



Making a positive difference  
for energy consumers

Secure and Promote market making  
licensees, Generators, and Suppliers

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Dear Colleague

## **Improving transparency for eligible suppliers on prices charged under the Secure and Promote Supplier Market Access rules**

### Background

The Secure and Promote licence condition<sup>1</sup> ("the licence condition") came into effect on 31 March 2014. Under Schedule A of the licence condition, known as 'Supplier Market Access' (SMA), Ofgem set out minimum standards that eligible<sup>2</sup> suppliers should expect when negotiating trading agreements with the large players. The rules were designed to address the specific issues faced by small suppliers. This letter explains some concerns expressed to us from suppliers, underlines the policy intent of the SMA rules, and reminds licensees of their obligations under these rules.

Some suppliers have raised concerns about the transparency of the credit and collateral terms applied to them in negotiating new trading agreements with generators under the SMA rules. Similarly, some stakeholders have concerns regarding the transparency of the prices offered to them under existing trading agreements. We have also been told that the amount of information requested by licensees may be burdensome insofar as it concerns information that is commercial and business sensitive material.

### Transparency of credit and collateral

Some suppliers have told us that they do not have enough clarity from licensees on the reasons why a credit or collateral decision is made.

### *Aim of SMA rules*

The SMA rules aim to ensure that the credit and collateral terms offered reasonably reflect the risks of trading and that the reasons underlying the terms offered to small suppliers are communicated transparently. As a consequence, this means that suppliers will have confidence that their individual circumstances have been considered, and that the terms they are offered are a reasonable reflection of the risks associated with trading with them.

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<sup>1</sup> Special Condition AA of the Electricity Generation Licence: Liquidity in the Wholesale Electricity Market: <https://www.ofgem.gov.uk/ofgem-publications/85717/decisionnoticeundersection11a1aoftheelectricityact1989-pdf>

<sup>2</sup> A list of Eligible Suppliers for the SMA rules can be found here : [https://www.ofgem.gov.uk/sites/default/files/docs/2014/08/listeligiblesupplierssmarules\\_2.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/08/listeligiblesupplierssmarules_2.pdf)

However, the rules do not aim to increase the level of counterparty risk in the market. We recognise that credit requirements are one of the main barriers to the wholesale market for smaller market participants. Although the SMA rules aim to mitigate the effects of this barrier, credit requirements play an important role in maintaining the stability of the market; it is in the interests of consumers to ensure that these terms remain robust.

### *Guidance on transparency*

Licensees remain free to pursue their own credit evaluation and assessment under the SMA rules. Evaluations of counterparty risk will inevitably vary in line with different company policies and the difference in credit offered that we have heard about may be a reflection of the risk appetite of the licensee.

Licensees are required to comply with the process set out at paragraph 9 of Schedule A of the licence condition for assessing the credit worthiness of the supplier, and in turn, consider and discuss (where appropriate) credit options.

We provided a credit transparency form in our guidance document<sup>3</sup> that must be used by the licensee in complying with the licence condition pertaining to credit terms and collateral arrangements.<sup>4</sup> The credit terms and collateral arrangements offered must be clearly explained in the form and will be a reflection of the information received, process followed, and the options discussed.

In order to be compliant with the licence condition, we consider that it is insufficient to explain a refusal to offer unsecured credit by stating only that a supplier has not passed the licensee's credit assessment criteria. A supplier must be able to understand the specific reason(s) as to what motivated the decision.

As stated in our guidance, we will not act as a mediator between parties, for example, assessing how reasonable credit terms are. Instead, we expect to see that a sound process has been carried out that fully considers the particular characteristics of the small supplier in question.

In addition, we remind licensees that the information requested from suppliers should be limited to making an assessment of a supplier's credit worthiness and not more, and that you explain for what specific purpose a document is required, if asked by a supplier.

### Pricing concerns

Some suppliers have concerns regarding the prices they are charged under existing trading agreements. They have told us that the underlying market prices reflect reasonable costs of power, however that the risk premium charged by licensees can vary without explanation. For example, a premium may not be applied to a longer-dated product (eg season ahead) but might be relatively high on products for shorter delivery (eg month ahead). Different levels of premia may also be charged on the same products to the same supplier at different times, with no perceived difference in the risk profile of the supplier.

We note that there is asymmetry of power and resources for small suppliers, which may make it difficult for them to challenge and understand the premia charged.

### *Guidance on pricing*

The SMA rules<sup>5</sup> stipulate that a quote provided by a licensee must be as good as the best price available in the market to the licensee for the relevant product at the relevant time.

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<sup>3</sup> Appendix 1 of the guidance

<sup>4</sup> Schedule A, paragraphs 8 and 9.

<sup>5</sup> Schedule A, paragraph 16

### *Risk premia charged*

The rules<sup>6</sup> allow generation licensees to add an objectively justifiable risk premium to cover the risk associated with trading in small clip sizes. The premium should be clearly linked to the underlying risk. The generator should be able to demonstrate this link and how it calculates the risk. It must itemise the risk<sup>7</sup> when the price is quoted, so that it is clear to the supplier.

If no demonstrable risk exists, then no risk premium can be charged.

### *Other premia*

The licensee can also add any wholesale market trading fees incurred by the licensee. In our guidance, we specified that any such trading fees should be passed on at cost, on a pro-rata per MWh basis.

In our guidance, we also noted a licensee may not pass on any of the fixed fees due to being a member of the trading platform, nor may it add any administration or service charge or any other internal cost (eg staff cost).

The concerns expressed to us suggest that the way the premia are being calculated and itemised are not clear to small suppliers in some cases.

### *Our expectations*

At present, we remind licensees of their obligation to itemise and explain the premia charged to suppliers pro-actively. In our guidance, we said that if we thought the risk premia rule was being abused that we would review it and might seek to make it more prescriptive or remove it. If there is no improvement in licensees' explanations of these premia, or if these are not justifiable, we may consider further action.

Yours faithfully,

Philippa Pickford  
Associate Partner, Markets

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<sup>6</sup> Schedule A, paragraph 16

<sup>7</sup> Schedule A, paragraph 16