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Secure and Promote Review Consultation

September 19, 2017

Dear Matthew and Hannah,

Thank you for the opportunity to respond to Ofgem's consultation on the Secure and Promote Review. This response is made on behalf of Uniper UK Ltd.

In summary, we believe that the benefits of the Secure and Promote are unclear and that it is difficult to justify the extent of the costs to obligated parties. Consequently we would be in favour of reducing the scope of the policy. As Ofgem has suggested, keeping the Supplier Market Access arrangements in place but removing or relaxing Market Making would be an appropriate way forward.

Our answers to the consultation questions are set out below.

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.
We believe that prices for forward delivery are robust up to Season +3, both inside and outside of the market making windows, for base products. Peak products are more difficult as parties tend not to want this position. Understandably, generators in the UK and indeed across Europe do not want to sell too far out; renewable generation in particular may only want to sell baseload forward, not peak. The market can also move relatively fast when the first price is hit.
While bid-offer spreads (base and peak, month and season-ahead) narrowed slightly then have stabilised since Q4 2014, this could be seen as much as a continuation of the downward trend since 2010, as the mandatory spreads introduced by Secure and Promote as assessed at close of trade.

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.
While there is a natural pick-up in trading around the time of the trading windows, the obligation has increased liquidity within these windows, but this does not always reflect the true appetite of the market for peak products and is at the expense of trading outside the windows, particularly before the morning window. Hardly any trading is

done before this first window although in the meantime underlying fundamentals have already moved. As a positive, the mandated windows ensure that there are two windows per day when a high volume of trading can take place, eliminating any concerns that some parties might have about liquidity. However, the 'missing liquidity' outside of the windows can make it more difficult to trade generally and we understand that the artificial constraints on trading that windows have created do deter some traders.

As far as the availability of specific products is concerned, we note that Ofgem's analysis of total OTC trading in market-making products showed that this has increased slightly over the last few years. However, we do not believe that the introduction of windows has had a particular effect on the availability of products, as these are largely liquid products anyway. Overall, we note that liquidity is comparable to the French market, which is the second largest market after Germany.

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.
The near-term market has very high liquidity, Day-ahead products are still very strong and the increased number of parties in the market has increased liquidity overall. However, there could be more trade in weeks; Week Ahead to Week +2 are relatively illiquid compared to the German and French markets.

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.
We agree with Ofgem's assessment of liquidity, this looks comprehensive.

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?
That highest volatility is in the near-term market is to be expected with or without a market making obligation; this is when parties are looking to extract value. Further out, the obligation can be difficult for parties to fulfil. It supports liquidity in benign times when it might naturally dry up, though this may be at the expense of the obligated parties; also sometimes the obligation to trade can exacerbate price movements. The need to comply with the obligation, and in many cases automation created to facilitate this due to the difficulty in fulfilling this manually, creates false liquidity. Products trading in the windows but hardly ever outside them is not true liquidity as often parties do not want to engage in the transaction and immediately trade out of it. This can distort prices by tending to amplify movements in the market, as market makers who do not wish to hold a position may try to close it out at any cost.

Question 6: What are your views on the fast market and volume cap rules, in particular on reducing risk for licensees when needed?
We agree that the bid-offer spread should be widened during a fast market; the present rules create an unfair commercial position for obligated parties and are arguably too harsh. One solution that could be explored would be to introduce two thresholds; when the first is reached, parties are still obliged to post prices but the bid-offer spread of that product could be increased. When the second threshold is reached, the obligation to quote would cease.

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

Ofgem's first objective with Secure and Promote was to ensure availability of wholesale electricity products that firms require to enter the market and compete effectively, and the number of registered Suppliers suggests that there are no significant barriers to market entry. From Ofgem's session on 02/05/17 we also understand that while the SMA arrangements have been of some use to small suppliers, they are less so now and not used at all by some, who have noted that they can obtain better deals elsewhere.

Question 9: What are your views on amending the licence condition to allow flexibility during certain market conditions?
As per our answer to question six, we would support such an amendment. However we would expect industry consultation on any specific proposals.

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.
On balance the policy gives obligated parties a reasonable balance of risk versus reward. However, volatile times will bring parties to the market without any market-making obligation. Additionally, when obligated parties would prefer not to trade, that false liquidity can potentially create artificially high prices as continuous forced trading becomes a self-fulfilling prophecy. Positions a party might not wish to enter also cause them to incur opportunity costs to back those out; in a volatile period you could easily see high losses, ultimately significantly above the ongoing annual cost of £1.6m for market making estimated by Ofgem in 2013. If the market goes into a benign trend, you can be continually forced back into an unwanted position as the market-making obligation becomes self-fulfilling. Added to this, obligated parties may incur additional administrative costs to record the reasoning behind trades.

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?
There is sufficient liquidity in the market, which is bolstered by the underlying liquid NBP gas market. Increased transparency also supports liquidity.

Question 12: Is there any other relevant stakeholder feedback we haven't captured that we should consider?
Potentially having prices during more hours of the day but with less strict rules could be an improvement on the current market-making obligations.

We hope that you find our response to be of help and we would be happy to discuss any aspect with you further.

Yours sincerely,

Esther Sutton

Uniper UK Limited