
UNC Workgroup 0555R Minutes
Review of the Market Operator (OCM) Provision
Friday 30 October 2015
31 Homer Road, Solihull B91 3LT

Attendees

| | | |
|-----------------------------|-------|--------------------------|
| Les Jenkins (Chair) | (LJ) | Joint Office |
| Mike Berrisford (Secretary) | (MB) | Joint Office |
| Adam Lane | (AL) | Centrica |
| Antoine Devilliers* | (AD) | PEGAS |
| Charles Ruffell | (CR) | (RWEST) |
| Darren Lond | (DL) | National Grid NTS |
| Debra Hawkin | (DH) | TPA Solutions |
| Egbert-Jan Schutte-Hiemstra | (EJS) | ICE Endex |
| Francisco Goncalvez* | (FG) | Gazprom |
| Gerry Hoggan | (GH) | ScottishPower |
| Graham Jack | (GJ) | Centrica |
| Jeff Chandler* | (JC) | SSE |
| Julie Cox | (JCx) | Energy UK |
| Laura Langbridge | (LL) | National Grid NTS |
| Nick Wye | (NW) | Waters Wye Associates |
| Nigel Sisman | (NS) | Sisman Energy Consulting |
| Sirko Beidatsch* | (SB) | PEGAS |
| Steve Nunnington | (SN) | Xoserve |
| Thomas Farmer | (TF) | Ofgem |
| Wouter de Klein | (WK) | ICE Endex |

* *via teleconference*

Copies of all papers are available at: www.gasgovernance.co.uk/0555/301015

The Workgroup Report is due to be presented at the UNC Modification Panel by 21 April 2016.

1.0 Ofgem Introduction

Opening the meeting, LJ summarised the pertinent aspects of the UNC Modification Rules relating to Requests (paragraph 11)¹ and outlined the proposed approach after which TF gave a brief overview of the 'Ofgem Gas Market Operator arrangements' presentation.

2.0 Outline of Request

The Request proposal aims to understand and develop Stakeholder views on the issues highlighted in Ofgem's Open Letter (12 June 2015) on the Market Operator (OCM – On-the-day Commodity Market) arrangements as detailed in UNC TPD Section D – Operational Balancing and Trading Arrangements, including Annex D1.

3.0 Terms of Reference

¹ A copy of the Modification Rules is available to view and/or download from the Joint Office of Gas Transporters web site at: <http://www.gasgovernance.co.uk/general>

A copy of the Terms of Reference is available to view and/or download from the Joint Office of Gas Transporters web site at: <http://www.gasgovernance.co.uk/0555>.

4.0 Initial Discussion

To commence discussions, LL provided an overview of the National Grid '0555R – Review of the Market Operator (OCM) Provision – Workgroup 1' presentation during which she introduced the Request and explained the aims and scope in more detail.

4.1. Background to the establishment of the OCM and key milestones

Please refer to slides 5, 6 and 7 of the presentation for more details.

4.2. Understanding of issues identified in Ofgem's Open Letter

Please refer to both item 1.0 above, and slides 8, 9 and 10 of the National Grid presentation.

In also looking at the areas to consider (slides 11 through to, and including 14), it was noted that currently the Market Operator Contract does not cover off reporting aspects and that the Workgroup might also wish to consider whether or not there are any financial related impacts that might need addressing. EJS pointed out that for the avoidance of doubt, the monetary value of the ICE contract is zero; it currently generates a revenue of circa £1.75 million p.a. from the OCM operation.

With regards to potential influence of the EU Utilities Contracts Directive (slide 14), it was suggested that it may be prudent to seek a legal view around whether the contract may be in scope.

It was also recognised that, where there is agreement of an impact on obligations (outlined in slides 13 and 14), consideration of the current provisions would be necessary.

A quick review of the process flow (slides 15 and 16) was conducted during which no adverse comments were voiced.

4.3. ICE Endex view of issues identified in Ofgem's Open Letter

EJS provided a brief overview of the ICE 'Introduction OCM – 0555 – Review of the Market Operator (OCM) Provision' presentation and explained that ICE welcomes the review and that the presentation itself focuses on the background to the current regime rather than present a view on what needs to be done.

EJS clarified that the systems supporting the OCM market for physical and locational markets were complex and the revenue generated by other trading activity, most significantly that of 'title' trading fund them.

When asked, EJS confirmed that ICE's appointment to the role was via a tender process and whilst this takes the form of an 'evergreen' appointment, their position is reviewed on a regular basis, most recently in January 2013 when the ownership of the platform changed from APX Endex to Endex Gas Spot Ltd.

In considering the contracts offered for trading on a 24/7 basis, it was explained that this potentially equates to 1,000's of markets and the service provision is underpinned by very complex algorithms and coding. It was noted that adding Demand Side Response aspects had only served to make the calculations more complex in nature. When asked, EJS confirmed that 'physical' had been traded in the past before adding that 'locational' can in certain situations feed in to the cashout price calculations.

In quickly examining the cost reduction benefit of circa £637k, EJS explained that this reflects improvements in both ICE's economies of scale and processes.

4.4. Summary to date of feedback from Stakeholders

DL provided a brief overview of slides 17, 18 and 19 during which an extensive debate was undertaken with the most salient points being captured as follows.

Stakeholder Feedback to date slide

- ICE has recognised that liquidity (volumes) have reduced and has engaged with its customers to seek views.

It is noted that factors such as weather and depletion of the North Sea reserves and a reduction in the number of banks taking part in trading and transfers have impacted liquidity.

Trading via brokers (between 09:00 and 17:00hrs) does impact the within day OCM liquidity position. A reduction of the within day liquidity is a concern, especially the impact on the SAP set position. It is felt that this possibly reflects the better over-the-counter (OTC) price provisions and could be the result of brokers seeking (more) confidence via OTC mechanisms (i.e. their respective benchmarks).

EJS explained the process behind the execution cost analysis, noting that the costs of trading encompass a lot of areas, including market access, clearing and any Independent service providers who may provide aggregation services to a market participant (i.e. an Independent service provider such as Trayport does not provide a complete solution for executing trades) – ICE are looking at options around this for future application.

- Cost of trading needs to be considered, especially when smaller Shippers are impacted / concerned.
- It was acknowledged that recent UNC modifications have been raised to change the market timings for the various processes, for example Mod xxx which brought forward the open of the OCM to 08:00 at D-1.
- Some parties believe that as far as the issue of within day volumes is concerned, the GB market might benefit by following the lead of the Dutch / German / French models and that improvements in the GB (NBP) market liquidity may be forthcoming as a result.
- It was noted that when the OCM was originally set up National Grid utilised the physical gas and that quickly it was the 'title' market which gained liquidity.

Action 0555 1001: PEGAS (AD/SB) to provide a presentation outlining how the equivalent German OCM Model works.

- National Grid confirmed that should a tender exercise be required then there are no plans to deviate from the current service provisions as provided by ICE Endex.
- It was acknowledged that the Workgroup is not looking to redefine the OCM products at this time, although it was felt that obtaining a holistic view of the OCM as a whole along with user behavioural patterns would/could be potentially beneficial.
- EJS felt that even reducing trading costs to zero would not necessarily create liquidity, as it is the impact of the 'human component' that has a significant bearing on the venue used for trading.
- The question as to whether or not National Grid should be able to access liquidity in other markets would be considered in due course.

- It was suggested that it would be prudent to seek to test whether or not the OCM provides a preferable price to any of the alternative mechanisms / options.

4.5 Identification of the first cut of fundamental industry requirements of a balancing exchange market

In considering both the 'Key Issues identified' and 'Risk Definitions' slides (slides 20 and 21 respectively), it was noted that as far as real time cashout prices are concerned, quality and reliability of information are important factors. It was suggested that the Demand Side Response, lessons learnt aspects should be added to the key issues list in due course.

In looking at the likelihood rankings, DL advised that initially, for discussion purposes, these have been compiled on a best guess basis and added that National Grid would welcome feedback on the approach, DL also highlighted that the process was about identifying those risks which the industry really believed were key.

4.6 Identification of the criteria for assessment of potential options against the current state

During examination of slides 22 through to, and including 25, LL provided an explanation behind the analysis and rationale in obtaining the figures.

A brief summary of discussions follows:

Market Liquidity Risks

Some parties questioned whether there was a real OCM liquidity issue to resolve as they believe that the market would naturally monitor the matter and respond accordingly.

In setting the scene and looking to put the proposed scores into perspective, LJ explained that the maximum total risk score would only ever be 25 (based on 5x5), so assessments in the order of 8 are not considered significant.

Risk 1 – during discussion around the proposed total risk score of 8 it was agreed that National Grid and ICE would liaise offline and thereafter provide more meaningful market liquidity evidence, including both a clear definition of 'liquidity' (in this context) and what potential volumes (inc. a summary of residual balancing requirements) are involved, in time for consideration at the next meeting.

Action 0555 1002: National Grid NTS (LL/DL) & ICE (EJS) to look to providing more meaningful market liquidity related evidence, including a clear definition of liquidity, potential volumes involved and a summary of residual balancing requirements.

It was recognised that there has never been a situation where the OCM was left 'dry', and even should this occur, it is expected that National Grid would take the necessary steps to encourage participants to respond.

It was suggested that perhaps a likelihood score of 1 would be more appropriate. It was then suggested that a further review (and subsequent resetting downwards) of the impact score of 4, that has currently been set to reflect potential cashout risks (i.e. price increments of 1p over the monthly neutrality volume), would be advantageous. National Grid agreed to look to providing meaningful supporting cost data including on an annualised basis.

LJ also suggested that as far as R1 was concerned, National Grid would need to state that they have an operational risk, the cost of which is directly related to the mitigating actions they would have to undertake.

Risk 2 – definition will be amended to take into account ICE feedback and additional supporting evidence (and assumptions information) will be provided, similar to the proposed Risk 1 enhancements.

Once again, it was suggested that the likelihood score should be set to 1.

Risk 3 – builds on R1 rather than being solely based on user feedback.

It was also suggested that a lack of market trading could / would impact on this risk and that care would be needed to avoid confusing price with volume related problems. Furthermore, it was suggested that care would be needed to distinguish between operational risks and risks associated to shipper cash flows, therefore those that impact on the function of the commercial regime. In short, R1 relates more closely to an operational style risk, whilst R3 focuses more on the the commercial regime aspects.

Some parties felt that as the 'title market' pretty much manages itself, the issue boils down to the careful assessment of the physical market requirements (i.e. when we use it and why we use it).

It was agreed that further consideration of the OCM title issues and how these affect the 'Impact' score would be needed in due course.

When TF suggested that the Workgroup also needs to consider what would be expected to happen should National Grid need to 'go long' (i.e. in instances where the market becomes dry and National Grid needs to post rather than lift or hit existing bids or offers), some parties felt that if liquidity was not there, then National Grid would have to become 'a price maker' rather than a 'price taker'.

Action 0555 1003: TPA Solutions (DH) to provide evidence in support of the concerns relating to National Grid having a need to 'go long' in the market.

During discussions, some parties voiced concerns that the potential relationship between the first trade undertaken by National Grid and the potential for the OCM to stay static until National Grid actually makes a move. In essence, the concern relates in part, to the fact that the market is not defined by the platform, but rather how participant trade (i.e. their behaviours) – however, some parties believe that in a market setup where there are multiple exchanges but National Grid is restricted to just one, there is more opportunity for participants through their behaviours to leave the OCM until they see National Grid making a trade, and thereafter returning, would be more difficult in a multi market based setup. In the end, the consensus view was that the score for R3 should be less than currently predicted.

It was noted that PEGAS provide a Trading Alert Report to its customers.

Consensus was that the total risk score for R3 should be amended to 4.

Real time cash out prices

R4 – National Grid perceives this as the biggest value risk (i.e. uncertainty driving market clearing volatility related risk(s)) as it is related to the timing of calculations and publication of information. It was suggested that this is a complex risk.

During the discussion, PEGAS outlined their obligations around providing market information and added that they believe that either exchange (ICE or PEGAS) would / should be able to provide near real time information. Responding, EJS pointed out that previously companies had requested provision of real time information before going on to suggest that a better understanding around how

SAP is calculated would be needed before committing to a more markets based approach – it was suggested that Shippers should consider the risk in more detail.

Summarising, LJ suggested that R4 is really a multiple market aggregation and information publication related issue. Some parties suggested that there might be value in consideration of the frequencies associated with the risk (i.e. is this a day-to-day related type of risk).

The consensus amongst those in attendance was that R4 is currently the most important risk and that it would be beneficial if National Grid undertook more work around the impact and likelihood assessment aspects, with a view to providing more supporting evidence at the next meeting.

It was then agreed that this risk should be split into two parts – part 4a (related to longer times to publish information) and part 4b (how often any delays would potentially impact the market) with supporting evidence around assumptions provided.

Trading costs

R5 – related to initial and trading fee related sign up matters.

It was suggested that the impact score might need to be set higher to take into account the fact that this relates to the provision of technology – possibly adopting a similar score to R1.

Some parties feel that this is a positive market consideration based around the introduction of more markets. LJ also suggested that the Workgroup would need to consider the potential impacts on the smaller market participants before settling on an appropriate impact score. It was noted that PEGAS already has a small participants introductory package.

The consensus was that a new Risk 6 should be added to cover ‘Level playing field across multiple markets’ aspects.

Concluding, DL advised that National Grid would welcome any further feedback on the risk statement assessments prior to the next workgroup.

WG2 process flow – slide 25

It was agreed to revisit this process flow map at the beginning of the next meeting and once amendment of the risk assessments had been undertaken by National Grid.

Action 0555 1004: National Grid NTS (LL/DL) to provide a breakdown of their scoring, including any assumptions made.

Action 0555 1005: National Grid NTS (LL/DL) to update the risk assessment.

5.0 Next Steps

When asked, those in attendance agreed to review the proposed schedule in more detail at the 27 November 2015 meeting.

The next meeting will consider the following areas:

- Consider the revised risk assessment
- Consideration of potential risk mitigation options / solutions (including prioritisation).
 - PEGAS to outline their views on mitigation actions
- Agreement of preferred mitigation actions (and potential routes to deliver them)
- Review progress against the Scope of the Request

Meeting papers and action updates should be provided to the Joint Office by 18 November 2015 in preparation for the next meeting.

6.0 Any Other Business

None.

7.0 Diary Planning

Further details of planned meetings are available at: www.gasgovernance.co.uk/Diary

Workgroup meetings will take place as follows:

| Time/Date | Venue | Workgroup Programme |
|--|------------------------------------|--|
| 10:00 Friday 27 November 2015 | 31 Homer Road, Solihull B91 3LT | Agenda items to be discussed: <ul style="list-style-type: none"> • Consider the revised risk assessment • Consideration of potential risk mitigation options / solutions (including prioritisation). <ul style="list-style-type: none"> ○ PEGAS to outline their views on mitigation actions • Agreement of preferred mitigation actions (and potential routes to deliver them) • Review progress against the Scope of the Request |
| 10:00 Monday 21 December 2015 | 31 Homer Road, Solihull B91 3LT | <i>Detail planned agenda items.</i> <ul style="list-style-type: none"> • <i>To be confirmed</i> |
| 10:00 Tuesday 26 January 2016 | 31 Homer Road, Solihull B91 3LT | <i>Detail planned agenda items.</i> <ul style="list-style-type: none"> • <i>To be confirmed</i> |
| 10:00 Wednesday 24 February 2016 | 31 Homer Road, Solihull B91 3LT | <i>Detail planned agenda items.</i> <ul style="list-style-type: none"> • <i>To be confirmed</i> |
| 10:00 Wednesday 30 March 2016 | 31 Homer Road, Solihull B91 3LT | <i>Detail planned agenda items.</i> <ul style="list-style-type: none"> • <i>To be confirmed</i> |

Action Table

| Action Ref | Meeting Date | Minute Ref | Action | Owner | Status Update |
|--------------|--------------|------------|---|---------------------------------------|----------------|
| 0555 1001 | 30/10/15 | 4.4 | To provide a presentation outlining how the equivalent German OCM Model works. | PEGAS (AD/SB) | Pending |
| 0555 1002 | 30/10/15 | 4.6 | To look to providing more meaningful market liquidity related evidence, including a clear definition of liquidity, potential volumes involved and a summary of residual balancing requirements. | National Grid NTS (LL/DL) & ICE (EJS) | Pending |
| 0555 1003 | 30/10/15 | 4.6 | To provide evidence in support of the concerns relating to National Grid having a need to 'go long' in the market. | TPA Solutions (DH) | Pending |
| 0555 1004 | 30/10/15 | 4.6 | To provide a breakdown of their scoring, including any assumptions made. | National Grid NTS (LL/DL) | Pending |
| 0555 1005 | 30/10/15 | 4.6 | To update the risk assessment. | National Grid NTS (LL/DL) | Pending |