

To all stakeholders

Email:

[wholesalemarketoperation@ofgem.gov.uk](mailto:wholesalemarketoperation@ofgem.gov.uk)

Date: 08 October 2019

Dear Colleagues,

In November 2018, we highlighted that market participants should prepare for the suspension of the Secure and Promote Market Making Obligation (“MMO”) if the number of remaining obligated parties reduced further<sup>1</sup>. On 19 September 2019, we received a request from RWE Generation plc (“RWE”) to remove Schedule B of Special Condition AA from Electricity Generation Licences held by the company following the sale of its shares in Innogy SE to E.ON on 18 September 2019. We are now considering this request.

We are minded to suspend the MMO licence condition as soon as practicable after we release RWE from the MMO. This reflects our concern that the policy could become less effective in meeting its objectives and that the remaining obligated parties could be subject to disproportionate and potentially unfair costs. Our position also considers other industry announcements that indicate the number of obligated parties could reduce even further to one. We welcome stakeholder views on this proposal.

## Background

In August 2018, we published an open letter seeking views on the suspension of Schedule B of Special Condition AA of the Generation Licence (the MMO) pending further review of the provision<sup>2</sup>. The letter considered the removal of Centrica and planned industry transactions that had the potential to reduce the number of obligated parties further. Our

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<sup>1</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/11/november\\_2018\\_update\\_-\\_secure\\_and\\_promote\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/11/november_2018_update_-_secure_and_promote_1.pdf)

<sup>2</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/08/ofgem\\_open\\_letter\\_-\\_secure\\_and\\_promote\\_update.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/08/ofgem_open_letter_-_secure_and_promote_update.pdf)

concern was that this could affect the efficacy of the MMO in meeting its original objectives and could result in the remaining parties facing disproportionate costs.

Following consideration of stakeholders' feedback, in November 2018 we decided that it would not be in consumers' interests to immediately suspend the MMO. We did, however, note that market participants should prepare for the suspension of the MMO if corporate transactions by two of the remaining obligated parties completed, reducing the number of market-makers to two. In January 2019, our decision to remove Special Condition AA from ScottishPower's Electricity Generation Licences reduced the number of market-makers to three<sup>3</sup>.

As part of our review of the effectiveness of the MMO in light of changing market structure, in May 2019, we announced that we would undertake an options assessment to support a decision on future liquidity policy. This is considering whether interventions to support liquidity are still required and, if so, whether they can be improved upon. We remain committed to working with stakeholders to explore alternatives to the MMO and this work will continue regardless of our decision on suspension.

### **Further market changes**

On 13 September, SSE plc announced that it had entered into an agreement to sell its retail services business to OVO Energy Limited. Subject to regulatory approvals, the transaction is expected to complete in late 2019 or early 2020.

On 19 September, we received a request from RWE to remove Schedule B of Special Condition AA from Electricity Generation Licences held by the company. RWE's main argument in support of their request relates to changes in the group's structure following the sale of its shares in Innogy SE to E.ON on 18 September 2019. We are now considering this request against our rationale for applying the licence condition originally and the non-exhaustive factors outlined in our guidance document on the condition.

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<sup>3</sup>[https://www.ofgem.gov.uk/system/files/docs/2019/01/request\\_for\\_modification\\_of\\_special\\_condition\\_aa\\_of\\_scottishpowers\\_electricity\\_generation\\_licences.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/01/request_for_modification_of_special_condition_aa_of_scottishpowers_electricity_generation_licences.pdf)

In the event we release RWE from the MMO, we are minded to suspend the MMO licence condition. Our concern is that a further reduction in the number of obligated parties could result in the two remaining parties being subject to disproportionate costs and that the benefits of the MMO could not be sustained. On balance, we do not think it is feasible for the MMO to continue with only two parties. In addition, the recent announcement by SSE also indicates that the number of obligated parties could shortly reduce to one. Our position, set out in November 2018, is that we do not think the MMO, as currently designed, could continue with one party.

### **Potential Market Impact**

Responses to our August 2018 open letter indicated a range of stakeholder views on the potential impact of suspending the MMO. Those in favour of suspension argued for a potential positive or negligible impact on account of the perceived distortive effect of the MMO on the market. The majority of respondents did, however, expect liquidity to fall in absence of the MMO with a reduction in the number of available products and volumes traded and resulting wider spreads. Many respondents also argued that suspension could have a disproportionate impact on smaller suppliers who would be less able to mitigate rising costs through reviewing their purchasing strategies or creating other cost efficiencies.

Given the influence of the MMO on the market, there is a lack of recent data on the natural state of liquidity in the market which means we cannot know with any certainty what the impact of suspension will be. If, following this consultation, we decide to suspend the MMO, we will continue to closely monitor market liquidity and will take the impact of the suspension into account in developing any new policy proposals.

### **Next Steps**

Given the timescales associated with planned industry transactions and our review of RWE's request, we invite interested stakeholders to provide views on this potential course of action on or before 06 November 2019. Responses to this letter should be submitted via [wholesalemarketoperation@ofgem.gov.uk](mailto:wholesalemarketoperation@ofgem.gov.uk).

To discuss further, please contact Heather Stewart on [Heather.Stewart@ofgem.gov.uk](mailto:Heather.Stewart@ofgem.gov.uk).

Yours sincerely

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