to embed but only the most acceptable practice. However, additional consideration needs to be given to independent generators, as discussed in more detail below. There will only be real and enduring liquidity in the longer term market when there are a significant number of participants on both the buy and sell side of the market which truly need to trade.

As discussed above, there is a real lack of consideration for independent generators, the needs of independent generators are again not being met by Ofgem's objectives, assessments and proposals in this consultation. The proposals should fully consider the needs all market participants. The Ofgem press release<sup>1</sup> on these proposals stated that "knowing that the big six will buy power at the prices they post will also help independent generators sell their output in the forward market." The factsheet also states that "the proposed rules will also make it easier for independent generators to sell their power"<sup>2</sup>. However, we do not see how these proposals will have any real impact on independent generators. The market making obligation will make forward prices clearer for generators but only for two years ahead. Independent generators need longer certainty than this. Additionally these provisions will be introduced with a time limit, they are currently proposed to only be mandated in licence conditions for three years, so in theory this obligation could it be withdrawn.

As an independent generator we believe our issues with liquidity lie outside the scope of this proposal and still need to be considered and addressed. At present the vertically integrated nature of the market and lack of liquidity mean we require Power Purchase Agreements (PPAs) with one of the Big Six suppliers in order to

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<sup>1</sup> Ofgem, 12<sup>th</sup> June 2013, [http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=13\\_06\\_12\\_Liquidity\\_release.pdf&refer=Media/PressRel](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=13_06_12_Liquidity_release.pdf&refer=Media/PressRel)

<sup>2</sup> Ofgem, 12<sup>th</sup> June 2013, [http://www.ofgem.gov.uk/Media/FactSheets/Documents1/liquidity%20factsheet\\_WEB.pdf](http://www.ofgem.gov.uk/Media/FactSheets/Documents1/liquidity%20factsheet_WEB.pdf)

secure project finance for our developments. It is vital that the wholesale market is made highly liquid so that independent aggregators and traders can be attracted into the market to compete with the traditional PPA providers. However, there are other barriers to this, so it should not be assumed that improved liquidity will lead to independent aggregators being attracted into the market place. Also the need for promoting a more liquid and transparent market is separate to the need of providing a viable route to market for independent generators that require a PPA. Liquidity is important for the large companies that have the facilities to trade in the market.

All market participants need to be considered, the whole market overlaps and the whole market needs to function on all sides. The scope of the liquidity review needs to be broadened. There is greater risk of unintended consequences if the market is not considered in its entirety for example, obligating the Big Six to trade with small suppliers will limit trading with other market participants such as aggregators.

Additionally, we fully support the Green Power Auction Market (GPAM) proposal to enable independent generators to find a route to market. We also welcome the backstop PPA route to market proposal, proposed by DECC but we have requirements that need to be in place to have confidence that this will work as a solution. The GPAM proposal builds upon the existing NFPA structure, provides a market-led solution, improves liquidity, allows market access for small suppliers and new entrants but most importantly will lower cost to consumers. Under GPAM a low-carbon generator will auction their output every six months to a supplier, in line with the current NFPA power auctions. The supplier will purchase all the output from that generator and manage all the balancing. The cost of balancing will be factored into the auction price and therefore adjusted every six months to take into account actual balancing costs, removing the risk of over estimating long term balancing costs in PPA's and CfD Strike prices. Under this proposal the auction clearing price will be used for each generator as their CfD reference price thereby removing CfD reference price risk. GPAM will promote competition and lower the cost of reaching renewable energy targets for consumers. Furthermore, the NFPA power auction is a good route for small suppliers to access power.

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

We agree with the proposed legal approach to the 'Secure and Promote' licence condition. As mentioned in our previous response, a robust change control process should be followed to ensure all stakeholders are consulted and implications appropriately considered before any changes are made. Including the detail of the 'Secure and Promote' obligation in three schedules to the licence condition will allow a robust change control process to be followed. We welcome the proposal that "modifications to those schedules would follow the standard statutory process, including consultation phases and opportunities for appeal." This is the normal modification process followed for market changes and it should also be used in this case, the process is established, well known and has historically been a good process.

In response to point 2.3 in the consultation document<sup>3</sup>, we believe that the legal structure of the requirements being in the licence conditions allows enough flexibility while thoroughly considering any changes necessary. To retain flexibility Ofgem need to regularly monitor the progress of these proposals and be fully prepared to act quickly. The robust change control process needs to be fully ready to be utilised when needed. We appreciate that additional guidance may need to be produced by Ofgem to support the 'Secure and Promote' licence condition. However, this should be for clarification purposes only.

We also welcome that the proposed legal structure of 'Secure and Promote' also allows for additional liquidity solutions or obligations to be added to the licence conditions when necessary.

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<sup>3</sup> Ofgem, 12<sup>th</sup> June, 2013, [http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Liquidity final proposals 120613.pdf&refer=Markets/RetMkts/rmr](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Liquidity%20final%20proposals%20120613.pdf&refer=Markets/RetMkts/rmr)

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

We agree that the market making obligation should only apply to large vertically integrated utilities, the Big Six. It should not be applied to participants only active on one side of the market and should not be applied to small suppliers as it would restrict their growth, further inhibiting competition and imposing a barrier to entry.

Regarding the Supplier Market Access rules, we understand there will be a benefit to small suppliers and new market entrants by having more trading counterparties. Large generators could actually offer better terms than those offered by the Big Six. However, these generators are not active on both sides of the market and are already disadvantaged in relation to the Big Six, therefore can it be viewed as fair and proportionate to also apply this obligation to these large generators? It could be that the two large generators provide sufficient volume to meet small suppliers needs which would lead to very little action actually being undertaken by the Big Six. It is not for us to comment on the current extension of the obligation beyond the Big Six, as only the other large generators will be clear on their ability to meet this obligation.

The Supplier Market Access rules should be not extended to any other independent generators nor should the market making obligation be applied to any other market participants. We agree with point 2.11 in the consultation regarding the Supplier Market Access rules that it would not “be cost-effective to broaden the obligation beyond the eight companies” identified. However, we appreciate in the future the nature of market participants will change. For both obligations we agree with point 2.12 set out in the consultation that the characteristics of market participants will change, therefore the list should be kept under review. Also, a clear criteria of when and how market participants will qualify for either obligation needs to be defined as it will impact future business plans.

The suggestion of only leaving the proposals in place for three years as outlined in point 2.14 of the consultation document provides very little certainty for market participants. We support that the conditions should remain in place for a defined period, however, only three years is not sufficient. The proposals should remain in place for at least five years, this will provide certainty to the market and encourage new market entrants, maybe even aggregators. Around two years before this expiry date Ofgem should consult on whether to extend the obligation or to allow industry time to prepare if it is not to be extended. Consulting and reaching a decision long before the end date will provide certainty to market participants if the obligations need to be continued. If the five year deadline gets to close and small suppliers and independent generators are still very much relying on the ‘Secure and Promote’ licence condition, then having the threat that it could shortly be removed would be detrimental to business operation and growth.

**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’?**

The final proposals for the Supplier Market Access rules should support objective one:

“The licensee must offer fair and reasonable terms when negotiating trading agreements”.

However, the proposals retain a lot of discretion for the obligated parties and it will be tough for Ofgem to prove when the terms are not fair and reasonable. Also under the Supplier Market Access rules, it does not mandate that the obligated parties have to trade with small suppliers only that they must negotiate reasonably. How much easier it will be for small suppliers to access the market will remain to be seen, for example the Big Six will still be able to require overly strict credit conditions which may make it difficult for some to trade. Therefore, the benefit of this obligation could be limited. Ofgem’s monitoring of the

implementation of these proposals will be very important, for example how will you assess failed negotiations and traded prices?

However, we welcome the recognition of openness and flexibility of the Supplier Market Access rules as outlined in point 3.5 of the consultation:

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

It is important innovation and flexibility is not deterred. The trading arrangements should not be prescriptive; they should be flexible to reflect each market participants’ circumstances and needs. However, in order to retain this openness and flexibility, the monitoring and enforcement requirements by Ofgem will be more difficult and even more important.

Additionally, Ofgem need to make sure that all of the Big Six are trading with small suppliers, as under this proposal it may transpire that only one of the Big Six will enter into trades with small suppliers. The Supplier Market Access rules do not necessarily encourage competition. If small suppliers are only trading with a single counterparty, that counterparty would have far too much power over the market and would be a significant market risk. It would not enable Ofgem’s liquidity objectives to be met. Furthermore, obligated parties should not be able to charge small suppliers for setting up trading arrangements under the Supplier Market Access rules. It would contradict the entire aims of the Supplier Market Access proposal.

We have the following comments and suggested changes on the detailed design of the Supplier Market Access rules:

1. **Scope (A2)** – To qualify as a small supplier under the Supplier Market Access rules and benefit from these proposals there is a generation limit of 1TWh. This is too low and should be raised to at least 5TWh in line with the supply threshold. The Supplier Market Access rules should not restrict suppliers to maintaining a generation portfolio of less than 1TWh, this could discourage small suppliers from building or owning their own generation. Additionally as the definition of generation is not clearly defined, it is not clear if the 1TWh will apply to long term PPA agreements, capacity contracted under the small scale Feed-in Tariff scheme or perhaps partly owned or invested generation assets. The definition of generation needs to be clear.

Furthermore, in order for the Supplier Market Access Rules to be successful and meet the objectives it must apply to trade agreements between the Big Six and all market participants such as aggregators and generators that do not have a supply side portfolio, not only independent suppliers. Independent generators face significant and deteriorating terms when seeking a route to market. The ‘Secure and Promote’ licence condition should support all market participants just resolving the liquidity issues for small suppliers will not solve the liquidity problem. Additionally, the Supplier Market Access rules could inhibit the Big Six trading with aggregators. Increased market participation by aggregators would further drive liquidity improvements.

2. **Responding to Trading Requests (A3)** – The majority of the timescales outlined for the obligated parties to respond to trading requests seem appropriate. However, point 4: “if no agreement has been reached within 60 working days from the receipt of a complete trading request, the licensee must write to the counterparty within 5 working days, noting the outstanding areas of disagreement, and offering a face-to-face meeting within 20 working days from the date of writing to discuss these areas.” This seems a disproportionate amount of time to wait for negotiations to stall and have to arrange a face-to-face meeting. This time period should be much shorter at around one to two months rather than over three months. Furthermore, it needs to be clearer as to when small suppliers are acting in a “vexatious” manner or one of the Big Six is acting in a deliberately obstinate

manner. Ofgem will have to clearly review and enforce penalties using a fair and balanced approach on any negotiations which reach this stage.

- 3. Credit and Collateral (A4)** – The Credit Transparency Form proposed represents a balanced way to monitor credit terms. It is stated in point 3.6 of the consultation that:

“Credit requirements play an important role in maintaining the stability of the market. It is in the interests of consumers to ensure that these terms remain robust. The SMA rules aim to ensure that the credit terms offered appropriately reflect the risks of trading and that the reasons for the terms offered to small suppliers are communicated transparently.”

However, it is not clear how Ofgem will monitor and enforce this requirement, every participant and Ofgem will have different perception of “the risks of trading”. To begin to monitor and evaluate credit and collateral Ofgem will need to speak to market participants and review current power exchange credit and collateral standards. It is stated in point 3.19 of the consultation that “Ofgem will not become involved in fine judgements about whether credit terms offered are objectively appropriate.” However, we do not see how this can be avoided. Additionally, with such little liquidity at present it will be difficult to benchmark the credit and collateral requirements fairly in the GB power market. Credit assessments will also be ongoing, therefore monitoring will need to be maintained over time. Although, it can also be argued that credit and collateral terms should improve if liquidity improves.

- 4. Clip sizes (A5)** – The requirement to trade small clip sizes (0.5MW) will be valuable to small suppliers but even smaller clip sizes would be much more valuable (up to 0.1MW). The reason for not requiring smaller trades appears to be solely for the benefit of the obligated licensees managing this exposure in the wholesale market. However, there is no guarantee that this trade would be backed by a trade in the wholesale market, given their own generation portfolio and there actually could be more smaller trades made at this level resulting in a higher volume overall to be backed in the wholesale market.
- 5. Product Range (A6)** – The product range looks suitable, although an additional requirement to offer shaped products on reasonable request would provide additional value.
- 6. Fair and Transparent Pricing (A7)** – Ofgem will have to get involved in the detail, we do not see how this can be avoided under this proposal. Ofgem will need to review and monitor all trading arrangements to ensure that fair and transparent pricing is taking place. Ofgem will also need to robustly analyse this against actual costs, otherwise this could be easily manipulated. Ofgem will also need to be firm and consistent on what it considers to be unfair and unreasonable.

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

Please see our response to question 2 and 5 above. In order for the Supplier Market Access Rules to be successful and meet the objectives it must apply to trade agreements between the Big Six and all market participants such as aggregators and generators that do not have a supply side portfolio, not only independent suppliers.

**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’?**

As discussed above we welcome the taking forward of Option B proposed in the previous consultation. We previously supported Option B and we also support the market making obligation proposed. The market making obligation should support the entry of aggregators and financial players into the market. Aggregators and financial players should be more able to buy and sell power as they should have more access to products and confidence in prices. Increased market participation by aggregators would further drive liquidity improvements. However, the Supplier Market Access rules could inhibit the Big Six trading directly with aggregators.

It is important that market making does not bring distortion into the market. However, the way the current obligation is structured this is unlikely to be the case. However, strong penalties for bringing distortion into the market needs to be put in place and robustly enforced by Ofgem.

We have the following comments and suggested changes on the detailed design of the market making obligation:

1. **Nominating a Third Party (B1)** – We see no reason why an obligated licensee cannot appoint a third party to undertake compliance with this obligation on their behalf, please see further comments on this in response to question 9 below.
2. **Platform (B2)** – As discussed in point 4.9 of the consultation we welcome that obligated licensees will have the freedom to identify the platform (or platforms) through which they market make and agree that they should not be able to market make “in a vacuum on a platform that is inaccessible to other market participants”. We support the proposal that at least ten parties should be present on the platform chosen. However, we disagree that all ten must be generation and/or supply licensees, market participation should not be limited in this way.
3. **Products (B3)** – The products proposed seem appropriate. Products for all obligated parties should be the same. Otherwise the obligation will become too complex, particularly as the nature of the obligated licensees will change.
4. **Availability (B4)** – We support the proposal that the obligated “licensee must post prices within the bid-offer spread limits specified for more than 50 per cent of the market opening time in any given calendar month” rather than Ofgem specifying specific time periods for all obligated parties which could coincide to periods of high prices or lead to distortions in the market. This 50 per cent requirement should be included and the proposal of 50 per cent represents a good amount of time to make the market in a given month. The 50 per cent requirement will allow for market making to be suspended for a period of significant market distortion. However, this requirement will need to be monitored by Ofgem to ensure that more detailed requirements are not also required as there are multiple ways to manipulate this requirement. For example the specified 50 per cent of the time may have a strong correlation with market making early in the morning, this complies with the market opening time requirement but may not be accessible to smaller trading parties, which may not operate 24 hour trading desks. This requirement will also need to be monitored to ensure that market making is occurring at fair and variable times. For example Ofgem need to make sure that the market is not being manipulated by obligated parties only making the market at times of high prices or perhaps never making the market at certain regular periods e.g. never making the market on Fridays.
5. **Bid-offer Spreads (B5)** – There is a concern that mandating such small bid offer spreads of just 0.3% could in fact deter new market entrants such as aggregators and financial players as the ability to churn products at a reasonable margin would be so small. This would have the opposite impact intended. Looking at the bid-offer spreads shown in figure 14, Appendix 2 of the consultation, it can be seen that 0.3% is at the lowest end of the gas market when looking at an average of four season ahead products. Admittedly bid-offer spreads of 0.3% is only proposed for baseload products up to two seasons ahead. However, 0.3% bid-offer spreads might be a bit low and optimistic for the market to achieve straight away, perhaps a sliding scale of bid-offer spreads could be introduced to work up to reaching this point e.g. 0.5% in 2014, 0.4% in 2015 etc. However, setting such strict bid-offer spreads could be the best way to kick start the market. As outlined in point 4.23 of the consultation, we would welcome Ofgem undertaking further analysis on the bid-offer spread limits proposed. Ofgem should look at historical bid-offer spreads in the GB market, other power markets and other commodities for comparison.
6. **Obligation to Trade (B6)** – This is vitally important, otherwise the whole market making proposal is pointless.



7. **Trade Size (B7)** - The minimum obligation of 5MW clip sizes under the market making obligation is a large trade, it is unlikely small suppliers will purchase at this volume. This product is for third parties such as aggregators or financial players to redistribute or another Big Six supplier to purchase.

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

The Impact Assessment presents that the market making obligation proposes a good balance between costs and risks for the licensees. However, it is for the obligated licensees and benefitting licensees to comment on the detail of the cost and benefit analysis. We cannot provide detailed comment here. Although, we do note that very little detail on the benefit analysis of this proposal is presented in the Impact Assessment. We would welcome more analysis here. Furthermore, Ofgem should analyse the detailed breakdown of the cost and benefit assumptions to ensure that they are realistic and not overestimated. This will also enable a more coherent review of 'Secure and Promote' post implementation.

**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?**

As stated in our response to the previous consultation on liquidity, we do not believe that the large vertically integrated utilities are the best entities to effectively make the market. Therefore we support a third party undertaking the market making role through an obligation on the Big Six. We see no reason why an obligated licensee cannot appoint a third party to undertake compliance with this obligation on their behalf.

The cost to a third party undertaking this role may be less as they could achieve efficiencies by undertaking the market making arrangements for more than one obligated party. Additionally, a third party, detached from the obligated licensee would be easier for Ofgem to monitor and would be more in line with the requirements of European financial legislation such as MiFID II and EMIR as discussed in the consultation. Taking this route should not take much longer than the Big Six undertaking the obligation themselves, it will only take the additional time of agreeing the contract, the time for setting up the arrangements should remain the same.

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

As stated in our response to the previous liquidity consultation, we remain concerned by the suggestion that there will be a benefit to Feed-in Tariffs with Contracts for Difference (FiTs CfD) reference prices from the promotion of day-ahead trading under the 'Secure and Promote' Licence Condition. We have concerns around the validity of this liquidity, whether it is real liquidity and indicating actual progress or just creating the right headline figures. If it is not genuine liquidity it will not help independent market participants nor encourage aggregators into the market. It is the net trading which is key figure, the net volumes and prices should be looked at in more detail by Ofgem. The increased day-ahead trading may not actually support FiTs CfD reference prices but enable a limited number of players to control FiTs CfD reference prices. Increased trading volumes from a few large vertically integrated players will in all likelihood lead to additional volatility in the day-ahead market.

It is stated in the consultation that FiT CfD "will give CfD generators an incentive to trade their generation in the auction to minimise their basis risk. It also provides an incentive for suppliers to trade a portion of their supply in the auction, to manage the risk they face in the magnitude of their contribution to the CfD." However, we disagree, it is because of FiT CfDs that the day-ahead market needs to be made highly liquid to

protect all FiT CfD participants. It is because of FiT CfD's that the market needs to be more effective, not the other way around.

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

We agree with the rationale for not intervening in the near-term market given its current relatively acceptable operation and given the other areas which require more significant intervention. However, we support point 5.11 outlined in the consultation, Ofgem should be monitoring and ready to intervene as soon as possible if deemed necessary. Therefore, we support the reporting requirements in relation to the volumes that licensees trade through day-ahead auction platforms. This should be backed up by Ofgem independently gathering information and analysis of trades on day-ahead platforms.