Flexible Generation Group
Gables Lodge
62 Kenilworth Road
Leamington Spa
CV32 6JX

Telephone: 01926 336127
www.flexgengroup.com

Deadline - 5pm on 19 September 2017
wholesalemarketoperation@ofgem.gov.uk

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

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Dear Mr Gardner and Ms Hopper

Secure and Promote

Introduction

The Flexible Generation Group (FGG) represents the owners of and investors in small scale, flexible generation. These power stations are embedded in distribution networks and provide a variety of services to the system operator to help it deliver secure, economic supplies to electricity customers. While our power plants have historically sold energy to National Grid, as SO, we have done so largely because of difficulty accessing the wholesale power market. Market access for our sector is an issue that Ofgem identified in its IA on CMP264/5 and therefore we believe Ofgem should try and improve access using its existing policy tools.

FGG believes that the Secure and Promote (S&P) licence condition has helped improve liquidity in the wholesale market, helping smaller suppliers gain access to the wholesale market. However, now is an opportunity to also use the condition to improve access to the market for smaller generators (of all types), further helping suppliers access peak products which they may require more with changes to cash-out and the introduction of the capacity market.

Rather than answer Ofgem's specific questions, we have instead outlined our thinking on ways the S&P conditions could be improved.

Impact of S&P

While FGG members do not currently trade a lot of wholesale power, we have noticed the increase in liquidity in the market. While it will never be possible to prove this was a result of S&P, it seems evident that S&P did not stop liquidity improving and economic theory would suggest it should have been a significant help. The existence of market makers in other markets is proof that liquidity improves with market making, and the way liquidity has become focussed in the windows required under S&P suggests that the market has responded well to the policy design.

FGG fully supports maintaining the S&P provisions as it is important that Ofgem remains focussed on ensuring that there is a liquid market that allows parties to both enter and exit the market. Liquidity is vital for the efficient operation of the market, allowing parties to manage their balancing risk and adjust their positions in light of changes to market fundamentals. Continuing the S&P requirements, notably on vertically integrated parties, seems prudent.

Proposed Changes

In terms of the way the S&P conditions are structured, we have no comments on the window, but we do believe the products could be altered to encourage trading in peak products: EFA blocks Working Day 5B and 6A for each calendar month for November to February, and the Working Day block 6 for the rest of the year. We believe that this would facilitate:

- A liquid market for peaking power stations to sell power forward to suppliers;
- An ability for suppliers to better shape their demand around the actual peak hours; and
- Give DSR parties an opportunity to sell peak energy back to the market when they plan to load manage, i.e. in Triads.

With a number of market changes making peak prices higher, such as more marginal cash-out prices, and reducing market access for smaller parties, this is an opportunity to encourage the larger parties to help improve liquidity in at peak times. The current S&P "peak" product is not reflective of the real "peak" demand periods. Liquidity would therefore be better served were the obligated parties made to trade these products at least once per day.

The way that the demand forecasts alter during the day, notably with changes to the weather, means that suppliers need to be able to refine the energy volumes secured for customers. It is difficult for them to secure peak energy products in the current market and it is also costly for small generators to sell peak power when the market in peak products remains illiquid. S&P can be refined to help address these problems.

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Further Comments

FGG notes that there have been changes in the market structure since S&P was introduced. However, rather than remove obligations from some parties, FGG believes that it may be more appropriate to extend the obligation to larger gencos with supply businesses such as Engie and Drax. We continue to believe that it is vertical integration that stops energy companies coming to market and S&P should be aimed at them.

The obligated parties seem to have argued that the obligation is costly, but FGG feels that they are exaggerating costs. Unless they can provide Ofgem with proof of costs, this should be discounted. We do not believe that extending the products offered should have a significant impact on costs. Were Ofgem to be convinced that costs are an issue, FGG would favour suppliers paying the obligated parties to market make rather than the removal of the obligation.

We have also heard obligated parties assert that the regime is focussing liquidity in the two windows and, without the obligation, liquidity would spread along the curve. FGG believes it is better to have liquid in recognised periods of the day, when parties know they can go to the market and manage their energy requirements, than to risk seeing days with no liquidity, which used to be common. Ofgem should not risk removing the obligation and seeing liquidity reduce again.

FGG understands that the obligated parties have also expressed concern over the fast market rules. Again, unless they can demonstrate to Ofgem's satisfaction that the rules need refining, then the rules should remain. We appreciate that there are risks in a fast moving market, but these do not appear to be unmanageable at the current time.

Summary

FGG would urge Ofgem to develop the S&P obligation to try and improve liquidity in the real "peak" products to the benefit of all smaller parties. With S&P obligations extended to peak product trading, FGG believes that the market would develop to the benefit of smaller gencos, suppliers and DSR providers. This could be an important development as we move towards further changes in cash-out and the introduction of the CM.

If you wish to discuss any of the issues raised in this letter please do not hesitate to contact me.

Yours sincerely

Mark Draper
Chairman, Flexible Generation Group