Our date	Our reference	Administrative officer
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Your date	Your reference	
21/03/2011	34/11	

London, 1 June 2011

Mr Stefan Bojanowski
Ofgem
9 Millbank
London SW1P 3GE

rmr@ofgem.gov.uk

Re: Retail Market Review.

Statoil welcomes the opportunity to comment on the Retail Market Review. The UK electricity market is important for Statoil being the largest importer of natural gas to the UK and as an investor in offshore renewable projects in the UK.

Please find in the Annex our answers to specific questions raised in the consultation. Should you wish to discuss our views in more detail please do not hesitate to contact us.

Kind regards,

Robert Cross
Head of Gas Regulatory Affairs
rcross@statoil.com

ANNEX

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

The domestic retail supply market in the UK is dominated by the vertically Integrated Big 6 utilities and this makes it difficult for potential independent suppliers to source the electricity that they should supply; this low liquidity situation constitutes therefore a barrier to entry. The lack of “shape liquidity” in the UK Power market before the day-ahead stage makes it very difficult for non-vertically integrated suppliers to manage their overall price risks in line with the Big 6 utilities.

On the generation side, small players are reluctant to invest in new merchant capacity because their revenue is a function of wholesale electricity prices, over which they fear the Big 6 have a major influence.

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?

Both the MA and the MMM could reduce entry barriers to the retail electricity market; however, their design and mutual interaction should be thought through very carefully as there is scope for significant side effects.

The MA is problematic in terms of the way it could affect the secondary market and create price volatility.

It is not quite clear how the MMM mechanism would be handled, with 6 players required to act as market makers at the same time. The only sensible way to deal with this seems to be to create a common platform, as suggested in the proposal. The cost side of this solution might, however, prove a constraint to its viability.

The Mandatory Market making proposal could increase wholesale market liquidity by removing market liquidity risk from the UK Power market thereby encouraging new entrants to trade UK Power. This would make it easier for potential new retail market entrants to cover their market exposure but additional shape liquidity might be required to further this aim. For the MMM to work effectively the bid/offer spreads must be competitive and across both the OTC and cleared routes to market.

The increased liquidity in standard curve products, that would be introduced by the MMM, would encourage smaller players to take positions with greater certainty of encountering less market liquidity risk. Most companies, including the Big 6, carry a lot of shape price risk to the prompt markets, but because of vertical integration they can manage those risks better than small independent suppliers who are completely exposed to wholesale markets. The main complaint from a wholesale liquidity point of view is lack of curve liquidity even in standard baseload products (i.e. beyond front two seasons). This makes it exceptionally difficult to hedge any open interest and ensures all companies take shape price risk to the prompt 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?

While both a Mandatory Auction and a Mandatory Market Making measure would be useful in order to make electricity available to the market on a regular basis, it is not clear how the two measures would be combined. The only sensible way to combine them would be to enforce them as separate requirements, i.e.

make sure that a 10-15-20% volume is auctioned and that, on top of this, 20-50MW are continuously available for the market to buy and sell.

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

The UK Power market should be traded on a calendar basis in line with European Power markets, the Gas, Coal and Emissions markets, possibly creating mandatory auctions on a day-ahead basis to ensure sufficient hourly priced liquidity at this stage. It is necessary to ensure at the very least market making on baseload, peak and off peak products on the curve (Day Ahead, Weeks, Months and Seasons). It would also be beneficial to have MMM on within day products (i.e. blocks).

A very important factor for a MMM solution to work would be that the bid-offer spreads are narrow enough to actually enable spark trading, and that the volumes on each bid and offer are at least 10 MW. In other words, the spread will have to be where the market is.

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**
- **Product requirements**
- **Frequency**
- **Governance arrangements**
- **Participation**
- **Platform**

Volume: Referring to Question 10, it must be clarified whether the requirements of MA and MMM would be cumulative or alternative.

Product: Prompt products.

Frequency: Consider a weekly auction for the MA, as monthly/annual auctions could increase secondary market volatility given the secondary market's limited size and depth.

Participation: In an ideal world the Big 6 should not end up buying back the amounts they made available to market, but we understand this might be difficult.

Platform: MMM needs a common platform to work effectively, preferably a cleared solution which can also serve to reduce barriers to market entry.

The main area in which liquidity is a concern at the moment is prompt-traded half-hours, and the MMM could help address this issue. However, we do not think that the "narrow range of frequently traded products" is ideal. Standard forward products would not necessarily help, what the market needs most urgently is liquidity in the prompt products.

Increasing liquidity in prompt products segments would also be in line with the broader goal of introducing more renewables in the electricity mix, especially wind as the proposed Contracts for Difference will most likely have a strike price related to the market which is relevant for wind generation, i.e. within-day and day ahead.

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?

The MMM and MA ideas could stimulate additional market liquidity but this is also dependant on other factors (i.e. credit, collateral / margining costs and risk appetite) which could mean that wholesale market liquidity may struggle to improve irrespective of the remedial actions Ofgem takes.

MA's should be held more frequently than annually to avoid excess volatility or potential lack of liquidity in secondary markets around the time of the auctions.

Ensuring mandatory volumes on Day Ahead auctions from the Big 6 might be easier to implement than longer term mandatory auctions but would still mean that companies would have to wait until this late stage before hedging their shape risk exposures.

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. It is important to make sure vertically integrated utilities keep their accounts separate and these are reported consistently across the industry.

Company
Statoil UK Ltd

Office address
1 Kingdom St
London W2 6BD

Telephone
+44 203 204 3200

Internet
www.statoil.com