Monkton Reach, Monkton Hill,
Chippenham, Wiltshire, SN15 1EE
goodenergy.co.uk
enquiries@goodenergy.co.uk
0800 254 0000

Hannah Hopper and Matthew Gardner
Market Intelligence and Oversight
Energy Systems
OFGEM
9 Millbank
London
SW1P 3GE

19 September 2017

Dear Hannah and Matthew,

Secure and Promote Review: Consultation

Thank you for the invitation to respond to the above document. Good Energy is a renewable energy company, supplying 100% renewable electricity and carbon-neutral gas, via the National Grid, 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

- Secure and Promote is instrumental in supporting effective hedging activity, and in providing crucial certainty that market participants will be able to hedge effectively in future.
- The limited range of products currently available is not well suited to market developments stemming from increased levels of renewable penetration. New Secure and Promote products should therefore be developed to further increase its value in supporting hedging.
- Any changes have the potential to significantly affect opportunities for market participants to hedge effectively. They must therefore be carefully considered, and introduced over time-scales which will not lead to adverse consequence for market participants – in particular smaller participants with fewer resources, and who are generally not as vertically integrated as some of their larger counterparts.
- The focus for the future development of Secure and Promote should be on delivering a wholesale market which better meets the needs of all participants, rather than a narrow focus on cost reduction for obligated parties. This risks losing sight of the purpose of Secure and Promote, and the value that it delivers to the entire market.
- There is a lack of transparency regarding how trades are valued by market-makers, for credit exposure purposes; this creates operational challenges for smaller suppliers regarding wholesale risk management.

Question 1: Please comment on whether you think prices for forward delivery are robust. Please refer to prices in and out of the market making windows and comment on the current mandated bid-offer spreads.

Generally we believe that prices for forward delivery within the market making windows are robust. However, liquidity is highly concentrated within the windows. This leads to very few market participants being willing to offer prices outside the window, on the grounds that there are no prices for them to benchmark against or to provide a route to reverse their position if necessary. This appears to create a circular argument of illiquidity breeding illiquidity.

This said, having certainty that we will be able to access robust prices with a narrow spread during the window significantly de-risks our trading activities. Although the current market-making window arrangements may represent a sub-optimal arrangement for the market, they result in a significantly better outcome than would be the case if there were no such requirements in place.

The current arrangements place significant pressure on the opening price points placed by mandated suppliers, and this does not support organic price discovery. However, there may be small changes to the policy that may help address this shortcoming, such as the introduction of a 'warm up' period at the beginning of each window.

Question 2: 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 windows.

It is not the case that Secure and Promote has led to a greater range of products being available; it has merely made existing products (i.e. base and peak products) consistently available within the windows. Neither during, nor outside of the window, are new and innovative products that are necessary for effective hedging, generally available. Steps should be taken to support a greater range of products which better reflect today's marketplace, rather than simply reflecting those which have historically been made available by incumbent market participants.

Question 3: 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.

Near term markets are much more liquid due to their nature (i.e. their use in allowing market participants to fine tune their positions, to cover plant outages, respond to changes in forecasts etc). They include multiple routes to market, and the Day-Ahead Market (DAM) auction does generally provide a robust outturn reference price, despite gross bidding. However, one major barrier to small suppliers being able to operate effectively in the market is the credit requirements imposed by EPEX spot. EPEX requires that each MWh of power sold in the DAM is valued at £123/MWh for credit purposes, (to cover their delivery exposure), irrespective of the outturn value of the trade. This means suppliers are required to tie up large sums in credit accounts, which can be particularly inhibitive for small suppliers, which generally have limited resources.

Beyond the day-ahead and intra-day markets, liquidity is severely limited. This could be addressed by steps to support week-ahead, week-ahead+1 baseload and peak products..

Question 4: 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.

Analysis of the state of liquidity would be for Ofgem to review the volume of trades which are taking place between obligated parties. We would also support more standardized and transparent reporting requirements to reveal how trades between obligated parties and those small suppliers which are not signatories to the SMA are accounted for.

There can also be challenges for smaller counterparties who are not contracted with all (or any) of the main brokers, meaning they may not have visibility of the prices being posted by the obligated parties.

Question 5: 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?

Rules which come into effect in certain market conditions, such as the fast market rules, are important to protect obligated parties. However, it is essential that liquidity is preserved, even within a volatile market-place. Therefore, only in the most extreme circumstances should the Secure and Promote rules be relaxed, and even then, they should not be relaxed so much that market participants are unable to carry out essential hedging activities.

Question 6: What are your views on the fast market and volume cap rules, in particular on reducing risk for licensees when needed?

The fast market rules have been shown to be used when there is significant market volatility. The current trigger is set when the bid-offer-spreads vary by 4%. We are aware that a number of MMO parties are of the opinion that this is too wide, however we have yet to see any convincing evidence that this represents an undue risk on their business, when compared to the certainty that is delivered to the market as a whole by having the certainty of knowing that there will be a forthcoming periods of strong liquidity. To narrow this requirement would be to reduce the level of that certainty, and so increase risk (and therefore impose costs) across the market.

Depending on how the policy develops going forward, it may be appropriate for the volume cap to be reviewed – i.e. if a greater level of trading were achieved, the cap may be more readily reached, and so artificially depressing levels of liquidity.

Question 7: What are your views on how the SMA part of the license condition has helped smaller suppliers to access the wholesale market?

Although a number of new suppliers have entered the market in recent years, the vast majority of them have not signed up under the Supplier Market Access rules. This demonstrates the importance of the market-making obligations under Secure and Promote, but the relatively unimportant Supplier Market Access part of the policy. Therefore, the possible cost savings from removing the SMA part of the license should be investigated.

Question 8: What in your view are the additional relevant external policy factors we should consider in our assessment of Secure and Promote?

There are now other barriers to entry into the energy market for commodity traders, such the role of REMIT, MIFID II and EMIR – these are likely to impact the inclination of traders from non-energy institutions, such as banks, from participating in the market and supporting liquidity.

Question 9: What are your views on amending the license condition to allow flexibility during certain market conditions?

Although we understand that flexibility of licensing may be necessary to produce a nuanced policy outcome. As set out in questions 5 and 6, it is essential that this does not undermine the confidence that market participants can have, that trading will be able to take place during the market-making window. Any flexibility that reduces a suppliers' requirement to deliver on its market making obligations should only be introduced if alternative parallel steps are taken to ensure that liquidity is maintained.

Question 10: 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.

There is significant value associated with both being able to trade at a robust price within the window, and the reduced risk which stems from knowing we will be able to do that. We would also be unable to robustly price our PPA or supply contracts without sufficient liquidity in the market to offer a reliable benchmark. Removal, or scaling back, of the Secure and Promote policy would inevitably lead to higher prices for end consumers. Although the current arrangements may not be the absolute best option from a market purist's perspective, the benefits more than outweigh the shortcomings. We understand that some obligated parties feel the costs imposed are too onerous, however we have yet to see sufficient evidence to convince us that this is the case overall. In addition, the obligated parties are some of the biggest benefiters from increased wholesale liquidity. To suggest otherwise would imply they rely heavily upon vertical integration to operate effectively. This would mean that their level of vertical integration gives them significant advantage in the market, and therefore is worthy of further consideration.

Question 11: How can liquidity be improved without the costs of the policy increasing significantly? Alternatively, how can costs of the policy be reduced without significantly reducing liquidity?

We would propose that steps should be taken which look to derive greater value in terms of level of liquidity achieved against the cost of the policy. This otherwise suggests that either the current level of cost, or the current level of liquidity may be deemed to be appropriate.

This said, there may be some opportunities for reducing costs and maintaining or improving liquidity. These could include the widening of market-making windows to reduce the intensity of trading during the period. Some have also suggested the introduction of a centralized market-making obligation, which is tendered for. Alternatively, introducing a more principals-based regulatory framework, which allows obligated parties to offer a diverse range of products which better reflects their generation base, could bring significant benefits at reduced costs. Close monitoring would be essential by OFGEM however to ensure that a minimum range of products was available at all times.

None of these proposals are mutually exclusive, and should all be investigated as part of a wide-ranging piece of work to establish the best route forward for Secure and Promote. It is essential that any changes are undertaken with adequate lead time to ensure it does not have a negative impact on current hedging activity – in particular for smaller participants with fewer resources, and which are generally not as vertically integrated as most of their larger counterparts.

Question 12: Is there any other relevant stakeholder feedback we haven't captured that we should consider?

The current range of products is too narrow to allow suppliers to hedge effectively, given then the nature of market developments in response to greater levels of renewable generation. The changing nature of the market place suggests that a greater range of products, such as super-peak, week-ahead, or 7-day-peak products, should be developed. We would also propose that greater liquidity could be supported by re-examining the criteria for market making companies. One of the big six has recently ceased to be obligated, and there are a number of other large generator firms which would be well suited to take on a market-making obligation, in particular those with large generation plant that also operate a supply business.

Finally, a lack of transparency in how different market-making participants value trades for collateral purposes creates challenges in that it is not clear how a trade will affect available credit. This is important information when formulating a robust hedging strategy, and so can create operational challenges for smaller suppliers.

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

Kind regards,

Tom Steward

External Affairs Executive