

Minutes of a Market Design Project Steering Group Meeting Held on 30th June 2006 at Cass Business School, 106 Bunhill Row, London EC1Y 8TZ

Attendees:

Paul Beynon - Chair
Jon Doughty – Deputy Chair
Paul Finnerty
Mark Fitchett
David Franklin
Alastair Hutson
Irfan Mannan
Iain McIntosh
Tom Sargent
Graham Schorfield
Shanthi Sivananthan
Magnus Walker

Apologies:

Nigel Felgate
Richard Hyde
Nigel Knee
Hugh Mortimer

Also Present:

Dave Carlton
Clive Furness
Sav Kanagasundaram

1. Apologies Apologies were received from Nigel Felgate, Richard Hyde, Nigel Knee and Hugh Mortimer.	
2. Minutes of the last meeting The minutes of the last meeting were agreed.	
3. Discussion of Continuous Workstream paper Jon Doughty presented to the Group the Continuous Workstream paper on how a continuous market could fulfil the criteria considered essential for any reference price. See document 'Continuous sub group paper.doc'. <ul style="list-style-type: none">• The Group discussed and agreed that the compilation of the index would have to be undertaken by a party who did not have a proprietary interest in the data.• A significant outstanding issue that was not covered by the work of the workstream was to approach LEBA to see if they would change their methodology/approach to their index. Clive Furness added that LEBA has legal ownership of the data once the separate components have been sent to them.	

<ul style="list-style-type: none"> • The issue of how to wind shape into a continuous market was discussed as not having been addressed in the paper. A comment was made as to whether the market should be focussing on developing a successful baseload product and then to address shape at a later date. The Chairman commented that, and it was widely agreed that the issue was not how to encourage the forward trading of complex shape, but rather to create a market design that allowed forward trading of simple products, while enabling the trading of residual shape on the prompt. Thus concentrating liquidity. This would replicate other market designs which allowed larger industrials to move away from full requirement contracts. • The investment banks potential role as market makers was discussed. It was remarked that they may only be interested in trading when a stable reference price and platform are in place. • The continuous paper also did not address the issue of options trading which has basically died in the UK. It was felt that shape pricing would allow the transfer of gamma from one player to another in the detail required. • Following a discussion on the optimum size of the window of trading it was agreed unanimously that to remove basis risk (one of the criteria for the market design agreed); all trades would need to go through during the window; and the window should be limited in time to <5mins. 	
<p>4. Discussion of Spark Spread Workstream paper</p> <p>Paul Finnerty joined the meeting</p> <p>Tom Sargent presented the Spark Spread Workstream's paper on how a methodology for creating a physically settled spark spread index under a power auction could be delivered. See document 'Spark Spread Working Group.doc'. He commented that in their discussions it had been assumed that this would be under an auction mechanism.</p> <ul style="list-style-type: none"> • Tom Sargent commented that there were a number of outstanding issues that needed to be investigated in order to take discussions on spark spreads forward. • It was commented on that limited physical players will be trading the product now and that they were not convinced that many more would want to trade a spark spread product. The Chairman and Irfan Mannan commented that out of the proportion of their proprietary trading done now =>70% is spark spread related. If a spark reference was created this should open the UK market to new players, while creating interesting arb opportunities for traders between existing gas and power underlying and the new reference price. • It was commented on that the proposed product would require liquidity to make it work and also a systems commitment. It would allow CCGT owners to manage hourly spark shape in the prompt (and reference was made to last winter where night spark spreads were at -ve £60 but players were unable to transact due to poor liquidity). This ability would bring liquidity into the reference price. It was unanimously agreed that a financially settled spark spread contract would add to liquidity from new entrants. The high correlation between the two products would enable great leverage for spec traders and hedge funds who wished to trade the fundamentals of the UK market. • The Chairman commented that the consensus amongst the Group is that clearing is important and that while clearing power and gas is expensive, clearing the spark spread would not be. 	

<ul style="list-style-type: none"> • It was discussed how such a proposal could be taken to the gas market and it was suggested that the market be approached with a planned roll-out plan which is seamless as per the criteria for any reference price. Such a roll out should address the eventual launch of a dark spread reference price. • It was agreed that the exchange on which the auction is run would provide the reference price. • It was commented on that such a product would need trading commitment to produce. The Chairman agreed and said that it would need wholesale commitment and that he had talked to the banks and the majority of them say they would trade such a product if it existed. • It was commented on the proposal would be a challenge to implement. The continuous option would be evolutionary but the auction would be a big bang. It was agreed that it may take a year of running an auction before its success could be gauged, and enough data was collected. However the lack of a transparent reference price in the UK was agreed to be one reason for the failing UK power traded volumes. • The concern was raised that although if the plan was put into place it would increase liquidity would the calculation not increase the potential for cherry picking. It was remarked that other European markets had teething problems and that these tend to settle within the hour. The Chairman added that an auction is believed to be the most efficient way of capturing the marginal cost. • The query was raised about what would happen if there were no trades during the auction time- in other words due to system issues a “fast market” existed. In these conditions it should be announced as early as possible that the spark part of the auction would be abandoned. It would be the prerogative of the exchange to propose a methodology, and as per the groups earlier criteria the market oversight committee would regulate these events. • The Chairman commented that there has to be a wholesale commitment from the large physical players for such a proposal to work. It was added that what does not exist at the moment is transparency. • The issue of what trading commitment would look like was discussed as was the potential cost commitment. Tom Sargent suggested that while the Group could spend time investigating this perhaps it would be better to approach exchanges first to see if this was at all feasible first. 	
<p>5. Agree approach to take forward</p> <ul style="list-style-type: none"> • The Group agreed that a briefing paper be written that brings all the strands of the proposals together plus a summary of the work undertaken and outcomes of the MDP to date. The document would additionally have questions to consider and point out the risks and issues of each option. Clive Furness agreed to produce the first draft of the document within the next two weeks and then distribute the document for the Groups comments/agreement. • The document would then, it was agreed, be sent to the Senior Commercial contacts at each of the Steering Group member companies in the second week of August. They would be invited to attend a meeting to be arranged for September/October. It was considered imperative that they attend in person. At this meeting the Senior contact will be asked to agree which option to take forward. The Group were asked to provide Sav Kanagasundaram with details of the Senior contact, their PA and also to ensure that they have been briefed to expect a communication from Clive Furness regarding coordinating an invite. 	<p>CF/All</p> <p>CF/SK/All</p>

<ul style="list-style-type: none"> The same document would be put before the exchanges, clearing houses and reference price providers approached in May 2006. They would then be invited to a meeting on the afternoon of 16th August at which the Steering Group would present each proposal to the group and they would be invited to raise questions and issues and consequently tender should they wish to. 	CF/SK
<p>6. Review and discussion of the overall plan/schedule of activities The plan/schedule of activities was not discussed.</p>	
<p>7. AOB</p> <ul style="list-style-type: none"> It was unanimously agreed by all present to invite David Reed back to the Steering Group following his departure from Gaz de France and new role at RWE Npower. Mark Fitchett agreed to approach Gaz de France to investigate whether they would be interested in putting forward another representative for the Steering Group. The Chairman asked for the Groups thoughts on whether as industry representatives they would be interested in drawing up an industry standard agreement on the question of non-carbon emissions trading. Those parties for whom this was considered relevant agreed and the Chairman agreed to email the Group with a proposal for the next steps forward. Shanthi Sivananthan agreed to approach EDFT for an investment bank representative to take part in the discussions. Clive Furness to coordinate on behalf of the PTF. 	MF PB/CF
<p>8. Date of Next Meeting</p> <ul style="list-style-type: none"> The Chairman suggested that a face to face meeting of the PTC be arranged over the next few weeks. Clive Furness and Sav Kanagasundaram to coordinate. The next face to face meeting of the MDP Steering Group to be arranged for Wednesday 16th August with an invite to the exchanges, clearing houses and reference price providers that were approached in May to attend in the afternoon for a presentation by the Group on the two possible approaches to new market design. Clive Furness and Sav Kanagasundaram to coordinate. Clive Furness/Sav Kanagasundaram to coordinate a meeting of Senior Commercial contacts for the MDP member companies for September/October. 	CF/SK CF/SK CF/SK