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The Retail Market Review - Findings and initial proposals

DONG Energy is a leading energy company operating in Northern Europe and headquartered in Denmark. It is heavily one of the most active offshore wind operators and investors in the United Kingdom with a total pipeline capacity of approximately 2.8GW, including four offshore wind farms in operation, a stake in a further four sites currently under construction and a strong pipeline of potential future renewable projects. In thermal generation, DONG Power UK has recently completed a new CCGT power station of 824MW output in South Wales.

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DONG Energy is pleased to respond to Ofgem's Retail Market Review. As an independent generator operating in the UK Market, we are particularly concerned with proposals 2 and 5, aimed at enhancing liquidity and improving market reporting transparency respectively. We have addressed the specific questions raised on these proposals in Appendix 1.

Generally, the initial proposals set out in the consultation document for enhancing electricity wholesale market liquidity are welcome as an important first step to improving market liquidity. In particular, we are pleased that Ofgem recognise the need for at least a proportion of the Big-6's production to openly marketed. However, whilst the obligation to sell a proportion of production may improve the liquidity issues for small supply companies, we remain concerned that the ability of independent generators to compete is not sufficiently addressed.

Additionally, the focus of the proposal is too heavily on delivering liquidity in the forward curve and not in the short-term (day ahead and within day) markets. As they are currently described, there is a risk that Mandatory Auctions will not deliver sufficient liquidity in the short term to address the issues likely to arise as the volume of wind generation connected to the system increases. In future there will be an increasing requirement for generators to meet short-term fluctuations in physical power through access to a liquid short-term wholesale market. Improvements in wind forecasting may go some way to address these issues but there is likely to remain a risk that cannot be mitigated through the proposals as drafted.

Furthermore, it has been shown in other markets, e.g. Germany, that sufficient liquidity in the short-term will lead to development of financial products along the curve; allowing a financial as opposed to physical hedge for supply companies.

DONG Energy welcomes the proposal for a Mandatory Market Maker mechanism. Of the two measures put forward in the consultation, we believe this has the potential for the strongest impact and improvement of wholesale market liquidity. The main aim of this should be to facilitate liquidity and trade in the granular parts of the short term market. The timeframe for this facility should therefore focus on the period where rebalancing needs become known (last 8-12 HH blocks), and have enough volume for the market to rebalance itself. Any volume mandated should also be replenishable, so the volume offered is not simply taken by the quickest trader. As the wind penetration in the UK system increases, the volume in the MMA facility should also be increased correspondingly.

We note with some concern the wording in Table 2: Mandatory Market Making (MMM) design features, "*This could be relaxed under volatile market conditions.*" as these will be the periods where the need for MMAs is the greatest. Any such restrictions on the obligation could diminish the trustworthiness of the resulting price indices to a level where they will not facilitate liquidity in financial products.

Further transparency on internal price discovery is also an essential building block for the development of a liquid market. We encourage Ofgem to ensure that ensure that companies report on volume and price of internal trades in a timely manner, enabling the information to be added to the public information on brokered trades used to establish benchmark prices.

Transparency and improved liquidity in the electricity market will lead to greater confidence both in existing participants and new entrants. Stronger competition in the retail sector will increase the opportunity and interest of potential market participants.

Finally, we encourage Ofgem to fully develop and implement these proposals at the earliest opportunity. Given the Government's proposals for establishing a system of Feed-in Tariffs with Contracts for difference (FIT with CFD) there is additional urgency in ensuring that there is sufficient liquidity to allow these contracts to work effectively.

Yours sincerely



Regulatory Affairs Manager
DONG Energy

Appendix 1: Specific answers to questions raised in respect of Proposals 2 and 5**Proposal 2 - Enhanced Liquidity**

Question 8: Do stakeholders consider that low electricity market liquidity constitutes a barrier to entry in the domestic retail supply market?

DONG Energy cannot comment on the domestic retail supply market as this is not a market segment in which we operate in the UK. However, as an independent generator, we have been, and remain, clear that the lack of liquidity in the wholesale electricity market is a significant barrier to entry for new generation. Whilst the proposals to enhance market liquidity, as set out in the Retail Market Review, are welcome they do not address fully the issues for independent generators.

Question 9: Do stakeholders consider that our two proposed interventions (the MA and the MMM) could improve the ability of the wholesale electricity market to meet independent participants' needs, and will ultimately improve the likelihood of retail supply market entry?

As noted above, the MMM proposal is, in our assessment, likely to have the greatest impact on the liquidity of the wholesale markets.

Question 10: Subject to the results of our further wholesale market assessment, do stakeholders consider that both interventions could be necessary to meet the objectives stated in questions 8 and 9?

At least, we believe the MMM proposal should be implemented as soon as practicable. However, the MA must require detailed design and could be implemented at a later date if the MMM does not deliver the requisite improvement in liquidity.

Question 11: Do stakeholders consider that there are other intervention options we should be developing?

DONG Energy believes greater consideration should be given to the needs of independent generators operating in the market. Whilst the proposals are a positive starting point they are designed to specifically help small suppliers. The solutions proposed, particularly the MMM initiative, may coincidentally improve conditions for independent generators but we would welcome more specific actions, for example, extending the MA obligation to the buy side as well as the sell side.

Question 12: On the basis that we could decide to take forward these interventions, do stakeholders have comments on the indicative design choices we have made, as set out in Appendix 2. In particular, views are welcome regarding our initial position on each of the following:

Volume requirements

For the MA proposals, we would encourage Ofgem to prescribe at least 20% of volume to be auctioned.

Product requirements

For the MA proposals, DONG Energy would encourage more emphasis to be placed on short-term products with the aim of encouraging a liquid short term physical market to develop. As has been demonstrated in other markets, this will allow financial products to develop in the longer term.

For the MMM, the main success factors will be the size of the bid/offer spread and ensuring liquidity availability to all market participants. The benefits of this should be a liquid and fully granulated price index, as well as giving e.g. independent wind producers the capacity of balancing their portfolio without incurring prohibitive costs.

Frequency

The proposal for monthly auctions is potentially limiting. If the auction model is introduced, auctions should be held on a rolling basis to ensure sufficient granularity.

DONG Energy supports the continuous market making proposal as set out in the design features for MMM.

Governance arrangements

The arrangements set out in the consultation document seem appropriate although we would anticipate further detail to be forthcoming during the development of the proposals.

Participation Platform

We do not have any views on the platform per se, but it is of importance that all the liquidity is accessible to all market participants. Furthermore we see it as important the trades done will be used in the relevant price indices, and any platform should take the dissemination of the relevant information freely available.

Question 13: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to take action to improve wholesale electricity market liquidity?

DONG Energy believes that intervention by Ofgem is necessary to address the lack of wholesale market liquidity. Successful intervention will reduce risks and costs to all independent market participants and encourage market entry.

One risk of the current proposals is that they are one-sided and only focus on solutions for small supply companies. An option to address this discrepancy is to apply a similar obligation on domestic retailers to source a set percentage of expected demand from the traded market.

Additionally, the detailed design of the proposals must seek to ensure that they do not further fragment market liquidity or exacerbate credit requirements and participation costs. That is, the market should be left to determine the most appropriate platform on which to trade.

Proposal 5 - Improve reporting transparency

Question 25: Do stakeholders agree with Ofgem's proposal to appoint a leading firm of accountants to review the transfer pricing and hedge accounting practices of the vertically integrated suppliers?

Yes, we support the proposals set out in the consultation document. However, we believe this could go further with a requirement on the Big 6 to submit volumes and prices to independent agents constructing price indices for publication on an anonymous basis.

Question 26: Do stakeholders have views on how Ofgem could improve segmental reporting in future years?

As noted above, we would like to see wider publication and reporting of price and volumes.