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Reference: 88/13
Deadline: 9th August 2013

2nd August 2013

Re: Wholesale power market liquidity: Final Proposals for a "Secure and Promote" licence condition

Dear Phil,

SmartestEnergy welcomes the opportunity to respond to Ofgem's final proposals on wholesale power market liquidity as this is an issue which we have been following closely and engaging in discussion for some time now. Our organisation relies on the wholesale market and we are keen that it works as effectively as possible.

We are pleased that Ofgem has moved away from the idea of the Mandatory Auction (MA) as we believe this intervention would not only have been unhelpful but also potentially detrimental to the wholesale power market for reasons which we have previously outlined. We agree that the MA would not provide continuous opportunities to trade and could be costly to access. The Mandatory Market Making (MMM) obligation is a much more welcome initiative.

By far and away the most important aspect of wholesale trading which needs to be improved is liquidity. The MMM will create markets for contracts that may have been suppressed due to vertical integration, with transfers happening internally instead of transparently trading in the market.

Ofgem have come a long way to define the products in some detail but we would like to see a market for weekday block 5, extended peaks (0700 – 2300 7 days a week) as well as peaks.

We are, however, still of the view that a self-supply restriction would be the best way of introducing liquidity as it would force the Big 6 to trade all of their volumes. This could be

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implemented very easily through a change to the rules around ECVNs. We understand that Ofgem may be concerned about equality of treatment. However, for our part, we would be happy for such an obligation to be placed on all market participants.

On the whole, though, we find these proposals preferable to the status quo and we encourage the Authority to take the decision to launch a statutory consultation on implementing the Secure and Promote licence condition as scheduled in Autumn 2013.

At the roundtable meeting on 23rd July two new issues came up which we would like to express a view on: firstly, there was talk of using windows in the MMM. Our view on this is that there should be as much continuous trading as possible and are therefore not in favour of windows. Secondly, there was the issue of bi-lateral vs central clearing. We have a preference for the former as the costs are lower.

We answer the questions below in the order in which they appear in the document:

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

Yes

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?

Yes. In the absence of a self-supply restriction we agree with the proposed Market Making intervention and as this is the most significant aspect of the proposals we are satisfied with the outcome of this project.

However, we are disappointed that Ofgem has not taken note of our concerns regarding the proposals to address Option 1. We are unable to see how forcing the large companies to offer fair and reasonable trades bilaterally to certain companies is beneficial for the wholesale power market liquidity when it is likely to reduce liquidity, market transparency, is discriminatory to other players and as such could put off new entrants (for example, financial players). We believe it is more appropriate to encourage medium-sized intermediaries to offer trading services to smaller players so that these players operate through the market and the current proposals achieve this.

The document states that "any external platform fees incurred as a result of sourcing the power in a wholesale market may be added to the price quoted; these fees should be separately itemised from the wholesale power price." But it would appear that a fee for providing the service is not to be added. This, we think, is inappropriate as it would be reasonable to allow for some recovery of set-up costs. The document goes on to say: "These fees are equivalent to those that the small supplier would have faced had they accessed the market directly." This is not true because the small supplier has not paid out for set up costs.

In our view the current proposals will reinforce the current market structure and block new entrants from coming in to offer access to market services.

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

Yes, we agree with implementation through a special licence condition in the generation licence so that where some of the relevant activities under S&P may be carried out by another part of a firm's business (for example, a separate trading business) the generation licensee will still be responsible for ensuring that the obligation is met by its affiliates.

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

Yes. Reference to generation size for access to market and to domestic customer base for the MMM seems sensible.

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'?

Scope – do you think the scope of the obligation that we have set out above is appropriate?

There does not appear to be much justification for the 5TWh limit. We note that below this threshold suppliers have access to a market in 0.5 MW clip sizes but above it in 5MW clips. This strikes us as rather arbitrary and unfair. It could become yet another disincentive for growth.

It is also unclear to us whether the 1TWh limit for generation is owned generation or contracted and this needs to be made clear.

Credit and collateral – does our suggested approach deliver benefits to small suppliers without imposing disproportionate costs and risks on the licensees?

The proposals appear reasonable and are not too one-sided in favour of the small supplier.

Response to trading requests – are the timetables we have proposed for negotiations on trading agreements clear and achievable?

Yes

Reporting -- We are keen to hear feedback from stakeholders on this approach.

The information requested appears reasonable.

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

There are no further areas for consideration that we can think of.

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'?

The document states: "Licensee may nominate a third party to undertake their obligation on the same basis set out in this licence condition (unless otherwise specified). The licensee must not nominate any party delivering more than one other licensee's obligation. The third party must be set up to trade with 10 generation and/or supply licensees." Should this read "at least 10"?

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

We would like to see a market in block 5 and extended peaks as well as peaks for the coming two seasons and front six months. (Extended peaks include daytime and block 6).

The availability requirement which Ofgem have proposed – 50 per cent over the course of a month – is lower than that set out in most commercial agreements. This seems a little low to us but we understand that this reflects the mandatory (rather than voluntary) nature of the market making being proposed. We are comfortable that this requirement strikes a fair balance between regular opportunities to trade and allowing the market maker to manage their risks appropriately.

We also feel that an availability of 80% where a third party is offering the service to two licensees is reasonable, as is the plan to have at least 3 market makers.

The following spreads are slightly wider than those that we have seen in the past but they are tighter than the way the market is trading currently. As such we believe these spreads are eminently reasonable.

Baseload		**Peak**	
Month+1	0.3%	Month+1	0.7%
Month+2		Month+2	
Quarter+1		Quarter+1	
Season+1		Season+1	
Season+2		Season+2	
Season+3	0.5%	Season+3	1%
Season+4			

The proposed clip sizes of 5MW and 10MW are also sensible.

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?

No. We are not convinced that a third party taking on the MMM service for a fee is either workable or appropriate; tendering for new institutions is, in our view, a greater intervention in the working of the market than encouraging existing players to behave as if there were a market.

From the document it is also unclear to us to how this will work given that there is a requirement for a licensee not to nominate any party delivering more than one other licensee's obligation. We agree with Ofgem that it is important to have at least 3 market makers.

There is additionally no guarantee that anyone would come forward and it is not as easily enforceable as a licence condition. Additionally, any fees should be met by those who have created the lack of liquidity, not smaller suppliers.

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

Yes. We believe the near term market is working sufficiently well with sufficient liquidity. This was never such a problem in the first place and, as Ofgem have highlighted, the introduction of GB Hub and FiT CfDs should ensure that liquidity continues to be healthy.

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

Yes

Should you wish to discuss any aspect of these issues further, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
Head of Regulatory Affairs

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