

Minutes of a Market Design Project Steering Group Presentation and Discussion held on 17th August 2006 at City Marketing Suite, Guildhall, London EC2P 2EJ

Attendees:

Accord Energy Ltd - Andy Gardner, Irfan Mannan
APX - Ben Mitchell, Jeremy Hall, Bert den Ouden
Argus Media - Peter Caddy, Nick Heath
British Energy Power and Energy Trading Ltd - Graham Schorfield
CBOT Europe - Cathy Lyall
Dow Jones - Louise Blythe, Ernest Onukogu
EDF Energy - Shanthi Sivananthan
EEX - Mr Hans-Bernd Menzel, Mr Albert Moser
E.ON UK - Tom Sargent
Euronext.LIFFE - Ian Dudden
FOA - Clive Furness, Hugo Jenkins
Heren - Patrick Heren, Glenn Rickson
ICE Futures - Mark Woodward
LCHClearnet - Isabella Kurek-Smith
Nord Pool - Hans Randen, David Whitley
Nymex Europe - Andy Gooch
Platts - William Powell, Vera Blei
Powernext - Philippe Redaelli
RWE Trading GMBH - Paul Beynon

Also present:

Contango Markets Ltd - Sav Kanagasundaram

1. Presentation

Clive Furness introduced the proceedings by asking all delegates to adhere to the Chatham House Rule and not report on the meeting.

Paul Beynon, Chairman of the Power Trading Forum presented the two options for market development of the UK Wholesale Power Market as defined by the Market Design Project Steering Group. See file 'MDP Presentation 17 August' for full presentation.

The presentation covered

- Tackling decline in market liquidity
- Steering Group
- Energy Exchange
 - The Chairman estimated a average day ahead volume of 85 TWh per year
- Spark Spreads
 - CCGTs ~ 19 gigawatts of load
- Options/Shape
 - The Chairman added that pre NETA days it was organisationally different. If there was spare capacity transfers of optionality would have been possible. The pool

provided a robust marginal price to the market for calibration of forward curve for shape and options.

- Reference Price
- Proposed Structures
- Summary
- What We Want From You
- What You Want From Us?
- Next Steps
- Contact

The Chairman stated that the options being presented were subject to internal approval at Managing Director level. In order to keep the project on course the Steering Group required the input of the exchange, clearing house and reference price provider community now, to move to the next stage in reasonable time.

He added that if at the meeting in October of Senior Commercial level contacts agreement was not reached on which reference price should be used; the chosen service provider will have to supply a solution that covers both options.

The Steering Group were interested in stimulating forward liquidity, and the results of the project to date were to construct a platform which had the most chance of doing that.

The Steering Group would be happy with any combination of service providers. The success of the project would come from the provision of services matching the maximum number of criteria.

It was agreed that interested parties from the exchange, clearing house and reference price community should contact the FOA (Paul Beynon, Clive Furness or Sav Kanagasundaram) by 15th September 2006.

2. Question and Answer Session

The Chairman then opened the meeting up to questions from the audience and suggested that they could be addressed to anyone on the MDP Steering Group panel there today.

- If the Group cannot agree on an option could new products just be included into the existing bilateral market?

The Chairman answered that the Group has a strong belief that launching new products on their own will not address the industry's concerns. It may diffuse liquidity further. The market structure as a whole needs to be addressed. The Steering Group agreed that a market oversight committee should include practitioners. This would enable the launch of new products to be by mutual agreement between the exchange and its users.

- What is the driver behind trying to concentrate liquidity?

Reduction of barriers to entry. Central management/ownership and dissemination of data.

Currently the various reference prices do not always agree hence the

desire to make a change/enhance the current process.

- Is it a question of concentrating all liquidity or just attracting sufficient liquidity?

Sufficient liquidity. Providing a prompt platform for matching residual load should encourage forward liquidity by allowing firms to risk manage in forward timescales using standard products.

- Presumably, one of the reasons the market is fragmented is because some people want it to be?

The Chairman agreed that there may be a few who are happy for it to be fragmented but that the fragmentation is harmful to the market. From a pure market design perspective it is the concentration of liquidity and the emergence of a trusted reference price for constructing a financial swap that the Group agrees is required.

- Currently you do not have a crystallization point. You still have not chosen a method. Do you have any more specifics on the chosen mechanism? Secondly, once the crystallization point has been reached i.e. the reference price, what is the timeline?

The Chairman stated that choosing a service provider will help address the timeline. The service provider should be able to manage at least two types of index. The market would decide which was the most appropriate. He wholly agreed that it takes time for any data to build up and therefore for any financial contract to become successful. There is currently no agreed timetable.

It was added that the process would not be dissimilar to the formation of IPE.

- Why don't the Steering Group trust the current reference price?

Any doubt about the transparency or validity of a reference price undermines the market and the Group agree that the current reference price is not robust enough. The Group have talked to end-users about how the data is generated and if it were to be published in the Financial Times (for example) it would be an upgrade – ie transparency is required whichever provider ultimately provides the solution. There is a need to consider what the best environment is to generate liquidity.

At present there are 2-3 indices which do not always agree. Which one should an end-user use? The way to overcome this issue is to have an exchange structure, accountabilities, auditing and proper governance in place.

- Hasn't this been tried before? E.g. the Majorca and Marbella groups?

It has but disparately. The make up of the Steering Group represents 90% of the physical generation capacity in the UK

The Steering Groups discussions have been conducted via the FOA, a properly constituted body without whom the progress so far would not have been achieved.

- What is the spread of underlying prices?

Approximately £35-80 per megawatt hour.

The proposal would provide an opportunity to trade spreads between gas and power. The aim would be to move away from the EFA calendar and towards a normal calendar month which would provide arbitrage opportunities.

- Where do you anticipate there being the greatest surge of volume/liquidity?

A change to the structure should reduce barriers to entry, and should attract more volume from existing traders as well as attracting additional risk capital. A financially settled spark spread contract was agreed to be a huge opportunity for any clearing house.

- Why have you chosen a quarter 1 2007 implementation date?

This is a timeline that needs to be agreed between the market and the chosen service provider. It seems sensible to avoid winter, but the start of clearing could come earlier.

There followed some feedback from the primary futures exchanges as to an estimated 6-28 months that would typically be required for any upgrade/product implementation. The primary futures exchanges commented that they thought that the timelines as stated were not achievable from their point of view. The Steering Group response was that any interested exchange should work with service providers to agree these timescales.

This insight was noted by the Group and the Chairman reiterated the need to begin collecting data as soon as possible. Price history must be available for a reasonable amount of time on any given reference price before companies will feel comfortable trading on them.

The observation was made that experience shows a need for the implementation requirements to be clear. It was agreed by the panel that the issues being aired were useful. One thing that the Group are keen to avoid is requirements 'creep'.

It was observed by a member of the audience that a physical solution could most probably be delivered quickly but that a financial solution would take longer to implement.

- Is a cleared solution for gas contracts required?

The Chairman responded that it may be but that the Group do not have leverage over the gas market but the Steering Group represents a large proportion of the gas market.