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Dear colleague,

Request for modification of Special Condition AA of Electricity Generation Licences held by the ENGIE corporate group

On 26 March 2018, ENGIE requested that Ofgem[1] remove Special Condition AA: Liquidity in the Wholesale Electricity Market from Electricity Generation Licences held by companies within the corporate group[2]. On 6 February 2019, ENGIE provided further information to us to support their request. ENGIE are currently subject to Schedules A and C of this licence condition.

ENGIE's main argument in support of their request relates to changes in the corporate group's business strategy. This has resulted in a change to their generation assets and reduction of their market share since Special Condition AA was first introduced into the licences of companies in their group in 2014. ENGIE contends that as a result of the changes, they should no longer be subject to the licence condition.

We have assessed ENGIE's request against our rationale for applying the licence condition originally and the non-exhaustive factors outlined in our guidance document on the condition. This letter sets out the background to the request and explains our reasons for consenting to it. To give effect to the changes, pursuant to Paragraph AA.1 of the Special Condition, today we have published a direction addressing the Electricity Generation Licensees in the ENGIE corporate group. We have considered our statutory duties and in particular our principal objective in making this decision.

Background

Special Condition AA: Liquidity in the Wholesale Electricity Market ('the Secure and Promote licence condition') first became effective on 31 March 2014. Liquidity is an important feature of a well-functioning market for a number of reasons. Liquid wholesale energy markets give market participants the confidence that they can buy and sell at prices that reflect underlying demand and supply conditions. They allow firms to manage risk effectively and reduce the scope for market manipulation. Importantly, they also provide transparent prices on which non-vertically integrated generation and supply businesses can base their investment decisions, and potential entrants can assess opportunities to enter the market.

[1] References to the "Authority", "Ofgem", "we", and "our" are used interchangeable in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work. This decision is made by or on behalf of GEMA.
[2] GDF Suez changed its name to ENGIE in April 2015. References to "ENGIE" and the "ENGIE corporate group" refer to companies with the ultimate parent undertaking, ENGIE SA.

The Secure and Promote licence condition aims to improve liquidity in three ways:

- **Schedule A - Supplier Market Access Rules**: seeks to improve the availability of products that support hedging. Seven large electricity generating companies are currently required to follow a set of rules when trading with small independent suppliers. These include defined standards for dealing with requests for trading agreements, pricing, products and minimum clip-sizes.
- **Schedule B - Market Making Obligation**: seeks to ensure the availability of robust reference prices for wholesale electricity products along the forward curve. Three large vertically integrated generation and domestic supply companies[3] currently are required to simultaneously post bids (buy) and offers (sell) orders for specified forward wholesale electricity products on energy trading platforms throughout two daily trading windows.
- **Schedule C - Reporting Requirements**: monitors forward and near-term market liquidity by imposing reporting requirements on obligated licensees.

Assessment criteria

We have assessed ENGIE's request by considering our June 2013 Final Proposals document on wholesale electricity market liquidity[4] in which we set out our rationale for applying the condition; and our 2014 Guidance on the condition[5], which sets out the non-exhaustive factors that we take into account when considering whether to remove the licence condition or adding it the generation licences of companies in additional corporate groups.

Our Final Proposals document indicates the main purpose of the Supplier Market Access rules is to ensure that suppliers can get access to power in the wholesale market and that the firms in the market that are best placed to provide this power are the larger generators. It is for this reason that we proposed that the eight largest GB electricity market generators should face the Supplier Market Access rules when we introduced the Secure and Promote policy.

Paragraph 1.10 of the guidance document contains the non-exhaustive factors that we will use in combination as the basis of any decision on whether to remove or add Schedules A, B or C of the licence condition to the generation licences of any corporate group. These factors are:

i. **Changes to generation market share:** any significant and sustained changes in the generation market share or generation output of a corporate group, taking into account its relative market share and overall size.

ii. **Disproportionate risks or costs:** an indication that an existing Secure and Promote licensee will face disproportionate costs and risks in continuing to meet the licence condition, or that a potential new Secure and Promote licensee could meet the costs and risks proportionately.

iii. **Success of the licence condition:** the sustained successful achievement of the objectives of this licence condition.

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[3] These are SSE, EDF Energy and RWE. Schedule B was originally in effect in the generation licences held by the E.ON corporate group, Centrica corporate group and ScottishPower corporate group but it was disapplied in November 2016, August 2018, and January 2019 respectively following changes to their generation businesses.
[4] Wholesale power market liquidity: final proposals for a 'Secure and Promote' licence condition https://www.ofgem.gov.uk/sites/default/files/docs/2013/06/liquidity-final-proposals-120613_0.pdf
[5] Liquidity in the Wholesale Electricity Market (Special Condition AA of the electricity generation licence): Guidance. https://www.ofgem.gov.uk/ofgem-publications/86717/liquidityinthewholesaleelectricitymarketspecialconditionaaoftheelectricitygenerationlicence-guidance-pdf

Supporting evidence and our assessment

The following paragraphs summarise ENGIE's evidence to justify the removal of the Secure and Promote licence condition from the Electricity Generation Licences held by companies within the corporate group and our assessment of ENGIE's request, in accordance with the assessment criteria listed above.

ENGIE state that in May 2013, they owned 4,999MW of licenced transmission-connected generating capacity in GB, equating to 6% market share[6]. ENGIE explain that following plant closures between June 2012 and October 2016[7], and the sale of remaining thermal generation assets in 2017, their equivalent generation capacity[8] has since fallen to 2,088 MW or under 3% market share as of 2017. ENGIE believe that this represents a significant and sustained reduction of their generation market share and note they are no longer one of the eight largest generators in the market. ENGIE also note that the changes to their GB generation are consistent with an established change in the corporate group's global strategy away from merchant generation.

ENGIE state that their remaining licenced generation assets are pumped storage power stations which serve the reserve and response markets. They explain that the nature of these assets means that trading activity is focussed in peak blocks; they trade minimal amounts of products which are obligated under the Supplier Market Access Rules from their own generation. ENGIE explain that they therefore face costs of trading in the wholesale market in order to fulfil trade requests from Eligible Suppliers under the rules. They also explain that they face market price risk from their exposure to smaller volumes and trade sizes when trading with Eligible Suppliers under the rules compared with the volumes and standard trade sizes available to them in the market. ENGIE consider these costs and risks, along with the ongoing compliance costs of agreeing trading agreements and carrying out credit assessments, to be disproportionate to their current asset base.

When the Secure and Promote licence condition was introduced in 2014, Ofgem used generated metered volume data to assess ENGIE's market share as approximately 4% of the market.[9] Our latest assessment using this data shows that ENGIE had a market share of 0.5% at the end of 2017. While the use of different data sets produces different valuations of ENGIE's current market share, both imply a notable decrease following the plant closures and sales.

Our rationale for requiring parties to comply with the Supplier Market Access rules was based on a substantial presence in the generation market. We agree with ENGIE's assessment of their significant and sustained reduction in generation market share which places them outside of the largest eight generators in the market. We further consider that, as a consequence of this reduction and their limited trading capability from their own generation, ENGIE would face disproportionate costs and risks in complying with the Supplier Market Access rules. This view is consistent with our assessment of E.ON SE and ScottishPower corporate group's request for removal of their equivalent obligations[10].

We think that the Secure and Promote licence condition is yet to fully meet its objectives[11]. We do not have any evidence to suggest that the balance of costs and benefits to consumers of the Supplier Market Access rules would change significantly if ENGIE no

[6] At that time, these assets were owned in a 75/25% joint venture with Mitsui of Japan
[7] Closures of Shotton, Teeside and Rugeley power stations
[8] Now owned in a 75/25% joint venture with Brookfield Renewables Partners
[9] Based on metered generation volume and interconnector imports. Generation shares are based on proprietary data. Station demand has been excluded. Please see 2015 Great Britain and Northern Ireland National Reports to the European Commission for more details: https://www.ceer.eu/documents/104400/3737359/C15_NR_GB-EN.pdf/ca0390a9-b6a2-bd9b-cb33-d17e65428e56
[10] https://www.ofgem.gov.uk/system/files/docs/2016/11/e.on_uk_special_condition_aa_letter.pdf; https://www.ofgem.gov.uk/publications-and-updates/request-modification-special-condition-aa-scottishpower-s-electricity-generation-licences
[11] The reasons for our views are explained in our 2018 decision on Centrica's request for modification of Special Condition AA of the Electricity Generation Licences held by the Centrica company group and remain valid: https://www.ofgem.gov.uk/system/files/docs/2018/08/centrica_special_condition_aa_decision_letter.pdf

longer complied with them. Our overall assessment is that, for the reasons above, we consider it would no longer be appropriate for the companies in the ENGIE corporate group to face the Supplier Market Access rules.

Assessment for Schedule C - Reporting Requirements

Given our assessments of Schedule A of the Secure and Promote licence condition above, we see no reason to continue for the Schedule C obligations to apply.

Our decision

For the reasons outlined in this letter, we consent to ENGIE's request to have the Secure and Promote licence condition removed from the Electricity Generation Licences held by companies within the corporate group. To give effect to this decision, we have today published a direction disapplying the licence condition in its entirety in the relevant Electricity Generation Licences.

Yours sincerely

Chris Thackeray,
Head of GB Wholesale Markets