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Significant code review

Response by Danske Commodities

Foreword

Danske Commodities is a Danish company trading in power, gas and climate products in Europe. Danske Commodities has operations in 29 European countries with a total of more than 220 employees. All of its ten business teams are all dedicated to delivering value-adding, flexible and innovative solutions.

Danske Commodities is committed to generating strong earnings and earnings growth based on a combination of good trading relations, skilled employees and a good working environment. In 2011, Danske Commodities generated revenue of EUR 818 million and profit before tax of EUR 22 million. The company was founded in 2004 by Henrik Østenkjær Lind and is domiciled in Aarhus, Denmark and now has divisions in several countries.

In 2009, Danske Commodities won the Danish "Gazelle of the year" award as the fastest-growing company in Denmark.

In the UK Danske Commodities has its focus on power trading, gas and managing renewable energy such as wind and solar. In Scandinavia and Germany Danske Commodities has more than 1000 MW wind and solar in its management portfolio and has extensive experience with balancing energy across Europe.

The SCR

Danske Commodites approves of Ofgems intent to overhaul the balancing mechanism and wishes to contribute with our international experience and best efforts.

The primary considerations

1: With reference to our expertize on market with a marginal cash-out price such as in Denmark, we find the producers, on a marginal trade market compared to producers on a par500 market, will have a greater incentive to offer balancing services at lower prices. The potential upside for producers with relative low production costs will trigger more bids and even bids below their marginal costs as the value associated with the likeliness to get paid the marginal price outweighs the costs associated with the likeliness of actually being called to produce below the marginal costs.

Pricing zones in the UK should be properly warned to market, but could as a one-time opportunity also give possibility to massive competition on the market for PPAs. This could be argued if general PPAs have not been contractually prepared to take into consideration that power can be traded as two commodities rather than as one commodity. There simply is discrepancy in the formal definition of what is actually sold to what price? This could lead to a general re-negotiation of contracts and therefore open a “backdoor” the get out of current contracts.

2: Danske Commodities clearly endorses a single cash-out price where market participants offer balancing services to the BM. We find the transparency to be an important feature and in general approve of the Ofgem considerations on this subject.

Though, we find the consideration on a two pricing systems for production and consumption to be unadvisable. We do not see the benefit, since market participants just avoid balancing their production account and perform all adjustments on their consumption portfolios.

3: Allowing parties with both generation and supply businesses to net their opposite balances from the two trading accounts is clearly advisable. Danske Commodities does not see the need for an overly complicated administrative system and therefore we recommend a simpler system with implicit netting.

4: Introducing a marginal price on this market will probably lead to more deepened liquidity (aggressive bidding) as more market actors have greater incentive to help the SO to balance the system. Danske commodities find this positive and recommend this sort of market development.

5: Danske Commodities fully agree that the SO balancing costs should be reflected in the cash-out price and trusts Ofgem to find the optimal way to administrate.

6: Making long term contracts are by nature non-flexible and will in all cases either overpay or underpay for the reserve power. Reserve power should ideally be contracted on the basis of an hour, a minute or a second. Though this is not without challenges.

It would be advisable to balance on a daily or weekly basis which will ensure that the price of balancing power reflects a fair value of the balancing power.

Longer term contracts clearly violate this solution. Furthermore, by making long term contracts with producers you also create a less flexible market since these plants are either forced into or out of operation by a contract and not by market conditions. Therefore, even though balancing power in theory could become cheaper by signing such a contract, the costs of lost flexibility could still make the overall cost higher by signing this long term contract.

7: Danske Commodities endorses an introduction of a balancing market that is closer to real-time. We find it very positive to be able to balance out imbalances as we gain knowledge as our weather forecasts. This will, ceteris paribus, reduce the cost of balancing to the advantage of the turbine owners.

8: Centralized balancing may due to the portfolio effect be effective but only last to a certain degree. After a certain number of turbines in a portfolio the effect will decrease, but centralised balancing will still be prone to extreme situations and extreme errors. Danske Commodities believes that the portfolio effect of having several private entities taking the responsibility for balancing should be preferred. This constellation will maintain the desired portfolio effect and reduce the risk of extreme errors. Furthermore the solution with multiple balancing entities, simultaneously ensure competition to the benefit for the costumers.

Final remarks:

Making prices more marginal could be a good idea in the sense that bids are expected to be more aggressive and prices more volatile. Among the problems are, that balancing prices becomes more prone to inefficient use of balancing power by the SO, an issue seen in other countries.

However, there are many obvious advantages by the marginal pricing approach, and at Danske Commodities we think the advantages clearly outweigh the disadvantages for functioning of the market.

It should be noted that markets based on a more marginal price setting potentially could increase the cost for balancing especially intermittent generation of energy compared to other types of energy generation. This should be considered fair as the fast increase of intermittent power production causes risk induced challenges to the grid and therefore should be given a fair risk penalty. Though, in order not to make intermittent resources less competitive due to the market design of balancing markets it would be possible to reflect their costs in the way renewable energy is subsidised.

For Danske Commodities,

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