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20 September 2018

Dear Cathryn,

### **Open letter: Suspension of Market Making Obligation Licence Condition**

InterGen would like to express our concerns around your intention to suspend the Market Making Obligation without completing a full review.

InterGen remains the only genuinely independent generator active in the GB market with a track record of developing, constructing and operating large scale thermal power generation projects. We have been active in the market since the 1990s and therefore bring a unique perspective to issues regarding the GB wholesale electricity market.

InterGen responses to the letter are set out below:

#### **Suspension of the policy should only be considered once a full and robust analysis has been completed.**

We were surprised to see that Ofgem were considering a suspension of the MMO license condition especially after acknowledging, in the 'Secure and Promote Review: Consultation on changes to the special license conditions', that the removal of the policy could jeopardise the support on which some market participants rely on. The complete turnaround in opinion is concerning, especially without any fundamental changes in the market other than the removal of Centrica's obligation.

S&P has given smaller market participants the option to access the market, we fear liquidity will dry up if the policy is suspended. With changes to the cash out market and the introduction of the CM, ensuring smaller generators have access to forward products is key and in turn will increase competition and keep prices down for the end consumer.

Making the choice now to suspend the policy despite the review not being completed seems a drastic decision especially without undertaking a full impact assessment. A suspension of MMO until a full review has been completed would add uncertainty into the market, which in turn would have an adverse impact on liquidity and end consumer prices.

**S&P has led to an improvement of product availability, more robust prices, and greater opportunity to hedge in both the prompt and on the curve.**

We believe that the robustness of prices has increased with the implementation of the S&P licence condition. The prescribed limits on the spread between bid and offer prices provides the market with robust price references, that are important both in and out of the market making windows. This is an essential by-product of the Market Making Obligation (MMO), as prior to its implementation many curve products would not even have a spread or trade for weeks on end.

InterGen's internal trade data shows that we execute 51%<sup>1</sup> of all trades in mandated products within the two one-hour liquidity windows, 82% of this volume is with obligated parties and 18% with non-obligated parties. Outside the windows, the remaining 49% of trades are executed with the share of mandated products traded with obligated parties increasing to 87%. In our experience, volume of trading is not restricted (or concentrated) to the liquidity windows. Rather, the windows generate robust reference prices that inform trade throughout the day.

**Despite a reduction in obligated parties they still dominate in the domestic electricity supply market and have little incentive to hedge via traded markets.**

Due to the natural hedge that vertically integrated businesses enjoy they have little incentive to hedge via the traded market. Since this hides the true value of generation from the market, barriers to entry are created, particularly for small and independent generators that depend on hedging their investments in the wholesale market. This in turn has a negative impact on competition, liquidity, and therefore the prices that consumers ultimately pay. We believe that intervention is justified to correct this kind of market distortion and any radical departure from current arrangements might have unforeseen consequences that set the market backwards.

**The cost to obligated parties are generally reasonable and not as severe as being mentioned by the obligated parties**

In the 2017 consultation, Ofgem noted that in the majority of years the ongoing costs of complying with MMO is below Ofgem's initial estimations. The exception is 2016, where in the winter very tight margins were causing volatile market conditions. It therefore appears as though Ofgem is allowing one year of higher costs, which can be argued are an outlier, to drive changes affecting all trade going forward.

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<sup>1</sup> September 2016 - 2 May 2017, all mandated products, % by volume

In direct response to the reasons provided for suspending MMO, InterGen have the following additional comments:

**Reduction in number of parties subject to the MMO will affect the efficacy of the MMO in meeting its original objectives and/or result in an undue burden being placed on the remaining obligated parties**

- Reduction in obligated parties is a concern.
- Criteria for obligated parties should be amended and potentially include financial institutions which hedge in the market.
- If a reduction in obligated parties is having a negative effect of MMO efficacy then suspension of MMO will have an even greater detrimental impact on liquidity.
- 4 licensees remain, despite others looking to consolidation and amalgamation in the future this has not happened yet and the remaining licensees still control a large share of the market. It would be premature to suspend the MMO on the assumption of a further reduction in number of licensees.

**As a result of changes and prospective changes in market conditions the remaining obligated parties will face disproportionate costs in continuing to meet the licence conditions.**

- Centrica in their 2017 review response stated that the costs were in line with what was originally forecasted apart from 2016 which were abnormal conditions and should not be treated as a normal state of practice.

In conclusion, InterGen are fully supportive of the ongoing review of the Secure and Promote licence condition in response to the changing wholesale market and agree that it has not fully met the objectives set out when introduced. We acknowledge that there is a reduction in obligated parties however the policy in nature is still going some way to addressing the original objectives it was set up for, therefore any changes must be carefully considered to assess their potential impact on current liquidity. We therefore urge Ofgem to complete the review of the S&P licence condition and not to suspend the obligations.

Yours sincerely,



Lisa Mackay  
UK Trading and Commercial Director  
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