

Energy Balancing Credit Committee Meeting 06 February 2009

held via teleconference

Participants

Joint Office

(Non voting)

John Bradley (JB) Chair
Lorna Dupont (LD) Secretary

Shippers

| | |
|---------------------------------------|---------------------------------|
| Gavin Ferguson (GF) | Centrica |
| David Trevallion (DT) (Non Voting) | Scottish and Southern Energy |
| Julie McNay (JM) | Scottish and Southern Energy |
| Simon Howe (SH) | RWE |
| Richard Fairholme (RF) | E.ON |
| Brett Date (BD) | Statoil (UK) |

xoserve

(Non Voting)

Mark Cockayne (MC)
Lorraine O'Shaughnessy (LO)

Apologies

Gary Russell (GR) Corona Energy

1. Introduction

JB welcomed the members to the meeting, which was quorate.

2. Minutes from the Previous Meeting

The minutes from the previous meeting held on 23 January 2009 were approved.

3. Actions Update

EBC11/03: xoserve (MC) to Draft a Modification Proposal to address the identified exposure from Users who are traders at the NBP.

Update: Development deferred, awaiting Ofgem's decisions on Modifications 0233 and 0235. **Action carried forward**

EBC 01/01: Ensure that the correct ratings are established for the Rating Comparison Table.

Update: Covered under agenda item 5. **Action closed**

EBC 02/01: Investigate the relevance of BSC rules to situations similar to the default of Lehman's Brothers.

Update: MC had reviewed Sections M and N of the BSC but had not identified anything that was of benefit or that would add more clarity; the gas arrangements appeared to be more robust than the electricity arrangements. RF reported that E.ON was part of a working group looking at comparisons of the BSC and the UNC and he agreed to report back any developments to the EBCC. **Action closed.**

Action EBC 01/02: Report on developments from the BSC/UNC comparison working group.

4. Operational Update

MC advised that the figures were not yet ready and the report would be issued before the scheduled next meeting. An interim meeting may be called to discuss if deemed appropriate.

5. Potential Changes to Energy Balancing Credit (EBCC) Rules

A draft copy the amended EBCC Rules had been circulated for members' initial review prior to the meeting. The document was then reviewed and discussed in detail and the amendments were accepted with the following further revisions being agreed:

Under Section 2.2:

The term "Aggregate Limit" to be defined, in the first instance.

All references to "Financial Institute" to be replaced with "financial institution".

Under Section 2.2a

Ratings Comparison Table

MC reported that this had been discussed with Moody's and Standard and Poor's, and there was a reluctance to provide comparisons. MC had researched and compared descriptions from both websites, together with the Banker's Almanac referenced by SH, and had found many similarities, and it was therefore proposed to publish the Banker's Almanac table. However, this would have an impact on Users as a number of the currently 'acceptable' financial institutions would then fall below the accepted ratings. An Aggregate Limit has to be speedily agreed and incorporate in the rules to avoid further exposures, bearing in mind that the market is continually changing and the 'pool' of acceptable financial institutions is shrinking. There were three significant questions to which answers needed to be agreed:

- Was the Banker's Almanac table an acceptable substitute?
- At what level should the Aggregate Limit be set, bearing in mind the impact it would have on Users who may have to seek new Letters of Credit?
- Was it correct to limit acceptable financial institutions to those with Standard and Poor's ratings of AA- or above, or should we introduce a lower tier of A+ so spreading the risk?

There was a brief discussion. It was noted that since September 2008 sixteen financial institutions had been downgraded in some way, and that a rating of A+ or above was acceptable but scaleback would increase the financial exposure to each company. BD agreed that some sort of tiered approach may be acceptable. JM pointed out that the nationalisation of some of the financial institutions may make some organisations more acceptable in terms of risk despite their apparent rating, rather than continue to downgrade their level of acceptability and thereby exclude them from the 'pool'. This was considered but there was concern that the EBCC may be elevating their judgement over and above that of the accepted ratings sources, and that serious 'runs' on financial institutions were by no means unlikely in the foreseeable future.

JM agreed that A+ was acceptable and that the ratings should be revised to that extent, although the Banker's Almanac suggests that rating may not be acceptable. It was her belief that this rating provided a sufficiently secure and robust level of cover for the industry.

The members agreed that if A1 (Moody's) and A+ (Standard and Poor's) was acceptable this would increase the number of financial institutions available. For the top tier an Aggregate Limit of £62 million (which would provide 20% headroom) was proposed. MC would be calculating a consistent limit for the lower tier and including this in the rules which would be circulated shortly for approval..

Action EBC 02/02: xoserve to circulate by email a final draft of the Energy Balancing Rules for EBCC members' approval. Members to respond by return.

Members agreed to respond by return as soon as the email was received.

The table would be revised according to the discussion and the columns headed 'Outlook' would also be removed.

Questions and Answers

The following changes to the draft previously circulated were agreed:

Q1: "What happens in the event an Aggregate Limit is exceeded?"

Replace "...can not be exceeded" with "...may not be exceeded".

Q2: "How often is the Aggregate Limits reviewed?"

Replace "... will be reviewed daily ..." with "... will be reviewed at least annually ..."

Q3: "What happens in the event where a Financial Institute has been downgraded?"

There was a short discussion. JM asked how the scaling back of an Aggregate Limit would actually work, and MC explained the renewal process. If there was more than one User affected, simultaneous scaling back would be preferable, and if all Users were affected then all should be scaled back by the same percentage. An explanation of how this would be applied/worked might need to be included in the rules, or perhaps on a briefing sheet for members. JM wondered if proportionate scaling back was the right thing to do as it would undoubtedly increase the administrative workload.

MC agreed that an explanation of how it would be reduced for Users should be included in the Rules. The administration involved would be quite significant but this was necessary in order to be equitable for all parties. The time period needed to be stated for scaling back, ie 30 calendar days; it was important that it should be very clear in order to avoid creating potential Cash Call situations, and to avoid the risk of a financial institution failing and the associated exposure.

The time period was discussed and the meeting unanimously agreed to the inclusion of 30 calendar days' notice.

Q4: "What course of action needs to be taken by the User(s) affected where a Financial Institution has been downgraded?"

An example scenario was described, and it was questioned whether it would be worth maintaining a list of 'acceptable' financial institutions to help parties who had to seek alternative or additional providers. MC advised that xoserve would first need to seek a legal view on the provision of such a list and the publication of any associated percentage numbers; it may be possible to provide a list on an individual basis, eg by email, to the affected User.

Action EBC 03/02: xoserve to investigate the possibility of providing and/or publishing on its website a list of 'acceptable' financial institutions together with a percentage figure for headroom.

The wording of paragraph 2 was then discussed, and the following changes were agreed:

"However in the event that a downgrade is below Moody's A3 or Standard and Poor's equivalent BBB+ **A-**, the User will be notified by **tele**phone,

email and by post that the User's ~~Security~~ **Secured Credit** Limit will be set to zero and **exposure will be managed by** the Cash Call Process ~~will drive any indebtedness which exceeds the User's credit limit.~~ The User shall put additional security in place as soon as possible.

Q5: "What happens if the User has not put in place alternative Security within 30 days of notification of the downgrade?"

The wording was discussed, and the following changes were agreed:

"If the User has not provided an alternative form of Security within the 30 days notice given, the User's ~~Security~~ **Secured Credit** Limit will be set to zero. The User will be contacted by phone, email and writing to advise that this has action has been taken and the **exposure will be managed by** the Cash Call Process ~~will drive any indebtedness which exceeds the User's credit limit.~~"

Q6: "What happens if the alternative Financial Institute provided. Exceeds the Aggregate Limit?"

MC pointed out that Users were capable of increasing their Letter of Credit without telling xoserve they had done so, and this had to be managed. Renewals and new Users would have to be managed proactively, on a 'first come, first served' basis.

This was briefly discussed and the meeting unanimously agreed that it should be specified that instances would be dealt with on a 'first come, first served' basis.

Q7: "Can Security be lodged with more than one Financial Institute?"

Replace "...the maximum Aggregate Exposure" with ".....the Aggregate Limit.....".

Following the review of Section 2.2 a, the members agreed that the Question and Answer format was helpful, and no additional Questions and Answers were seen to be required.

It was agreed that email approval would be requested once the revised rules had been circulated. The normal notice period for changes would be waived.

MC confirmed that the EBCC Rules had been amended this month, following the implementation of Modification 0234.

MC then raised a further issue. It had been identified that although there was a specified obligation to provide a maximum level of Security, no such obligation had been specified in respect of the provision of a minimum level of Security. This could cause problems when a User wished to exit the market as an exiting User may wish to have in place as little security as possible. It would be prudent to revisit the Rules and formally specify that all Users have an obligation to post a minimum level of security to support/cover the level of trading activities in which they had been engaged/continue to participate in.

MC asked if a minimum value was acceptable. The TSC was thought to include something like this, in thousands and by generation unit. DT advised that in the TSC the minimum was set at £30,000 or €50,000; there was no minimum in the BSC.

It was then agreed that an appropriate obligation should be included in the Rules.

Action EBC 04/02: Revise the rules to include an obligation on Users to provide a minimum level of security.

6. Current and Potential UNC Modification Proposals

MC reported that, pending resolution of Proposal 0233, no further work had been carried out on the draft Proposal put forward by GR at a previous meeting.

Modification Proposal 0235

MC had been in discussion with Claire Thorneywork (National Grid NTS) to try and address the legal text issues, and an approach had been agreed that could be worked through with Richard Riley (National Grid Legal Team) and RF, and then taken forward.

SH commented that he had received representations from a party (unnamed) that made clear its disappointment with the length of time that it took to produce the legal text for Modification Proposal 0235. MC responded that it was proving to be a very complicated and time consuming task for all involved, including those parties who were greatly experienced in the area. JB suggested that perhaps SH would like to advise the unknown party to approach a member of the UNC Modification Panel, should their level of dissatisfaction increase to a point of gravest concern.

Consent to Modify CO26

JB reported that Ofgem had agreed to the change requested in CO26, which related to a change to a reference in UNC TPD Section X. The EBCC Rules (page 30) would be adjusted accordingly.

7. Any Other Business

It was agreed that there would probably be no reason to meet specifically to discuss the Operational Report, although a teleconference could be called at short notice to discuss any urgent matters arising if necessary

JB reminded members that the UNC Panel had requested to EBCC to meet prior to any Variation to Proposal 0233 being raised. It was agreed that a teleconference could be called at short notice to discuss any such variation and the associated text.

8. Next Meeting

The next meeting will be held via teleconference at 10:30 on Friday 20 February 2009.

Action Log – Energy Balancing Credit Committee: 06 February 2009

| Action Ref | Meeting Date(s) | Minute Ref | Action | Owner | Status Update |
|------------|-----------------|------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------------------------------------------------------------|
| EBC 11/03 | 21/11/08 | 7 | Draft a Modification Proposal to address the identified exposure from Users who are traders at the NBP. | xoserve (MC) | To follow decision on recent UNC Proposals Carried Forward |
| EBC 01/01 | 23/01/09 | 5 | Ensure that the correct ratings are established for the Rating Comparison Table. | xoserve (MC) and RWE (SH) | See 5 above Closed |
| EBC 02/01 | 23/01/09 | 6 | Investigate the relevance of BSC rules to situations similar to the default of Lehman's Brothers. | xoserve (MC) | Closed |
| EBC 01/02 | 06/02/09 | 3 | Report on developments from the BSC/UNC comparison working group. | E.ON (RF) | |
| EBC 02/02 | 06/02/09 | 5 | xoserve to circulate by email a final draft of the Energy Balancing Rules for EBCC members' approval. Members to respond by return. | xoserve (MC) and Members | |
| EBC 03/02 | 06/02/09 | 5 | xoserve to investigate the possibility of providing and/or publishing on its website a list of 'acceptable' financial institutions together with a percentage figure for headroom. | xoserve (MC) | |
| EBC 04/02 | 06/02/09 | 5 | Revise the rules to include an obligation on Users to provide a minimum level of security. | xoserve (MC) | |