VPI Immingham LLP

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To – wholesalemarketoperation@ofgem.gov.uk

18th September 2017

FAO Ofgem Wholesale Markets team:

VPI Immingham (VPI) welcomes the opportunity to respond to the above consultation.

Ofgem has suggested three approaches for the future Secure & Promote licence condition. VPI strongly support maintaining the status quo or increasing the scope of the policy. Any increases or decreases to the existing market marker obligation (MMO) should be based on robust evidence.

VPI is a single portfolio player who own and operate a transmission connected combined heat and power (CHP) balancing mechanism unit (BMU) in Immingham, North Lincolnshire. The plant has a CHP linked must-run element as it provides operational steam services to the nearby Humber and Lindsey oil refineries. VPI has a small trading team who hedge the asset out along the curve, according to a policy, which is largely determined by reference prices in the forward market. As "generation only" we are inherently long and also do not own or have long term contracts with an associated supply business. Therefore VPI does not have the characteristics of a natural market maker and, without a multi-generation portfolio, has limited visibility of the market and limited available volumes to dramatically shift the market.

As a smaller physical-delivery participant, on a day to day basis, we focus our resources on analysing market fundamentals as well as actions by the Electricity System Operator. Immingham's CHP must run element means that both these items can significantly impact its financial exposure during every settlement period throughout the year.

VPI trade the full spectrum of mandated products and, outside the S&P windows, leave orders in the market with OTC brokers to shape our hedge profile to our dispatch. Beyond the mandated products, where there is no implied reference price, we are proactive in going to market to create interest and discover the current price.

VPI strongly support Ofgem's desire to retain existing levels of liquidity and encourage greater number of market participants. We believe that this review is about evolution and not revolution – and S&P should be recognised as successfully achieving its initial objectives: promoting the availability of products, robust reference prices and market liquidity. In short,

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since S&P's inception in 2013, the number of market players as well as overall accessibility to hedging products has increased. It is therefore frustrating to hear feedback from certain MMOs that S&P has not had any positive impact. For example, it is widely ignored that MMOs also benefit from increased liquidity and that all market participants remain free to trade physical power across the entire working day. S&P has been incredibly successful concentrating liquidity which also prevents dominant 'retail and generation players' dictating trading patterns to their advantage by drip feeding in volume along the curve. Every day, all participants – including MMOs - can come to market, to trade out their physical position or supplier obligations at a competitive price which accurately reflects supply and demand in the long term best interest of consumers.

In recent years the business models of some MMOs has changed. VPI would therefore recommend Ofgem consider publishing updated guidance about what constitutes being a MMO – and whether the right MMOs are currently obligated in the market. We would also like to highlight that several generation players have identified opportunities to expand into the retail sector. Therefore, we believe the costs of the S&P obligation are being totally overblown and are clearly not significant enough to deter new market entrants.

VPI has not answered every question within the consultation in detail as we agree with the analysis presented. We do not believe that reducing the scope of the policy is in the best interest of suppliers, the wider market or long term interests of consumers. Ofgem should rule out any changes which run the risk of reducing liquidity in mandated products. We are also concerned that diluting the liquidity obligation within the windows will result in MMOs not market making at times of volatility – the exact time when other parties need market access the most.

(1) Please comment on whether you think prices for forward delivery are robust. Please refer to prices in and out of the market making windows and comment on the current mandated bid-offer spreads.

- VPI agree with Ofgem's analysis of figure 2 which shows how liquidity in baseload markets has increased post 2010, and been preserved since 2013.
- In 2016, tighter market conditions resulted in increased volatility and greater baseload volumes being trading in the forward market.
- In 2016, S&P ensured liquidity existed for both MMOs and the wider market to trade out positions at a time when all participants needed it the most.
- In 2010 pre-S&P, our records suggest increased volatility, but lower levels of baseload traded in the forward markets. In subsequent years, we have seen no evidence to suggest that market access and liquidity would have been higher without S&P obligations.
- In figure 7, Ofgem has highlighted an upward trend in the spread of two non-mandated products. Although we agree that where S&P is not applicable spreads are

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wider, in the example given it would also be possible to access these products via the existing S&P products.

- Robust index prices are also vital when valuing hedges and future investment decisions. Without access to this liquidity, Vitol Group would not have entered the UK market in 2013.

Figure 2 – OTC trading in baseload forward products. Source: ICIS

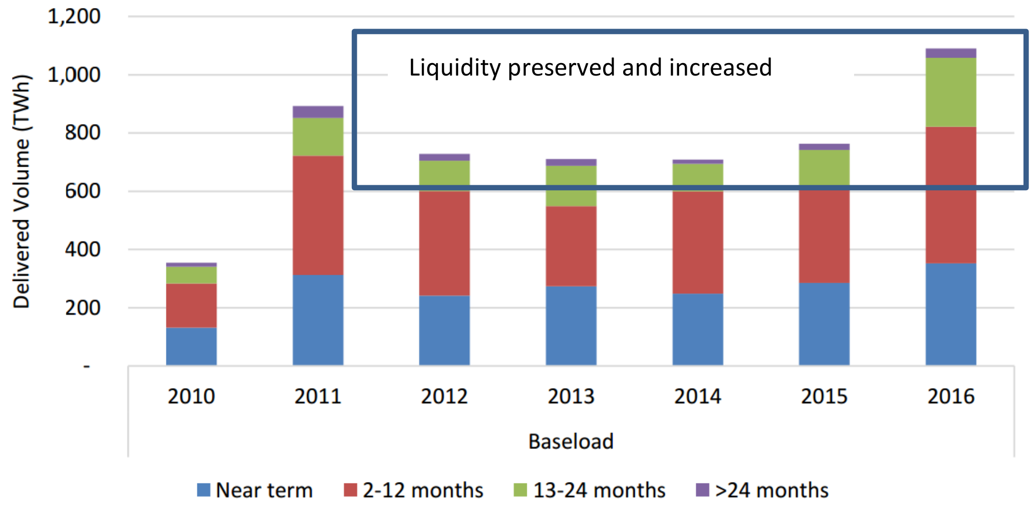

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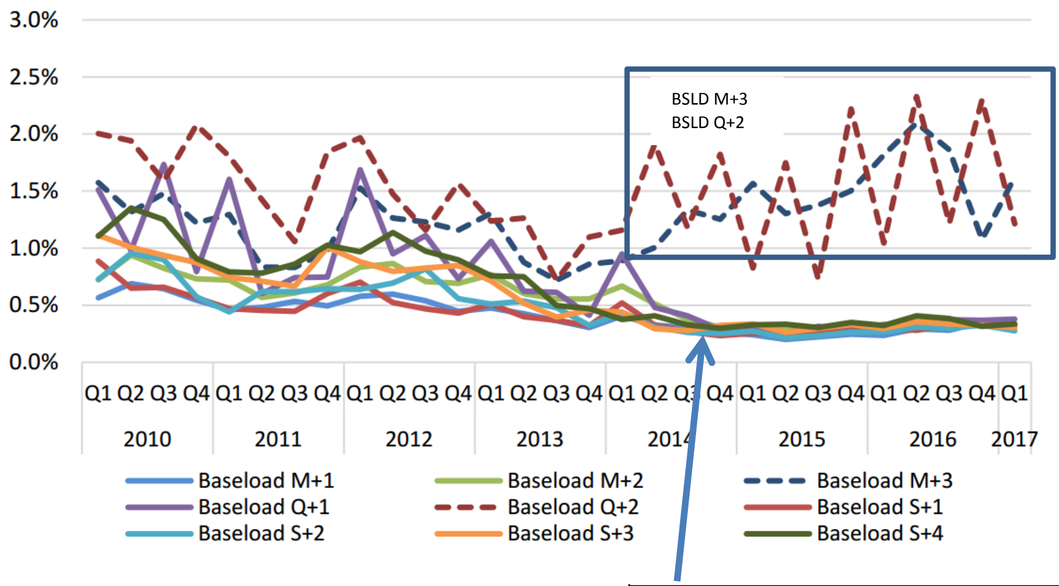
Figure 7 – Bid-offer spreads on selected baseload products. Source: ICIS



Baseload		**Peak**	
Month+1 Month+2 Quarter+1 Season+1 Season+2	0.5%	Month+1 Month+2 Quarter+1 Season+1 Season+2	0.7%
Season+3 Season+4	0.6%	Season+3	1%

(2) Please comment on whether the windows promote greater availability of products needed to hedge. Please provide evidence you may have on the availability of products outside the windows.

- We agree with Ofgem that S&P has improved our ability to hedge Immingham power station accordingly. As stated, VPI operations include a must run element as we provide 24/7 steam services to 25% of the UK's oil refinery capacity. It is therefore vital that we can access longer term products once we have greater certainty around our operations.
- The changing GB generation mix means that we have an increasingly significant exposure to off peak prices and costs of balancing the system. Hedging these products further out on the curve allows us to contain this exposure and use near term markets to fine-tune our position.
- VPI note that the liquidity in the market is greater during the MMO windows than at other times.
- As stated, VPI trade the full spectrum of mandated products and, outside the S&P windows, leave offers in the market to be worked on by brokers. Beyond the mandated products, where there is no implied reference price, we are proactive in going to market to create interest and discover the current price.
- We believe it would be a huge and unnecessary risk to dilute obligations within these windows based on MMOs assurances that there will be no impact on the wider market.

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- As stated, liquidity helps all market participants including MMOs - not just non-obligated parties.

(3) What are your views on how liquid the near-term market is? Please refer to any factors that you consider have contributed to the liquidity of the near-term market.

- Near term markets are naturally more liquid than longer term markets as participants refine their positions closer to real time.

(4) What are your views on our high-level analysis of the state of liquidity? Are there any factors not identified that we need to consider to assess liquidity or Secure and Promote? Please provide quantitative or qualitative evidence where relevant.

- VPI supports the continuation of the existing licence MMO obligations.
- As stated, as the industry has evolved it may be prudent for Ofgem to release updated guidance about what constitutes being a MMO.

(5) What are your views on the impact of the market making obligation on liquidity in different market conditions, including in benign times and in times of price volatility?

- The MMO allows products to be available in the windows both in benign and volatile times with the costs incurred for proving liquidity changing depending on the amount of volatility in the market as the bid offer spreads expand.
- Where market conditions are unfavourable there are mechanisms, such as the fast market rules, which limit MMO exposure during the window.

(6) What are your views on the fast market and volume cap rules, in particular on reducing risk for licensees when needed?

- The evidence supports Ofgem's view that the fast market and volume cap rules have both been used successfully during times of volatility.
- We have seen no evidence to suggest that the current trigger when the bid-offer-spreads vary by 4% is to the detriment of MMOs, the market or consumers.

(7) What are your views on how the SMA part of the licence condition has helped smaller suppliers to access the wholesale market?

- An increased numbers of suppliers show that this part of the licence obligation has been successful.

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(8) What in your view are the additional relevant external policy factors we should consider in our assessment of Secure and Promote?

- Ofgem's position on scarcity pricing supports a well-functioning market and the best longer term price signals in the interest of consumers.

(9) What are your views on amending the licence condition to allow flexibility during certain market conditions?

- VPI does not support amending the licence obligations during certain market conditions.
- The fast market and volume cap rules should be sufficient to protect MMOs from unreasonable levels of product exposure.

(10) What are your views on the costs and benefits of complying with the policy either as an obligated licensee or as a general participant? Please provide evidence and detailed costs/ benefits per annum.

- As a market participant, VPI cannot validate the breadth of suggested MMO costs incurred.
- We also strongly disagree with the suggestion of socialising MMO costs across the industry. This would result in a negative outcome for suppliers, smaller market participants and consumers.
- Given the range of cost discussed, it would also be extremely difficult to measure performance and likely require a regulated S&P price control.
- S&P obligations should be normalised and become part of choosing to invest in both generation and retail sectors.

(11) How can liquidity be improved without the costs of the policy increasing significantly? Alternatively, how can costs of the policy be reduced without significantly reducing liquidity?

- VPI would not support changing the duration of windows or diluting MMOs obligations during the windows.
- We have seen no evidence to suggest that costs are disproportionate.

(12) Is there any other relevant stakeholder feedback we haven't captured that we should consider?

- VPI believe that the volume cap and fast market rules are adequate tools to limit obligated party's exposure during certain market conditions.

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I am happy to discuss any of these issues if of help.

Yours sincerely

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