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Dear Cathryn,

Secure & Promote: Market Making Obligation

Thank you for the invitation to respond to the open letter on Secure and Promote. Good Energy supplies 100% renewable electricity and carbon-neutral gas to homes and businesses across the UK. Good Energy is working towards a 100% renewable future, helping to support technologies including wind, solar, biofuel, hydro and tidal. Our purpose is to power the choice of a cleaner, greener future together.

Overview

- The removal of the market making obligation creates significant risk for small suppliers.
- This risk is likely to lead to significant consumer detriment.
- Major changes should not be made to the market making obligation until sufficient evidence is in place to justify them, and the transition to future arrangements has been established.

High levels of wholesale market liquidity and robust forward prices are essential to allow small suppliers to access the necessary traded products to hedge and balance their positions, whether trading via a market screen, or bilaterally with a counterparty. In the absence of liquidity, or robust prices on screen, the ability to access a true market price is severely reduced. Even in situations where there are prices on screen, but products are illiquid, a counterparty will often include a significant risk premium when carrying out a bilateral trade. This increases costs, particularly for smaller suppliers who are less able to absorb cost increases, leading to consumer detriment.

The market making obligation is an essential part of the regulatory framework for ensuring adequate levels of liquidity in the wholesale market. Although having this liquidity concentrated into two hours of the day is a second-best arrangement to having robust liquidity throughout the day, there is no reason to believe that removal of the market maker obligation will give way to high levels of liquidity throughout the day. In its recent consultation on secure and promote, OFGEM highlighted views that that *"liquidity is good inside the market making windows and for mandated products."* and that having ready access to products with robust prices allows market participants to "*better hedge their activities, and robustly price their supply contracts and power purchase agreements (PPAs)*"[1]. Therefore, in the absence of an alternative arrangement being introduced, these changes do not appear to be in the best interests of either market participants, or end consumers

We also have concerns that there is a lack of clarity how these proposals interact with the supplier market access arrangements (SMA). Although we are not currently a participant in SMA, we feel it encourages larger counterparties to engage with smaller suppliers. If it were rendered ineffective by these changes (because

[1] OFGEM (2017) Secure and Promote review: Consultation on changes to the special licence condition

although large counterparties have to offer prices, there will be no requirement to offer *robust* prices), all small suppliers would be likely to suffer detriment – and their customers with them.

The market making obligation was introduced to address concerns over the lack of liquidity in the wholesale market. To remove it without a viable replacement, or without adequate evidence to suggest that liquidity will be maintained without it, risks fundamentally undermining the operation of the wholesale market, and leading to significant consumer detriment. As OFGEM stated when they launched the Secure & Promote licence condition, *'Ofgem's principal objective is to protect the interests of present and future consumers. In accordance with this objective, we want to ensure that liquidity in the GB wholesale power market is sufficient to underpin well-functioning, competitive generation and supply markets'*[2]. We do not see how removing the market making obligation, without sufficient evidence to justify doing so, is consistent with this objective.

The risk stemming from the removal, particularly at such short notice, of the market-making obligation will lead to increased costs, particularly for smaller suppliers. This risk cannot be mitigated through either a prudent hedging strategy or control of internal costs. This is particularly detrimental in the context of the forthcoming default tariff cap, the methodology for which does not currently capture the increased trading costs stemming from a removal of the market making obligation. The current market volatility, and systemic changes like the move to PAR1 in November 2018, add further risk to suppliers not being able to sufficiently hedge their positions in the wholesale market, with the impacts potentially being felt either in higher prices for consumers, or supplier defaults.

We propose that any significant changes to the market maker obligation should not be made until, at the very least, OFGEM has had adequate time to complete its review of the secure and promote framework (as progressed in OFGEM's consultation which closed in February 2018). This will facilitate decision-making based on robust evidence, and alternative arrangements that better meet the objectives of secure and promote to be developed, without unnecessarily increasing costs to end consumers.

I hope you find this response useful. If you have any questions, please do not hesitate to contact me.

Kind regards,

Dr Tom Steward

Regulatory Affairs Executive

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[2] OFGEM (2014) Liquidity in the Wholesale Electricity Market (Special Condition AA of the electricity generation licence): Guidance