TATA

Camilla Eggington
GB Markets
Ofgem
9 Millbank
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10 May 2012

Dear Camilla,

As a very large end user Tata Steel are supportive of any initiatives to attempt to improve the woeful level of liquidity in UK Wholesale Power Markets, which is particularly pronounced on the forward curve. Reasons given for this situation are very varied and as an end user we are not in a position to comment on whether they are inherent to the UK market or not.

We have seen the emergence of some new initiatives notably the N2EX Trading Platform. However, these have tended in the first instance to grow based on Day Ahead trading where the curve is most liquid. It is Ofgem's view that the near term market needs to interface properly with other policies and we also share the view that the near term market is not the priority for intervention in this manner.

End users have many different objectives and differ widely in their cultures, whilst some may wish to hedge their forward price exposure using Financial products, others may wish to solely use physical hedging via OTC transactions using their licensed power supplier, and a minority may wish to self-supply and be a direct market participant. What is important is that each of these approaches can use robust pricing indices over the forward curve that are reflective of the perceived value of that product at that time amongst a large population of market participants.

The consultation make reference to what may be the beginning of trading in financial products to hedge price but we would caution that such growth should not be relied upon.

We therefore welcome workable initiatives to increase trading in a variety of standard products across the forward curve. However, we are relatively unconvinced by the MA proposal, though we accept it is probably the most suited to the immediate objectives.

Pursuit of the MA presents us with several concerns: -

1) The MA may act to remove trading from existing OTC physical markets and exchanges rather than providing additional traded volumes.

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2) Participation by end-users to hedge their forward prices using the MA may be very limited, due to credit, collateral and other barriers, leaving the MA to trade between generators, licensed suppliers and other participants.
3) Good and robust governance of the MA will be needed, particularly a sensible set of buy side rules.
4) Allowing the Big 6 to select their own MA providers, albeit an option at this stage, seems to undermine the MA concept somewhat.

There are good reasons quoted for not pursuing the other mechanisms at this time. The longer dated MMM approach would seem at first to have some merit in conjunction with the MA. However, we would not be supportive of regulatory interference in the bid-offer spread, and that seems to push longer dated MMM out of the picture. The SSR approach is also attractive at first but some suppliers are inherently short on their own generation anyway, and others trade multiples of their own generation anyway.

We attach additional responses to the questions raised in the consultation document.

Yours sincerely,

S.C. Russell.

Simon Russell
Manager, UK Electricity Supplies

Tata Steel response to Ofgem Questions within
Retail Market Review: Intervention to enhance liquidity in the GB power market Ref 21/12

Q1. Do you agree with the objectives we have identified?
Yes, very much so.

Q2 Do you think there are other objectives we should be pursuing?
Not at this time.

Question 3: Do you agree with our views on market developments since summer 2011?
Section 2.1 We would also emphasize and agree that whilst 'increased volumes traded day-ahead on exchanges' is positive, the lack of traded volumes further out on the curve remains an issue for large end-consumers who wish to fix their energy prices for further out seasons.

Section 2.8. In our view the growing access offered by some Big 6 companies to bilateral trading for independent market participants does little to increase churn beyond 1 year for base load and probably contributes little to increasing access to products all along the curve.

Section 2.9. Increased use of financial hedging products would increase traded volume at the Day Ahead position but may operate to reduce physically traded volume further out on the curve. This may act against the interests of those wishing to hedge through physically settled transactions. For end-consumers of power hedging through physically settled transactions is easier contractually via agreements with their licensed power supplier, or simply price fixing arrangements, has fewer accounting complexities, does not require use of specialist Treasury functions and gives greater flexibility at a potentially lower cost. These factors may limit the uptake by end consumers of financial hedging products in the UK.

The lack of liquidity is in our opinion too, reflected in wide bid-offer spreads for power.

Question 4: What specific further developments would be necessary to meet our objectives?
No response

Question 5: Do you agree that objectives one and two are current priorities given market developments?
Yes, the near term market is not of anything like as much concern.

Question 6: Do stakeholders agree that the MA is the appropriate mechanism to meet our immediate objectives?
Broadly we acknowledge that the MA mechanism probably makes the best direct contribution towards achieving objectives 1. And 2. However, we would be concerned that in the proposed form it may not bring additional traded volume to market but merely displace volumes traded through other mechanisms. In addition we would be concerned that although it may not greatly adversely affect liquidity in the OTC market, it does nothing to improve it either.

Question 7: Do you agree that, at the present time, the other mechanisms identified would not be appropriate for Ofgem to pursue?
The other mechanisms do not address Objectives 1. and 2. to anything like the same degree as the MA. However, that is not to say that the MMM does not have a role to play as suggested in improving availability of forward products as suggested. The other mechanisms are probably not worth pursuing at this time for the various reasons given.

Question 8: Do you agree with the key features of the MA we have set out?
As the MA as proposed with mandate that 25% of generated output be sold through the auction we would be concerned that this may have the unintended consequence of reducing availability of products through the current OTC markets. There is also the question of what degree of access to the MA will be offered to end consumers by their Big 6 supplier, if access is limited or non-existent that would limit participation by end consumers to those consumers having direct access to the MA. Hurdles to participation should be as low as possible.

We are unclear who the obligated counterparties will be, are they holders of generation licenses that qualify as obligated by virtue of their ownership by one of the Big 6 energy groups?

In terms of the products sold, we would ask if it is appropriate that Month +3 and QTR +2 be included.

The introduction of a standard calendar would probably need to be on an 'all markets' basis at the same time so a long timescale for introduction would be required say 3 years.

We are not sure that a monthly auction will not simply distort trading in other markets on a once a month basis. It may be better to insist and ensure that the Big 6 sell multiples of their generation output through existing market platforms.

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?
Buy-side rules in principle sound necessary. As stated there seems to be a risk that Big 6 suppliers which are naturally short could end up selling power at low prices and then purchasing it back on behalf of their customer base at inflated prices. Whilst this may increase churn it may increase end-consumers bills, rather than decrease them.

Question 10: Do you consider that there are benefits and risks to the approaches that we have not identified?
No response.

Question 11: Which approach do you consider is best placed to deliver our objectives at least in terms of cost and risk?
We are of the view that allowing Big 6 to select their own MA providers rather obscures the objectives of introducing the MA in the first instance. Again, we could observe that creating mandatory levels of trading in aggregate across all OTC markets may be just as effective.

Question 12: Do you consider that both approaches are able to meet our objectives?
No see, comments under Q11. above.