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Open Letter: Implementing the European Electricity Target Model in Great Britain

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DONG Energy welcome the discussions on the implementation of the European Electricity Target Model in GB and Ofgem's efforts to start an open process on this important issue.

Our ref.

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The GB electricity sector is facing a significant challenge in delivering secure, affordable and low-carbon electricity. The Electricity Market Reform is dealing with key aspects of this challenge, but in order to provide the investments needed the markets need to work efficiently.

This calls for a holistic approach on all key challenges arising from the future changes. It will be important to look openly and critically on present market arrangements both in the GB and other European markets in order to maximise the benefits that free and open markets can create.

For instance, the Target Model will have knock-on effects on areas such as transmission network use of system charges, which have been under review by Ofgem through its Project TransmiT. A further review of changes as a result of the Target Model need to be developed in a transparent and timely way to minimise any additional market uncertainty. This underlines the need for a sound and holistic impact assessment with appropriate stakeholder engagement.

The Target Model would if markets get aligned and efficiently coupled lead to more transparent, liquid, open and competitive electricity markets across Europe. This development would also be very beneficial to the GB market in order to attract investments and reduce overall costs. It could mean more efficient and cheaper balancing of a constrained system, security of supply will be strengthened, GB consumers will get more freedom of choice and generators will get access to a larger power market.

If the GB market and the surrounding markets get more aligned it would significantly minimise the entry barriers of independent suppliers and generators. Understanding the differences between the European power markets and their balancing regimes often makes the cost for new entrants insurmountable.

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The Target Model creates the platform for getting bigger and more liquid markets. It does, however, not solve the GB market structure problem of low transparency and liquidity, which is critical to new investments. The incentives to trade openly by the vertically integrated companies need to be established as a requirement by Ofgem in its liquidity intervention.

The best outcome of implementing the Target Model can be achieved by actively facilitating strong and liquid day ahead and intraday markets that can be coupled to other countries.

An efficient and healthy market is one that has sufficient liquidity and competitiveness for all participants to sell and buy at all times. In assessing price zones this would indicate that fragmentation should be avoided. If separate price zones are considered the design criteria should be transparent. Attention should be given not only to security of the system, the location and frequency of congestions, the impact of power flows created within a bidding zone on other bidding zones, impacts on balancing mechanism, but certainly also to the overall market efficiency in terms of liquidity and adequacy of investment signals provided by the market.

Stronger market integration with the European Energy system is a way to secure optimal deployment of capacity across countries in the long term. Developing cross border balancing as envisaged in the Target Model could reduce the need for reserves and increase competition on the balancing market, thereby improving reserve procurement efficiency and reducing the costs of balancing the system.

Furthermore, the physical market coupling through interconnectors is an essential element of the electricity system of the future. Experiences in other North European markets show that being well interconnected to the surrounding markets enables a cost efficient integration of high shares of intermittent renewable generation. An interconnector between GB and Denmark would be a natural first step in the integration of markets in the North Sea area. Such a connection would make it possible to exploit wind power more optimally as the wind profiles vary across the region. At the same time, the aggregate need for back-up capacity would be reduced as the same flexible capacity can be used in multiple regions. Thus, an interconnection between GB and Denmark would increase the value of wind power and be beneficial for security of supply.

About DONG Energy

DONG Energy is one of the leading energy groups in Northern Europe. We are headquartered in Denmark. Our business is based on procuring, producing, distributing and trading in energy and related products in Northern Europe. We have approximately 6,000 employees and generated DKK 57 billion (£ 6.2 billion) in revenue in 2011.

In the United Kingdom DONG Energy is one of the most active offshore wind investors and operators with a total capacity of approximately 5 GW, including four offshore wind farms in operation, a stake in further four sites currently under construction and a strong pipeline of future projects. In thermal generation, DONG Energy is operating the highly efficient CCGT power station Severn in South Wales.

This spring we established DONG Energy Sales UK with an annual supply of around 2.5 billion cubic metres of natural gas after acquiring the gas supply business Shell Gas Direct.

Developments of the GB electricity market arrangement and structure are very important to DONG Energy both in terms of present generation capacity, but certainly also for our significant future investment programme.

DONG Energy would be pleased to discuss any of the issues raised in this response and look forward to engaging with Ofgem. Should you have any questions, please contact Jakob Forman on +45 99 55 91 66.

Yours sincerely



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