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Suspension of Secure and Promote Market Making Obligation

RWE welcomes the opportunity to respond to Ofgem's open letter regarding the proposed suspension of the Secure and Promote Market Making Obligation (MMO) pending a wider review of the policy.

The MMO is no longer tenable in the light of recent market developments and it should be suspended immediately pending the planned review. The release of Centrica from the obligation further erodes the crumbling foundations of the obligation and wider market developments mean that the balance between the benefits of the policy and the costs imposed on the obligated parties has now shifted decisively against continuing with the obligation. Specifically:

- **The obligation has become ineffective.** The market-making volumes available under the obligation are now two-thirds of that originally envisaged and the planned restructuring of two of the remaining obligated parties will see the obligated volumes shrink to a third of the original volumes.
- **The costs of meeting the obligation are disproportionate.** The costs of complying with the obligation exceed the projected costs when the obligation was imposed. While Ofgem forecast ongoing costs to be around £1.6 million we currently estimate costs to be between £3.5 and 4 million per obligated party. Costs are likely to increase further with the imposition of the default tariff cap. Suppliers will all be forced to hedge within the narrow constraints of a very challenging cap and with shorter hedging horizons given the six-monthly recalculation of the cap. The resulting fall in liquidity will further increase the cost to the remaining parties of meeting the obligation.
- **The basis for the obligation is no longer tenable and distorts competition significantly.** The logic of vertical integration as the basis for imposing the obligation was inherently flawed. Since the obligation was introduced, the CMA has concluded "we have not identified any areas in which vertical integration is likely to have a detrimental impact on competition for independent suppliers and generators." Moreover, the impressive growth of independent suppliers and the resulting fall in the major suppliers' market shares means that the obligation now represents a significant distortion to competition. When the obligation was introduced it applied broadly to six major suppliers accounting for the bulk of the domestic market; in the coming months it will become narrowly focused on two remaining suppliers accounting for some 30% of that market.

RWE looks forward to contributing to the subsequent review of the policy and the appraisal of the need for and possible form of any subsequent measures to promote liquidity. We see little need to delay the review to 2019. The evidence that the MMO has been effective in improving liquidity and access to prices is already inconclusive and any evidence on liquidity impacts immediately following the suspension is likely to be similarly inconclusive. As noted, we already expect liquidity to fall in the coming months following the introduction of the default tariff cap. Any review should therefore start from a blank slate and not presume that a replacement policy is necessary.

If Ofgem concludes from the review that some form of market-making obligation is still required, Ofgem should tender for one or more market makers or exchanges to provide the service on a commercial basis and socialise the costs across all retailers. A tender would secure both the effective and economic provision of the service – by parties willing to make markets and bear the risks – and efficient, fair recovery of the costs. Any other means of allocating the obligation is likely to both increase costs and retain the current distortion to competition in the wholesale and retail markets.

If you have any comments or wish to discuss the contents of this response further, then please do not hesitate to contact me.

Yours sincerely,

Paul Dawson