

Energy Balancing Credit Committee Minutes

Friday 28 September 2012

31 Homer Road, Solihull B91 3LT

Participants

Joint Office (Non voting)

Bob Fletcher (BF) Chair
Lorna Dupont (LD) Secretary

Shippers (Voting)

David Trevallion (DT)
Gavin Ferguson (GF)
Richard Fairholme (RF)

Xoserve (Non voting)

Mark Cockayne (MC)
Loraine O'Shaughnessy (LO)
Sam Moody (SM)

Observers

Chris Wright (CW)
Claire Thorneywork (CT)

Ofgem Representative

Apologies

Adhir Ramdarshan
John Costa
Jon Wisdom
David Holland

1. Introduction

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

Members were happy to welcome CW and CT as Observers for the Significant Code Review section of the meeting. BF advised that Dimuthu Wijetunga would join the EBCC and replace Jon Wisdom from 01 October.

MC advised he would arrange an induction for the new Member for 2012/13.

2. Significant Code Review (SCR) Update.

CW and CT discussed concerns on impacts of SCR to members as follows:-

It was CW's perception that the SCR was likely to have some impacts on the area of credit, and he was concerned that the significance of these might not have been sufficiently recognised and considered, as Ofgem's assessment appeared to be silent in this area. He then gave an overview of his concerns regarding £20 per therm and the perceived increase in risk and incremental exposure, believing that the requirement to compensate customers and residual smearing may cause some difficulties and have the unintended effect of pushing some Shippers into bankruptcy. This posed other questions - Was National Grid exposed to this? Would the Market Operator underwrite trades,

and to what extent? What sort of liquidity might be seen?

Reference was made to the last gas emergency event – a Gas Balancing Alert (GBA) in 2010, and it was suggested this might be looked at in terms of the new proposals to see what effects might have been produced in that scenario. There was a brief discussion and MC recalled that 6 Shippers would have been cashed out that day (3 having insufficient credit); most were long as expected; 6 would have been cash called. At the time there were no major concerns regarding the levels of security and this was shared with Ofgem. CT observed that perhaps now it would need to include consideration of the exposure of 'long' Shippers who would be picking up exposure costs, ie relative indebtedness. GF and MC agreed that exposure was there and required consideration; socialisation costs get smeared back over the next few months. It would not be accounted for in the current exposure. It would be imprudent not to track this – effect on multiple parties over a period of time? GF suggested the other 3 Shippers might also have been cash called because their credit funds were short?

CW then referred to Winter 2005/06 which he believed was the closest that the industry came in recent years to disconnecting firm customers. CT and CW suggested that perhaps EBCC would consider replaying this to see the effects under the new proposals, as this was a long duration experience and could provide the closest corollary to what would have to be dealt with.

Observing that 2 Shippers exited the market during that event, MC thought that this could be reviewed to see what might happen. He added that some small Users are not 'balancing savvy' and others for various reasons prefer to be cashed out by the market.

Notwithstanding the fact that the EBCC has a fair amount of discretion on whether to take action or not, it was noted that the EBCC Rules prevent the taking of 'earlier' action, and it was commented that the Rules as they stand could contribute to a ripple effect of failure. MC explained what picture could be gained from the system and acknowledged that sometimes the EBCC could be prevented from taking action because of the rules that were in place. The credit rules could be changed by the EBCC, but the UNC also exercises governance in this area and this particular issue may fall under its remit. Under the UNC as drafted there was a window of 10 days where the EBCC was unable to act, and this has a knock-on effect. GF added that 'big' numbers can be carried through for quite a long period of time and this creates uncertainty for companies. Commenting that a better idea of true exposure could only be gained by taking all offline and doing manually, MC believed that it would be a struggle to do this with big numbers and in an appropriate timescale.

CT suggested mitigating the level of risk by reducing the timescales; MC responded that this first required a better understanding. Special measures may have to be initiated as a fall back; by the time a party is insolvent it is too late, as the industry is exposed to costs before then. CT added that there needs to be an awareness that Shippers who are

keeping the industry afloat at such times will also be impacted by any defaults.

CT indicated that there was an element of wider frustration that under the SCR consultation potential credit issues were not being properly described and understood, and it was suggested that EBCC might be instrumental in considering and highlighting any cause for concern by providing a response to the current consultation. There was to be a Workshop on 08 October 2012 and the consultation closes on 24 October 2012.

What might be included in a potential response was discussed. CW referred to the target price issue – the effect it has on prices before it gets to emergency - we do not know what the price is or the likelihood of failure – in the new world it would be different – it could be any winter when the position begins to get tight - it could be routine to see distortion in prices.

There may be cash out/back issues in the winter for some parties; there does seem to be an increase in the risk of failure for some parties.

GF commented that parties balancing out of the system seems bizarre to those who do not; '£20 a therm' issues left to the community is not a good result.

'Barriers to entry' was considered. CW observed that Ofgem supports the creation of appropriate market entry, as opposed to an inappropriate market entry by responsible parties who cannot manage behaviours.

RF suggested scenarios should be discussed and what actions the EBCC could take should be considered.

MC pointed out that the economic climate has changed significantly; 186 banks have been downgraded since May. Parties are trying to respond to that and it is increasingly difficult for parties to go to banks to adjust their requirements. GF observed that unusual circumstances might require very difficult decisions to be made by EBCC, and multiple parties might have to go although as an industry we make every attempt to support parties as far as possible, we must not make 'negligent' decisions. Different information might be required to demonstrate sound decision making in such circumstances.

GF believed that an EBCC response to the consultation would be in order and that it should make clear the perceived issues that exist. What might be included in the response was discussed.

CT suggested that it should make clear concerns regarding the increase in level of risk of exposure to the industry, and that it might require a change to the relative indebtedness rules to be able to strengthen the position rather than contribute to any inherent weaknesses. GF added that attention might need to be drawn to the fact that the EBCC does not have the flexibility that common perception believes to be within its power; it has a one-sided discretion *not* to act. The issues identified may exaggerate deficiencies that exist at the moment without giving the EBCC the proper tools or mechanisms with which it can appropriately react and address to safeguard the industry.

CW believed other impacts/exposures might surface which will need to be addressed. MC explained some areas which immediately sprang to his mind, and there was a brief discussion of potential effects, eg massive imbalances, cash out and neutrality.

CT suggested that in the response it would be useful to include the figures involved wherever possible.

GF observed that APX would have to put up a lot of money for the community and this could be difficult.

It was suggested that Xoserve draft a response that expresses the EBCC's concerns. This could be reviewed before formal submission.

New Action EBC 0901: Xoserve to draft a response to the SCR consultation that expresses the EBCC's concerns and circulate to EBCC Members for review/comments before formal submission.

Should a UNC modification evolve from this then it would have to be sponsored by an industry party other than Xoserve. MC believed that any such modification would require system development.

RF sounded a note of caution whereby the perception may be that the situation under discussion may never arise and any pre-emptive solution may therefore just be causing extra cost to the industry. An alternative may be to develop separate rules to invoke and enact in times of emergency. MC believed that if this were proposed then very close consideration would need to be given to the effects of suspending normal rules/operations, and other risks.

In consideration of a potential modification being required, CW pointed out that it would need to demonstrate that any proposal for change is proportionate to any risk imposed on the community. Responding to CW's question on what might be the increase in exposure, MC suggested that some analysis could be attempted. The levels of Security currently required are based on a Peak Day; increasing this still further would be a significant issue for parties and may provide a barrier to entry for small parties.

DT referred to liquidity frailty and believed the market would go straight to the £20 cut off point on the day.

To help parties enter/exit the market would create massive issues either way; numerous terminations would be a major problem on many levels. CW added that he intends to draw attention to SCR concerns at the next Transmission Workgroup (04 October 2012) to highlight awareness to a wider audience.

CW and CT left the meeting and the Operational Meeting continued as normal.

3. Minutes and Actions from the Previous Meeting

3.1 Minutes

The minutes of the previous meeting were approved.

3.2 Actions

EBC 0701 - MC to re open discussions with the TSO with a view to getting a deposit deed put in place.

Update: MC confirmed that a meeting had been arranged for 04 October 2012.

DT reported that the Market Operator APX was looking to split its business and separate the gas and power sides. Some parties confirmed they had already received an advance communication relating to this. MC noted this and will check the APX website for further information and will also raise this point in the October meeting.

Closed

EBC 0702 – SM to publish an amended final version of the EBCR by 01 August with an implementation of 01 October 2012.

Update: SM confirmed that a final version of the EBCR has been published. **Closed**

4. Operational Update

LO provided the following Operational update for July and August 2012.

4.1 Cash Call Notices

During July there were 2 Cash Call Notices issued and 2 were paid on time.

During August there were 4 Cash Call Notices issued, 1 was appealed and withdrawn, and 3 were paid on time.

4.2 Further Security Requests (FSRs)

No FSRs were issued during July 2012.

Two Further Security Requests were issued during August 2012, one of which was resolved by the provision of a revised Letter of Credit that satisfied requirements.

4.3 Settlement

The following performance was reported:

| Month | Payment Due Date | Payment Due Date +2 |
|-------------------|------------------|---------------------|
| July 2012 | 100% | 100% |
| August 2012 | 100% | 100% |
| Rolling 12 Months | 99.31% | 100% |

GF commented that the statistics/performance looked very good.

5. Modifications

An update was given on the status of the modifications of interest to the EBCC. Of particular note were:

5.1 Modifications 0395 and 0398 - Limitation on Retrospective Invoicing and Invoice Correction

BF reported that Ofgem had advised that a document relating to these modifications would be issued next week.

5.2 Modification 0410 0410A - Responsibility for gas off-taken at Unregistered Sites following New Network Connections

This modification proposed the concept of a 'neutrality pot' and raised issues of which party might own/manage such a 'pot'. The modification indicated National Grid NTS. The proposer, in discussion at the Workgroup, had suggested that something along the lines of an ESCROW account could be set up to hold any monies until distributed. MC briefly explained what might be involved in attempting to fulfil this concept and pointed out the setting up of anything like this would probably incur significant cost. GF suggested that members should raise their concerns by making representation.

5.3 Modification 0429 - Customer Settlement Error Claims Process

As was pointed out at the previous meeting, this modification highlights an inequity between the Limitations Act and UNC. Shippers were exposed to claims from consumers for a minimum of 6 years after their discovery but they have no redress under UNC due to the 'line in the sand', which was currently 5 years. Modifications 0395 and 0398 are proposing to reduce 'the line in sand', and this modification is seeking to extend it. Members raised concern regarding the fact that it appears to be a one sided modification and will affect both market entrants and those who wish to exit the market. Due to the proposed smear based upon current month neutrality. GF again suggested that members should make representation in respect of both Modifications 0410 and 0429. .

5.4 Draft Modification

Xoserve had identified some inconsistencies that needed to be addressed, regarding the smearing of recovered debt pre Code Cut Off Date and in TPD Section X4. These were currently under discussion with National Grid NTS.

6. Winter Planning

A presentation had been provided in respect of Winter Operations 2012/13, which Members were encouraged to read. Attention was drawn to the section 'Energy Supply Company Special Administration Rules'. Comments should be forwarded to Xoserve.

7. F1 Aggregate Limit/Ratings Update

SM reported that a number of financial institutions currently providing Security for energy balancing purposes have been downgraded by Moody's. Standard & Poors have yet to undertake a review and this is expected to follow a similar trend. Some Eurozone institutions are on 'negative' watch; events are being monitored and a watching brief maintained. Using a proactive/timely approach to advise/remind companies to review their arrangements has produced good results. MC commented that the actions taken prior to December seem to have been proved the right ones to take.

8. Energy Balancing Credit Rules

A new draft had been published; no comments received to date. RF suggested that a formal communication should be issued to advise parties that the new version had been published.

New Action EBC 0902: SM to publish Notification of revised EBCR to Operational Contacts

9. Deposit Deed - Update

SM gave a breakdown of the current position. There was a positive trend in favour of these as Parties were beginning to recognise the benefits of putting a Deposit Deed in place rather than using a Letter of Credit (LOC). LO was reviewing current provision and whether replacement deeds were required.

DT reported that the requirement to have 2 signatures appended to a LOC had been questioned. MC responded that the 2 signature had been adopted as best practice and was a requirement in the Credit Rules, though there was not a legal requirement and one was sufficient from a legal perspective.

10. Risk Register

MC gave a brief overview and will maintain visibility of how the Gemini re-platforming may affect the Credit Team. UAT (system integrative testing and gas Day testing, etc) was progressing very well. GF expressed concerns regarding contingency arrangements, and would like assurance in respect of failure, ie parallel platform, workaround arrangements, etc. If the EBCC were unable to access the data it requires for its decision making purposes what would its course of action then be? MC understood the concerns regarding re-platforming and explained what was being done.

New Action EBC 0903 GF reiterated he would like a plan to be in place in the event that the changeover was not successful. MC noted these concerns and would discuss the EBCC perspective with the Project Team.

Lehman's - Update

MC reported that the sale of the claim that was due to go ahead in August has been delayed. The second disbursement is expected in the week commencing 01 October 2012 for approximately 4% of the value of the debt.

11. Any Other Business

11.1 European Update

Xoserve has asked to be included in the National Grid NTS Workshops, to contribute from an EBCC and operational perspective. It will assess any impacts and issues and maintain a watching brief, updating the EBCC as appropriate. It had been requested to provide information on how the EBCC works to European forum, and had received welcome feedback that EBCC is the best practice in Europe.

11.2 Business Continuity Planning (BCP)

Loss of Banking System Credit or Debit Payments

Following recent events relating to system failures in the banking industry, an issue had been identified – What happens in the event of a system failure of a Bank?

This was briefly discussed. It was proposed to put procedures in place to manage a situation where such a failure caused transaction payments to fail to be processed.

GF observed that having interest paid is fairly low down on the list – cash flow was far more important to organisations affected. DT commented that it could be a problem where a Shipper's bank was unable to formally confirm that a Shipper's payment had been processed. Any form of communication purporting to confirm the position would require authentication, and how would this be acceptably verified? What demonstration of proof would EBCC require of the affected party? How would EBCC assess what action to take/not take and establish a sound position in respect of any 'unpaid invoice' in such circumstances?

MC gave an overview of the proposed processes that might be followed should there be a loss of banking system Credit or Debit payments, and these were discussed.

It was suggested that normal rules and processes should apply, and that an EBCC meeting should be convened to assess, discuss and review the issue, should it arise.

Risk Management – Barclays

It was noted that the community has a high risk exposure to any potential negative events that may affect Barclays, and a review was being undertaken with NG Treasury and Barclays regarding the possibility of moving part of the community banking arrangements, thereby spreading the risk. Further research was being undertaken to assure the best outcome.

11.3 Cross Industry Credit

MC gave an overview of the six key considerations that had emanated from an exploration of cross industry credit options with Elexon. These were briefly discussed. It was noted there was no equivalent to the EBCC in the electricity industry, and the BSC Panel encompassed the role. It was observed that the BSC was not composed of credit experts.

There was no appetite for examining the use of insurance rather than credit methods.

11.4 Holiday/Absence Notifications – EBCC Members

LOC reminded Members to provide details of their holiday/absence dates to Xoserve.

12. Date of Next Meeting

The next EBCC meeting will take place via teleconference on Friday 26 October 2012 at 10.30.

Action Log – Energy Balancing Credit Committee

| Action Ref | Meeting Date(s) | Minute Ref | Action | Owner | Status Update |
|------------|-----------------|------------|--|--------------|---------------|
| EBC 0701 | 27/07/12 | 4.4 | Re open discussions with the TSO with a view to getting a deposit deed put in place. | Xoserve (MC) | Closed |
| EBC 0702 | 27/07/12 | 7.0 | Published the amended final version of the EBCR by 01 August with an implementation of 01 October 2012. | Xoserve (SM) | Closed |
| EBC 0901 | 28/09/12 | 2 | <i>SCR Consultation</i> - Xoserve to draft a response to the SCR consultation that expresses the EBCC's concerns and circulate to EBCC Members for review/comments before formal submission. | Xoserve (MC) | Pending |

| Action Ref | Meeting Date(s) | Minute Ref | Action | Owner | Status Update |
|------------|-----------------|------------|---|---------------|---------------|
| EBC 0902 | 28/9/12 | 8 | Publish EBCR to Operational Contacts. | Xoserve (SM) | Pending |
| EBC 0903 | 28/9/12 | 10 | MC to discuss concerns raised by EBCC members | Xoserve (MCO) | Pending |