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Aalborg, 08 May 2012

Dear Camilla,

**Consultation on Retail Market Review: Intervention to enhance liquidity in the GB power market**

We would like to thank you for the opportunity to respond to Ofgem's consultation paper on the intervention to enhance liquidity in the GB power market.

Nordjysk Elhandel A/S (NEAS) is one of the largest traders of intermittent generation in Scandinavia and is currently in the process of expanding its activities towards GB. As part of the expansion of our services in GB, we were happy to engage with Ofgem and other market participants in the roundtable discussions as well as this written response with regards to the intervention to enhance liquidity in the GB power market.

Our response is contained in the attachment to this letter. Should you wish to discuss any of the issues raised in our response, or have any further queries, please contact my colleague Lars Weber on +45 50565966, or myself.

Yours Sincerely  
Nordjysk Elhandel A/S



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## Responses from Nordjysk Elhandel A/S (NEAS) to the questions

### Chapter One

#### *Question 1: Do you agree with the objectives we have identified?*

We agree with the objective as set out in this consultation by Ofgem.

#### *Question 2: Do you think there are other objectives we should be considering?*

We believe that these Objectives, when met, are sufficient to support competition in supplying domestic end consumers in the UK.

### Chapter Two

#### *Question 3: Do you agree with our views on market developments since summer 2011?*

We largely agree with the views as stated by Ofgem regarding the market developments since summer 2011.

We would like to comment on the availability of financial products on N2EX. A range of products is available which is covering multiple front months and Quarters together with the coming 5 Seasons. In addition, bids and offers are quoted for all of these products. Therefore, participants already have today the possibility to cover their needs for hedging for any exposure they occur for the coming 30 months.

We do acknowledge that bid/ask spreads offered with these financial products are significantly higher than, for example, in the gas market. Still, the spreads here are a symptom of the limited liquidity in this market and not a symptom of the lack of products as a whole.

#### *Question 4: What specific further developments would be necessary to meet our objectives?*

Objective 1 is currently met as it is referring to the availability of a range of products to support hedging. Products which support hedging are readily available in the financial futures market on N2EX as bids and offers are quoted for all products.

Objective 2, the development of a robust reference price, is currently underway but is not yet sufficiently completed. The bid-offer spreads are a good indicator of the uncertainty of where the reference price should be and what its robustness is. The currently relative large spread is indicating that the reference prices fragile and from showing the desired robustness Ofgem and the market wants. We would like to stress that to underpin a robust reference price for financial futures, a further development of liquidity on the Day-Ahead Market would be necessary. An increasing liquidity of the Day-ahead market (DAM) enhances the confidence in the financial future prices as the DAM is used as a clearing instrument for the financial future products.

Objective 3, an effective near-term market, is currently developing. To ensure that this near-term market will exist also in the coming years, we would like to request Ofgem to monitor the liquidity of the day-ahead auction on N2EX continually. This is not only important to ensure that Objective 3 is met, but also that there is sufficient robustness in the day-ahead price for it to function as a clearing

price for the financial futures of the N2EX platform and thus to meet Objective 1 and 2. In order to achieve the long term liquidity targets set out by Ofgem, we believe that the amount of physical power sold through the DAM and Intraday markets should increase and account for at least 50 % of the production.

***Question 5: Do you agree that objectives one and two are current priorities given market developments?***

We agree that Objective 3 is currently at a lower priority than Objective 1 and 2, but only while the liquidity on the day ahead market is enhancing. Further actors are, according to our knowledge, in the process of underwriting commitments and thus are providing more liquidity to the DAM, but this process should continue consistently until a majority of the physical volumes in the short-term are traded via the DAM.

From our point of view, Objective 2 should be seen in conjunction with Objective 1. Objective 1 is partially met, as two of the “Big Six” act as market makers is to quote bids and offers for all products offered by N2EX. However, we would like Ofgem to encourage all major market participants to act towards more transparency via market maker agreements for these products to stay available in the future. Objective 2 the development of a robust reference price, is, from our point of view, the most urgent as the relatively large spreads between bids and offers in the futures market are a clear sign of a low robustness of these reference prices.

### **Chapter Three**

***Question 6: Do you agree that the MA is the appropriate mechanism to meet our immediate objectives?***

We believe that the MA is one mechanism out of many to help meet the immediate objectives. We believe that the MA is not the only mechanism that could meet the objectives, nor that the MA in itself could be seen as sufficient for all market participants. Therefore, we would like to stress that if Ofgem is considering the introduction of an MA, it should be seen as a part of a group of measure and not as the single solution in itself.

Even so, we would like to stress that only the creation of an MA alone, is likely to be a time-consuming and complicated process. The creation of this mechanism has to be balanced against the gains that it will give to the energy industry as a whole. Other methods that could stimulate the development of a robust reference price could be less complicated to deliver than the MA.

***Question 7: Do you agree that, at the present time, the other mechanisms identified would not be appropriate for Ofgem to pursue?***

We believe that most of the other mechanisms (in itself) where indeed not appropriate to pursue at this moment in time.

## **Chapter: Four**

### ***Question 8: Do you agree with the key features of the MA we set out?***

Overall we agree with the key features and rationale as set out by Ofgem. We have, however, some reservations regarding the rationale that monthly auctioning would generate a robust reference price for the market. Depending on the design of the buy-side rules, it could be possible that the outcome of the prices set in these auctions could defer from prices seen in the financial futures on N2EX or the OTC market. If these prices would defer, it would weaken the robustness of any reference price as it would not be in line with other prices of similar products.

Furthermore, the MA only allows Wholesale participants to hedge themselves once a month, which is insufficient. Hedging of client flows needs to take place on a continuous basis.

### ***Question 9: Do you consider it appropriate to have buy-side rules in place and do you have any comments on the detail of such rules?***

We would find it appropriate that there is a mechanism in place that would ensure that volumes in the MA would be ready to be bought and sold by and from non-obligated parties. We are, however, reluctant to state that the buy-side rules as envisioned by Ofgem would be the appropriate mechanism to deliver the flexibility of the MA as needed to engage in trading between, on the one hand, smaller suppliers and generators and the Big Six on the other.

## **Chapter: Five**

### ***Question 10: Do you consider that there are benefits and risks to the approaches that we have not identified?***

In general, the risks and benefits as identified by Ofgem would seem appropriate. In addition, we would like to suggest that the time aspect of developing either of these two approaches could be included. This is to ensure, that the improvements the MA could deliver to the wholesale market would be delivered as timely as possible, without undermining the integrity of the MA.

### ***Question 11: Which approach do you consider is best placed to deliver our objectives at least in terms of cost and risk?***

Approach 2 would be favoured over Approach 1 as it would be supported by the obligated parties per definition. To ensure that the costs would be limited, we would suggest that Ofgem will request the obligated parties to choose a single platform.

### ***Question 12: Do you consider that both approaches are able to meet our objectives?***

We consider that both approaches would be able to meet the objectives as set out by Ofgem.