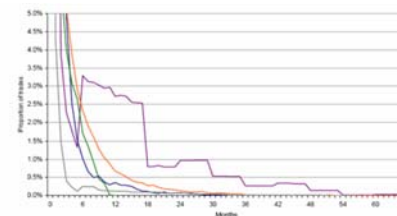
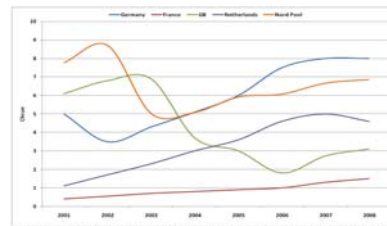


Creating liquidity in the wholesale electricity market

An independent perspective

Deficiencies

- Declining liquidity
 - halving of multiple
 - 30% (15%) generation
 - 45% (23%) supply
 - concentration in front months and seasons
- Counter-trend
 - gas
 - European benchmarks
- Assessed before downturn
 - banking withdrawal since
 - credit issues



Unambiguous evidence that the wholesale electricity market is not working

Does it matter?

- NETA market design premised on healthy bilateral contracting model
 - unconstrained by a centralised pool, parties would opt to do this, including integrated players
- Trading not the only an end in itself
 - means of constraining abuse of market dominance
 - also stimulant to transparency and investment
- But we didn't set any indicators of success
 - price reporters but data difficult to evaluate
 - wrongly seen as outside sectoral regulator's remit

It is inhibiting market access, fair trading and new entry

3

But isn't that a bit theoretical?

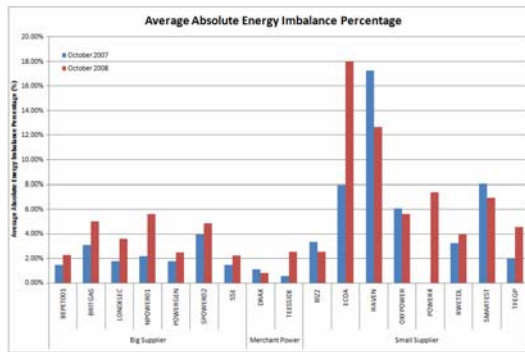
- No – it greatly compromises the supply market:
 - market for annual power is virtually non-existent in UK
 - size, shape as well as duration
 - but Big Six offer complex bespoke products into non-domestic market
 - wholesale market not open to many who need it most
 - no market access for new entrants who do not have critical mass
 - also deters financial players and delimits risk management
- Not good for independent generators
 - cannot get product to market (Drax and Haven)
 - increases purchasing power of the incumbents
- Bad for consumers
 - no credible forward prices
- Bad for sector
 - as heightens political scrutiny
 - distorts investment signal

Increasing misalignment with competition objectives and NETA market design

4

Aggravates cash-out exposure problems

- Independent suppliers pushed back onto short-term markets as default purchasers
 - over-buy at high prices to avoid being short
- Ultimately rely on the imbalance market
 - loads premium plant costs
 - reinforced by RCRC
- Merchant generators see portfolio disadvantage
 - sell up or move into supply



Trading parties told to contract bilaterally but the dysfunctional wholesale market prevents many from doing so 5

The challenge

- No fundamental drivers on Big Six to encourage or increase trading
 - reversing trend or increasing trading at the margin would fall well short
- Regulator needs to define unambiguously characteristics of healthy wholesale competition
 - test options identified against these criteria
- If this cannot be done quickly or effectively, Ofgem needs to address competitive detriments

Incremental change will not bring liquidity to the market urgently: volume, shape and size 6

Several options ...

- Mandatory trading the key
 - separation of generation and supply for Big Six
 - backed up by self-supply limit, will necessitate trading
 - in addition organised auction
 - additional to, not replacement for, wholesale market (targeted on non-Big Six)
- Reintroduction of self-supply restriction on its own insufficient
 - would not on its own help smaller players and new entrants
- Market makers would emerge if primary liquidity problem is addressed
 - complement to healthier market, not mechanism for delivering it
- Trading initiatives inadequate
 - APX, N2EX, ENDEX futures, Spectron reference trades etc could fragment liquidity
- And of course further urgent reform of central trading arrangements
 - Gate closure, contract notifications, ex post trading, tolerance bands

A credible package subject to further testing
and design, but mandatory trading is the key

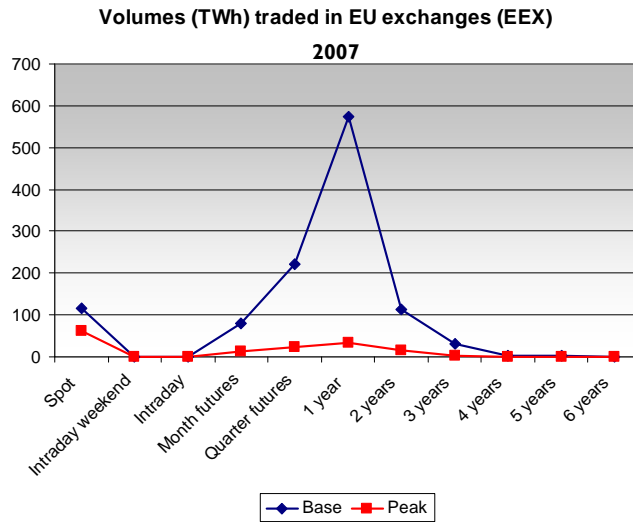
7

Some concluding thoughts (I)

- Retail competition cannot flourish without properly functioning wholesale markets
 - regulator must now report routinely
- Policy agenda suggests diversity of participant essential to attainment of diversity
 - but market structure is inhibiting this
 - generation as well as supply
- Have we transferred one arena for market power into another?
 - and look what happened last time ...
- Is it as difficult as some say

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Some concluding thoughts (2)



Source: Ecorys for European Commission

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Thank you for listening



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For more detail see response [here](#)

Cartoon courtesy of www.cartoonstock.com