Matthew Gardner,
Market Intelligence & Oversight,
Ofgem,
9 Millbank,
London,
SW1P 3GE

16th August 2016

Dear Matthew,

Consultation on the Secure & Promote review

Thank you for the invitation to respond to the above consultation. Bristol Energy is an independent supplier of electricity and gas with a business model that has a regional focus on the South West of England, although we supply customers across Great Britain.

Executive Summary

Bristol Energy welcomes Ofgem's review of Secure and Promote and believe it has successfully aided new entrants and smaller parties to trade and hedge their retail position, and we have proactively engaged with Ofgem to date on the subject.

The wholesale energy trading market is changing. There are now more eligible suppliers utilising the market making windows, whilst the number of obligated parties has reduced. In addition, more customers are being settled using half hourly meters rather than profiles, which means suppliers are more exposed to unique shapes in their portfolio compared to standard profiles. To this end, the need to procure more granular products is increasing and liquidity in this area has not improved.

We also note that some larger suppliers are offering longer term fixed retail tariffs, which smaller suppliers are unable to do as they would need to trade further along the curve than they currently can.

We therefore believe Ofgem should extend the range of mandated products to include blocks and possibly half blocks, as well as extending the period that products can be secured out to at least four years ahead.

In addition, Ofgem should review the credit terms obligated parties are offering eligible suppliers to ensure they are complying with the terms of the licence.

We have answered your specific questions below, expanding our response where necessary.

Q1. Please comment on whether you think prices for forward delivery are robust. Please refer to prices in and out of the market making window and comment on the current mandated bid-offer spread.

Currently prices for the mandated products within the market making window are generally robust. However, prices are less robust for non-mandated products within the market making window, and prices for both mandated and non-mandated products often have a wide bid-offer spread outside the window.

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Q2. Please comment on whether the windows promote greater availability of products needed to hedge. Please provide evidence you may have on the availability of products outside the window.

The market making windows do not increase the availability of a range of products. Mandated products are available within the windows, but in order to hedge effectively, suppliers need more product types at a greater degree of granularity to hedge out price risks effectively. With the increase in customers being settled on a HH basis due to P272, and in the future, potentially domestic customers, then this granularity of products is becoming more important. Like many independent suppliers, the vast majority of our customers are on fixed term, fixed price contacts rather than Standard Variable tariffs as is the case with the larger suppliers. Hence being able to hedge to a high degree of granularity is vital.

Q3. What are your views on how liquid the near-term market is? Please refer to any factors that you consider have contributed to the liquidity of the near-term market.

Liquidity in the near-term market is sufficient for our requirements, however, accessing the short-term market has become more difficult recently with the increased credit support requirements for trading on APX, and more onerous clearing and settlements processes in contractual relationships.

Q4. What are your views on our high-level analysis of the state of liquidity? Are there any factors not identified that we need to consider to assess liquidity or Secure and Promote? Please provide quantitative or Qualitative evidence where relevant.

The high-level analysis is fine except that it only considers part of the issue, that of the mandated baseload and peak products. For suppliers to hedge effectively, then they need to be able to access more granular products, and further along the curve. As stated previously, there is limited availability of non-mandated products and as more metering points are settled half hourly this will become an ever more pressing issue and could hinder Ofgem's desire for a more flexible energy market.

Q5. What are your views on the impact of the market making obligation on liquidity in different market conditions, including in benign times and in times of price volatility?

We believe that the bid-offer spreads in the market fairly reflect market conditions in both benign and volatile times. The importance of the MMO is that it ensures that mandated products are available irrespective of the market conditions and do not disappear in volatile times which was the case prior to Secure and Promote.

Q6. What are your views on the fast market and volume cap rules. In particular, in reducing risk for licensees when needed?

We understand the need for these rules to be in place to protect licensees, but feel they need to be reviewed. In particular, we feel the current 30MW volume cap is becoming a constraint as more suppliers become eligible suppliers and could result in some suppliers being unable to hedge their position. This is demonstrated by the increasing application of the volume cap. Alternatively, Ofgem may need to consider widening the number of relevant licensees required to offer products within the window.

Q7. What are your views on how the SMA part of the licence condition has helped smaller suppliers to access the wholesale market?

The SMA requirements have been helpful, and our experience is that licensees are good at meeting requests from eligible suppliers. However, the availability of non-SMA products continues to be an issue and smaller suppliers have to hedge in a 'chunky' nature based on baseload and peak patterns rather than to match the shape of customers' usage. We also note that a couple of larger suppliers have started to offer long term (i.e. 3years+) fixed retail products, which smaller suppliers are unable to do due to the absence products further along the curve. This shows the market is still skewed in favour of 6 companies and they are utilising this imbalance of market power.

Q8. What in your view are the additional relevant external policy factors we should consider in our assessment of Secure and Promote?

EBSCR and the move to PAR1 next November (2018) will increase the need for suppliers to balance their position to a greater degree of granularity to avoid extremely high system imbalance prices, especially in times of high volatility. In addition, to accrue the benefits of P272 and the forthcoming mandatory HH settlement SCR (as a result of the smart metering programme) suppliers will have a greater need to hedge their own bespoke shape rather than baseload and peak products.

Ofgem has stated it wants a more flexible market which allows more dynamic pricing and scope for demand side aggregation. This can only be done if suppliers can access greater granularity of products, and further along the curve. Secure & Promote was designed to meet a more static market and needs to look forward to what the market requirements will be over the next 5+ years.

Q9. What are your views on amending the licence condition to allow flexibility during certain market conditions?

The evidence does show that trading increases in times of market volatility, although we are doubtful that this is dominated by smaller suppliers rushing to hedge and has more to do with non-physical traders and obligated licensees leveraging trading opportunities on a wider bid-offer spread. To this end we do not see the need for flexibility based on market conditions.

It may be prudent for Ofgem to insert flexibility to reflect the changing nature of the market. In particular, the ability to amend the volume cap dependent on the number of eligible suppliers v obligated licensees, and the fast market rule when it appears to be hindering the market.

Q10. What are your views on the costs and benefits of complying with the policy either as an obligated licensee or as a general participant? Please provide evidence and detailed costs/ benefits per annum.

Obligated suppliers will have had set up costs to deliver Secure and Promote, but we do not believe the ongoing costs are significant given the products traded are priced appropriately. As a participant, we have benefited from the removal of the risk of not being able to trade baseload and peak products. However, we still have a trading risk in that Secure and Promote does not allow us to trade closer to our portfolio's shape, nor allow us to trade further out and offer long term prices to both business and domestic customers. So this remains a cost and a barrier to us.

Q11. How can liquidity be improved without the costs of the policy increasing significantly? Alternatively, how can the costs of the policy be reduced without significantly reducing liquidity?

If windows were made wider and more products made available, then liquidity would improve making it easier for smaller suppliers to hedge their position more accurately further along the curve and reduce cost to customers as the risk premium associated with imbalance due to chunky hedging could be mitigated. This would also enable obligated parties to leverage more trading opportunities and thus spread the fixed cost of Secure and Promote over more trades.

In our view the costs of setting up Secure and Promote are now sunken costs and we would expect the cost of more granular trades and/or trades further along the curve to be offered in a cost reflective manner, so this would not increase costs significantly.

Q12. Is there any other relevant stakeholder feedback we haven't captured that we should consider?

The licence condition requires obligated licensees to offer reasonable credit terms based an assessment of the eligible supplier. However, in this review there is no indication that Ofgem has taken steps to review whether obligated licensees are doing so. Obviously, we are aware of the terms offered to us (which vary materially by supplier), but are unable to see how they stand in terms of terms offered to other eligible suppliers. We believe Ofgem should review compliance with this aspect of the licence to ensure licensees are assessing eligible suppliers on an individual basis rather than applying the same requirements across the board.

Local network companies and NGC offer unsecured credit lines to suppliers with a good payment record which aids smaller suppliers. In return this makes payment of DUoS and TNUoS invoices a priority for suppliers to avoid losing this credit line. We believe Ofgem should look into mandating this type of relationship between obligated and eligible suppliers.

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

Kind regards,

Chris Welby

Chris Welby
Head of Regulation

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