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9th November 2015

Dear Leonardo

Extension of Supplemental Balancing Reserve

VPI Immingham welcomes the opportunity to respond to the above letter, dated 15th October 2015. VPI Immingham is a combined heat and power (CHP) plant near Immingham, on the south bank of the river Humber. It is one of the largest CHP plants in Europe, capable of generating 1240MW – about 2.5% of UK electricity peak demand and up to 930 tonnes of steam per hour, which is used by the nearby oil refineries to help turn crude oil into products.

Having spoken to you previously, VPI Immingham's lack of support for the Supplemental Balancing Reserve (SBR) product is well documented. We were also part contributors to the analysis presented to National Grid in response to their proposal to extend these services, which we have also previously shared with Ofgem. We do not believe that appropriate levels of analysis regarding the impact of the SBR product has been conducted, or at least shared externally.

However, we do recognise the wider concern regarding capacity margins in Winter 16/17 especially and the political landscape surrounding these concerns and accept the inevitability that the SBR product will be continued until the Capacity Market starts in earnest in Winter 2018. It is imperative that the two products, i.e. the capacity mechanism and SBR, do not run concurrently and therefore we are pleased to see the proposals to remove the products from National Grid's licence following Winter 17/18.

In addition, we do not want to see the lights go out across the UK and, in the absence of an alternative product, this does appear to be the only current solution. Given the potential for negative supply margins in Winter 16/17, it is important the sufficient Capacity be maintained on the system, profitably, to keep maintain positive margins. However, we would note, that purely by extending the SBR product or any other interventions in the market, market signals are less likely to incentivise any generation (or DSR) to come forward to resolve the issue.

Ofgem are well aware of the existing difficult conditions facing the vast majority of the existing thermal portfolio. With the much needed revenue from the capacity market still three years away, the wholesale market must be allowed to provide the right price signals – the reformed cash out arrangements should help in this regard. Without appropriate signals, it is likely that plant that does not hold a capacity contract will close sooner rather than later, the "slippery slope" that is often referred to, exacerbating the situation.

Currently, looking ahead to Winter 16/17, the reported scarcity does not appear to be factored into prices with the NISM on 4th November having little noticeable effect on Summer 16 or Winter 16/17 spreads. We believe that this is because the market is over-supplied for most settlement periods and it is only for the limited number of settlement periods where intermittent generation is not available that prices will reflect scarcity. For all generators, but most of all the marginal plant, it is essential that prices are allowed to reflect these conditions on these tight

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days.

With this in mind, we therefore look to Ofgem to ensure that the design of the SBR product minimises any further distortion to the market that will prevent plant from accessing high prices needed to keep them open. We therefore outline our major concerns regarding the proposed changes below:

1. Testing regime

As outlined in our letter to Ofgem on 29th October 2015, we are very concerned by the testing regime. We appreciate that changes have been made to alleviate industry's concerns, but we believe that further changes are required. This is especially so if significantly higher volumes will be tested going forward. Plant should only be tested under benign conditions, i.e. overnight or at the weekend, to ensure that there is minimum impact on the market. This must hold true for both proving and non-proving tests. Interactions with the new cash out arrangements should also be taken into consideration.

2. Volume Cap

We have serious concerns regarding the proposal to increase the volume cap for Winter 16/17. The fact that this is happening does suggest that the initial warnings regarding the "slippery slope" when the product was first suggested are now in fact becoming a reality, i.e. the very existence of SBR has meant that market signals have not recovered and marginal plant, that the market cannot afford to lose, has been forced to close for economic reasons.

As demonstrated in our independently produced analysis, an increase of 1GW can have approximately a £30m further impact on the market, a market facing incredibly challenging conditions already. In addition, it is likely that the marginal plant, the plant that needs this revenue the most, is most impacted by the increase. Whilst you can disagree with the assumptions used and the exact numbers in the analysis, we believe that the order of magnitude would remain the same.

We understand that the volume cap could be increased by an additional 1.5GW, costing consumers significantly more money and potentially removing a further £45m from the wholesale market, or up £25/MWh for low efficiency CCGTs. We expect Ofgem to publish detailed cost benefit analysis detailing the consumer benefit and impact on the wholesale market to fully justify any proposed increase.

3. Allowing Longer Warming Plant to Participate

This proposed change appears to be solely aimed at enabling coal plant that might otherwise have closed to participate in SBR. We do not think that this is appropriate for two reasons:

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- a. The likely cost to the consumer of more expensive coal plant participating:
 - We believe that coal plant would have costs multiple what SBR has cost for Winter 15/16. This would be a huge additional cost for consumers and should be considered against the value of lost load.
- b. The operating parameters that coal plant may require:
 - Much of the coal plant that could participate is not designed to be operational for just a few hours over Winter. Therefore we have concerns regarding the reliability of such plant should it be required in earnest. These concerns could be mitigated by further testing, which in itself further would further impact the market. In addition, this plant expected to have longer ramp up times than the existing gas plant and significantly longer minimum non-zero times.

We believe that it would be more appropriate to incentivise additional flexible capacity via market mechanisms for the low number of settlement periods where SBR may be required.

4. Information Provision

Whilst we understand and support the proposed timings regarding tender rounds, consideration must be given regarding the timing of announcements. As set out the analysis that we shared regarding the potential impact of SBR on the capacity mechanism, we do not believe that any tender results should be published ahead of the capacity mechanism to ensure that SBR has no impact on the capacity auction.

In addition, we believe that the total volume expected to be procured in each tender round must be shared ahead of any tender. This would avoid the situation during last year's tender whereby the first tender round resulted in higher prices than the subsequent tender. To minimise costs to the consumer, tender rounds must be as open and transparent as possible

We would be happy to discuss our concerns in more detail at any point, or to further discuss our previously submitted analysis. Please note that as we have previously shared this analysis with Ofgem, we have not submitted it again alongside this response. However, should you want a further copy, please do not hesitate to get in touch.

For further question regarding any of the above, please contact:

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