Joanna Campbell
Ofgem
9 Millbank
London
SW1P 3GE

Joanna.campbell@ofgem.gov.uk

Due: 11th June 2012

Dear Joanna,

Ref: 52/12 Mitigating network charging volatility arising from the price control settlement

Corona Energy (CE) would like to thank you for the opportunity to respond to your consultation on the volatility of network charges. CE would like to thank Ofgem for responding to the concerns raised by customers, suppliers and shippers over the level of charging volatility. CE believes this consultation is vital to reduce the inequitable burden that network charging volatility places on other industry participants.

CE is an independent supplier, active in the I&C gas market. It is the sole supplier to central government and the largest supplier to the public and not for profit sector.

For the avoidance of doubt CE does not consider the majority of its response to be confidential and we are happy for the non-confidential comments to be shared with other interested parties. CE has included an Appendix II which is considered to be confidential as it contains information which may be of commercial interest to our competitors. CE does not wish for this information to be shared outside of Ofgem without our consent.

As a member of ICoSS, CE has actively participated in the development of Ofgem's RIIO proposals including meeting with all Transporters to input to their business plans. ICoSS used this opportunity with all the networks to highlight pricing volatility, predictability and transparency as the number one issue it wanted to see the networks address in their business plans. ICoSS demonstrated the impact volatility has throughout the supply chain and ultimately on customers. All networks were clearly informed of the impact on risk premiums in fixed price contracts and intra-contract price increases on pass through contracts.

ICoSS also expressed disappointment that the clear commitments to decreasing charging volatility made by the Gas Transporters when introducing the 95% capacity regime appeared

Edward Hyde Building, 38 Clarendon Road, Watford, WD17 1JW tel 08442 64 64 64 fax 08442 25 29 25 email mail@coronaenergy.co.uk www.coronaenergy.co.uk

to have been dropped. Despite this ICoSS offered to work with the transporters to develop proposals to reduce volatility and increase predictability and transparency in transportation charges.

It was frustrating therefore to see very little in the first drafts of the Transporters business plans to address this issue.

CE notes however that following the publication of this consultation some of the Transporters now appear to be working to address a number of the concerns and CE welcomes this proactive approach from some Transporters.

After considering the Options proposed by Ofgem, CE believes that Options 1 to 3 should be implemented immediately. This would immediately provide the benefits to consumers of improved information, improved predictability and reduced volatility. CE believes Options 4 and 5 need further development but also that they would incentivise the Transporters to more reduce volatility and therefore would bring significant benefits to consumers. On balance, CE currently supports the implementation of Options 4 and 5.

One possible solution would be to implement Option 5 with initially wide tolerances with a glide path to tighter tolerances over the 8 year price control period. This would provide an appropriate incentive on the relevant Transporter to ensure they proactively manage volatility relating to charges but would reduce the negative impacts during the initial phase of the controls.

If you would like further information or clarification of this letter or any of the responses attached then please contact Richard Street on his mobile (07920 803271) or email (richard.street@coronaenergy.co.uk) and I will be happy to discuss this in more detail.

Many thanks,

Richard Street
Regulatory Affairs Manager - Corona Energy*
*please note that this letter will not be signed as it has been sent electronically

Appendix I

CHAPTER: Two

Question 2.1: Have we correctly characterised the scope of the problem we are trying to address?

CE believes Ofgem has correctly described the problem. CE notes that the problem not only affects suppliers but also consumers.

CE notes that many I&C sector consumers (including those in the public sector such as schools and hospitals) set an energy budget on an annual basis based on their expected energy costs. While the market provides a mechanism for consumers to fix their energy costs, no such mechanism exists for transportation costs. As these amounts can be material in the I&C market it is a source of repeated frustration for customers that see their costs increase during this budgetary period.

CE has attempted some analysis on the costs to consumers of funding and managing these transportation price increases but was unable to complete this work in the time provided. It would encourage Ofgem to consider these costs itself during its assessment.

Question 2.2: Are there certain market segments or groups of customers that are particularly affected by charging volatility?

All Customers are affected by charging volatility. For I&C customers, those on a fixed tariff will bear a premium which will be priced according to the likelihood of increase occurring and the suppliers assessment of the likely size of the increase. This estimate will take into account previous increases and the costs of these increases. Customers on pass through contracts have to manage the cash flow risks in their own budgets.

Domestic customers will also be affected. The effects in this market are likely to be more stark at a collective level rather than at an individual level.

Question 2.3: Do you agree with the assessment criteria? Are there additional criteria that we should adopt for our final assessment?

CE has repeatedly requested Transparency, Predictability and Stability in transportation pricing. CE once again notes that the cost of a lack of Transparency, Predictability and Stability in transportation charges on consumers needs to be included.

CHAPTER: Three

Question 3.1: Do you have any further suggestions of what could be done to mitigate network charging volatility arising from the price control settlement?

CE believes that Ofgem's proposals are a reasonable set of Options to consider at this time.
While not affecting the level of charging volatility, CE propose Ofgem include a set of requirements on the network around transparency which includes '**plain** and **intelligible** language' requirements around their descriptions of changes to their charges.

Question 3.2: Do you agree with our initial assessment of each option?

CE generally agrees with Ofgem's assessment of Options 1 to 4. (See later questions for areas where CE believes the assessment could be refined.)

CE disagrees however with Ofgem's conclusion after assessing Option 5. CE recognises the difficulties Option 5 would create and agrees with Ofgem's assessment of the potential negative consequences of its implementation. CE believes however that the costs of volatility on consumers may not be fully understood at this time and therefore the benefits of the implementation of this Option may not have been fully assessed.

CE would support the implementation of Option 5 where analysis demonstrated the benefits would outweigh the costs, or where other options had failed to deliver the promised reduction in volatility.

Specific questions in relation to option 1:

Question 3.3: Do code and licence charge notification differences in each network sector create problems in managing charge changes?

Yes. The largest cost is the complexity this creates in providing customers in different networks with the reasons for the increases. As these reasons are not always clear, this can create a lack of confidence in the consumer in the suppliers and regulators ability to control the Gas Transporters costs.

Question 3.4: What information would you like the network operators to provide, that they currently do not, in order to help improve predictability of network charges for different customer groups? This should include:

a) **what information you would like to see in their business plan submissions, and**
b) **what information you would like to see provided on an ongoing basis.**

Wales & West Utilities April 2012 Updated Business Plan Submission										**Nov '11 B.Plan**
Category	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	**Totals**	Totals
Controllable Opex	90.3	90.3	92.9	95.7	89.4	90.7	91.7	88.3	**729.3**	734.3
Non-Controllable Opex	44.9	44.5	44.1	45.5	45.0	44.6	44.3	37.3	**350.2**	334.8
Total Formula Opex	**135.1**	**134.8**	**137.0**	**141.2**	**134.4**	**135.4**	**136.0**	**125.6**	**1079.5**	**1069.1**
Replacement Costs	95.9	95.6	99.3	97.8	96.8	95.1	92.3	85.7	**758.5**	764.7
Capital Costs	60.8	59.6	46.3	45.7	43.7	41.8	43.8	45.6	**387.4**	414.0
Formula Totex	**291.9**	**289.9**	**282.7**	**284.7**	**275.0**	**272.3**	**272.1**	**256.8**	**2225.4**	**2247.8**
Non Formula Totex	6.5	5.7	4.9	2.6	2.7	2.6	2.6	2.6	**30.2**	30.2
WWU Totex	**298.4**	**295.6**	**287.6**	**287.3**	**277.7**	**274.9**	**274.7**	**259.4**	**2255.6**	**2278.0**
Total Allowed Revenues (£m)	**332.4**	**333.0**	**337.7**	**339.8**	**333.6**	**334.4**	**333.2**	**330.6**	**2674.6**	**2719.5**

CE notes that suppliers and shippers have consistently called for a uniform approach across all Transporters. WWU recently shared with ICoSS a proposal to publish information (above) to aid understanding across the market. ICoSS has requested that WWU to add additional information including: -

1. Providing figures which take into account a view of Inflation and showing the % inflation figure used
2. Showing an indicative utilisation figure (aggregate estimated throughput in energy) for LSP and SSP sites
3. Showing an illustrative ppkWh transportation figure based on Revenue divided by throughput for LSP and SSP sites
4. Contain both original data and revised data

ICoSS has also requested that the table be maintained and be republished on an annual basis or in the event of any material change. The intention would be that the table would always fit on a single A4 piece of paper and would be published with a simple explanation (again on no more than a single A4 page). This explanation would be in clear and intelligible English and would provide the reasons for the change from the previous data.

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Question 3.5: What information do you think we could provide, that the network operators cannot, that would benefit you in terms of improving predictability of network charges?

CE believes Ofgem has a role in ensuring that explanations are clear and that assumptions used by the Networks are reasonable.

Specific questions in relation to option 2:

Question 3.6: In the last five years how frequently have networks introduced intra-year changes? What were the main reasons for these changes?

Data suggests that on average the gas industry has been subject to an average of three changes to transportation charges per year over the last decade.

Question 3.7: Are there any business processes that would mean only allowing one change per year on 1 April would not be feasible?

CE recognises that many industry processes occur at other times of the year (e.g. AQ review, capacity and interruption auctions etc). Despite this CE believes that a universal 1 April change for all Transportation networks would be a welcome improvement in the current process.

CE therefore fully supports Ofgem's proposal for a single change to all Transportation charges on 1 April each year.

Question 3.8: Do you think that there should be exemptions that would allow for changes due to specific events? Do you think these events should include the occurrence of errors when calculating charges or changes to the charging methodologies? Are there any other events that should potentially be exempt?

Having set the principle CE does not believe it is appropriate to provide an exemption regime within the framework to be able to make changes within year. CE notes however that Ofgem could rely on other processes to implement changes in the event of an emergency or where a significant error would disadvantage consumers unfairly.

Perhaps Ofgem could consider an incentive regime on Transporters that paid compensation to consumers where a transporter made a significant error to the unfair, disadvantage of consumers.

Edward Hyde Building, 38 Clarendon Road, Watford, WD17 1JW **tel** 08442 64 64 64 **fax** 08442 25 29 25 **email** mail@coronaenergy.co.uk **www.coronaenergy.co.uk**

Question 3.9: Do you agree with our proposed change to the penalty for over or under recoveries were this option to be implemented?

CE agrees with the concerns that the existing arrangements incentivise intra-year charge changes and would welcome any proposals that avoid this perverse incentive. Rather DWOs should be allowed reasonable costs for small inter-year carry-overs of under/over recovery as CE believes that in many cases this would be to the advantage of the consumer.

Question 3.10: Do you agree with our initial view that there should be a two year lag on adjustments due to the over or under recovery of revenue through the correction factor?

Corona Energy fully supports this proposal and believes it would allow greater predictability of charges over the single year period that most fixed price contract operate and that most I&C (and many domestic) customers budget over.

Question 3.11: Are you aware of any errors that have been made when calculating network charges in sectors other than electricity distribution?

Transportation pricing is so complex and opaque that our teams of analysts would be unable to identify errors without assistance from the Networks.

Question 3.12: Do you think that introducing an additional licence condition to penalise NWOs when they make charge calculation errors is warranted?

Clearly any regime should be proportionate and should avoid penalising non-material errors or errors where consumers have not been unfairly disadvantaged. Conversely it does not appear fair or reasonable that the full costs and impact of a NWO's error lands on the shipper, supplier or consumer.

CE would hope that the introduction of an incentive in this area would ensure that no errors occur.

Specific questions in relation to option 3:

Question 3.13: What do you consider to be an appropriate notice period for changes to allowed revenues?

The answer to this question is dependent on your view of whether the network is principally run for the benefit of consumers or NWO's. Were CE striking a commercial contract with a competitive service provider then it would insist on a one

Edward Hyde Building, 38 Clarendon Road, Watford, WD17 1JW tel 08442 64 64 64 fax 08442 25 29 25 email mail@coronaenergy.co.uk www.coronaenergy.co.uk

year notice period as this would align with the standard year term on fixed price contracts and customer budgetary periods.

Question 3.14: Do you consider there to be any potential exemptions to our proposal to lag all incentive adjustments?

No. CE questions the amount of weakening a lag would create. CE notes that price control periods typically generate considerable response in terms of time and effort from the Networks despite the ‘gains’ being several years in the future.

Not only should the guaranteed nature of the incentives, largely mitigate any theoretical weakening in the positive behaviour by the NWOs but it should encourage them to avoid taking short-term benefits to maximise personal/corporate yearly targets at the expense of long-term economies.

Specific questions in relation to option 4:

Question 3.15: Do you agree or disagree with our initial assessment of whether a lag should be applied to the following uncertainty mechanisms? Please explain your reasoning.

a) indexation
b) pass through costs
c) revenue drivers
d) within period determinations
e) reopeners
f) innovation funding

a) indexation – Transporters have the ability to make reasonable predictions of general inflation and other relevant indexation effects. CE therefore believes that Transporters should be required to make a reasonable attempt to include these in their predictions and to fund/pay interest on any under/over recovery due to their effect.

CE believes that it should be easily achievable to allow the Transporters to use the Office for Budget Responsibility figures plus/minus a tolerance to create an allowable range. Were the actual figures outside this range then the Transporter could ask Ofgem for permission to pass through the costs on an exception basis.

b) pass through costs – Transporters have the ability to make reasonable predictions of pass through costs and, other than those imposed by government and Ofgem, these can be mitigated through commercial agreements. CE therefore believes that Transporters should be required to make a reasonable attempt to include these in

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their predictions and to fund/pay interest on any under/over recovery due to their effect.

c) revenue drivers – CE believes that Ofgem should do further analysis to understand the potential costs and benefits from allowing these to be changed at short notice rather than lagged.

d) within period determinations – CE believes that Ofgem should reconsider its view here as CE believes it has not yet considered the funding costs on suppliers and consumers of funding increases in transportation costs that were not envisaged at the setting of a fixed price contract or at the beginning of a yearly budget.

e) reopeners – CE believes that Ofgem should have the flexibility of making a determination on the appropriateness of lagging during a reopening period. By its very nature a reopener is in response to an unpredicted event and it would appear hasty to decide now on the most appropriate response to an unknown event.

f) innovation funding – CE recognises the desire by the networks to gain funding as soon as possible however it does not believe that the weakening effect mentioned is as significant as presented. Like all funding this would be guaranteed, would return a profit and would be reasonably predictable ensuring the Networks would have adequate appetite to invest.

NB. CE notes that by all measures of investment, NWOs currently receive a much greater profit margin than the I&C gas supplier market. Typically I&C suppliers have years worth of capital tied up in long-term contracts and market positions, yet Ofgem has expressed no concerns on weakening incentives for investment and innovation. This seems at odds with the statements here and with the effort the Networks are making to secure Innovation budgets.

Specific questions in relation to option 5:

Question 3.16: Do you agree or disagree with our initial assessment that the benefits of introducing one of the three options for a cap and collar do not outweigh the drawbacks?

CE has attempted to quantify its costs, the costs of the networks and the costs of the consumer of either removing volatility or letting it remain.

Thus far it has only been able to ascertain its own costs (Appendix II) but has developed a high level methodology for assessing the impact on consumers.

Question 3.17: Do you consider there are any other options for the design of a cap and collar mechanism that we have not considered?

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The high level options considered are a good starting point for any discussions.

Generally CE prefers simple mechanisms as it believes they are easier for consumers to understand and reduce the opportunity for perverse incentives to apply. It does recognise however that more complex caps, collars and mechanisms could be considered. It does not believe however it is profitable to develop any of the models further until a better understanding of the benefits of a cap and collar would add to consumers is developed.

Question 3.18: Do you have any views on whether a cap and collar, if implemented, should be symmetric or asymmetric?

See above

Timing of implementation:

Question 3.19: Do you agree that if changes are needed in the gas distribution or transmission sectors that they should be implemented on 1 April 2013, the start of the next price control period?

We would like to see the proposals implemented asap to give consumers the maximum opportunity to understand the new regime.

Question 3.20: When should we apply any changes to the electricity distribution sector?

We would like to see the proposals implemented asap to give consumers the maximum opportunity to understand the new regime.

Edward Hyde Building, 38 Clarendon Road, Watford, WD17 1JW tel 08442 64 64 64 fax 08442 25 29 25 email mail@coronaenergy.co.uk www.coronaenergy.co.uk