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Joanna Campbell
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Dear Joanna,

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

Due: 11th June 2012

Gazprom Energy (GE) would like to thank you for the opportunity to respond to your consultation. GE welcomes Ofgem's timely consultation on reducing Network charging volatility and believes it is important to address the levels of pricing volatility before entering into the next price control period.

We do not consider our response to be confidential and we are happy for our comments to be shared with other interested parties.

GE operates in the UK Non Domestic Sector as a Gas Supplier and a Gas Shipper. In addition we also operate in the UK Non Domestic Power Market as a Electricity Supplier.

As a member of ICoSS GE has actively participated in the development of Ofgem's RIIO proposals including meeting with Transporters to input to their business plans. During this engagement we reiterated our concern about pricing volatility and the negative effect it has throughout the supply chain and in particular on consumers who suffer the consequences either as a consequence of higher risk premiums on fixed contracts or through direct price increases on pass through contracts.

GE have repeatedly argued for Transparency, Predictability and Stability as the key high level principles for future price controls to reduce, as much as possible, the high levels of volatility we have seen recently.

Based on the significantly higher future funding requirements to support a transition to a low Carbon Economy the need to ensure that appropriate price signals occur in a timely manner is critical to both Suppliers and our Customers to avoid disruption to business and to minimise risk premiums.

	Option	Initial assessment
1	Improved information for suppliers and customers	Reduces risk to suppliers, and reduces risk premium No additional risk for NWOs and low cost Implementation likely to be beneficial
2	Restricting the frequency of intra-year charge changes	Reduces risk to suppliers with limited additional risk for NWOs Implementation likely to be beneficial
3	Increasing the lag on incentive rewards/penalties that networks recover through allowed revenues	Reduces risk to suppliers with limited additional risk for NWOs Implementation likely to be beneficial
4	Increasing the lag on adjustments to allowed revenues from uncertainty mechanisms	Reduces risk to suppliers but at cost of increased risk for NWOs Consider changes on a mechanism-by-mechanism basis
5	Imposing a cap and collar on changes to allowed revenues	Reduces risk to suppliers but potential material additional risk for NWOs Implementation unlikely to be beneficial

In reviewing the proposals from Ofgem and discussing these with our customers we believe **options 1, 2 & 3 should be implemented** to provide improved information and to minimise the within year volatility. However options 1, 2 and 3 do not in themselves incentivise Transporters to change their behavior to reduce volatility and therefore we believe that Options 4 and 5 should also be considered for implementation. Our preferred **solution would be to implement Option 5 as well** to provide an appropriate incentive on the relevant Transporter to ensure they proactively manage volatility relating to charges.

We have set out our specific responses to the questions set out in the consultation in the Appendix set out below. Should you have any questions on our response or would like to meet to discuss our response please don't hesitate to contact me directly

Regards

Steve Mulinganie
Regulation & Compliance Manager

Appendix 1 – Answers to Specific questions set out in the consultation document.

CHAPTER: Two

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

Yes

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

Gazprom Energy (GE) believes all Customers are affected by charging volatility. Those on a fixed tariff will bear a high volatility premium which will calculated according to the estimated high risk of historic pricing uncertainty. While Customers on pass through contracts have to manage the cash flow risks in their own budgets.

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

GE has repeatedly requested Transparency, Predictability and Stability to be at the heart of the Transporters approach.

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?

GE believe Ofgem's proposals to be a robust set of Options to address the issues

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

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

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.

GE would welcome a consistent approach across all Transporters and believe a common format such as that set out below from the WWU, Summary Overview April 2012, would aid understanding across the market. GE through ICoSS has asked for WWU to consider including 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)**
3. **Showing an illustrative ppkWh transportation figure based on Revenue divided by throughput**
4. **Contain both original data and any revised data**

We have also asked that the table be maintained and be republished in the event of any material change so that all market participants will have advanced notice of any material changes which impact on the charging mechanism. The updated table should include the original analysis as well as the proposed revision to enable understanding.

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In publishing the table and maintaining it we have also asked for any updates to be in plain English.

We believe if all Transporters issued a standard table which was then updated with a plain English explanation of any change all market participants would have a clear understanding of any forthcoming changes which materially affect them.

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**

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?

We would welcome any information which would aide us in understanding any proposed changes and which provides us with as much notice as possible of any material changes which would have a direct impact on pricing.

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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?

In the Gas Market changes are generally implemented in April and October

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

We are not aware of any issues

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 we do not believe it is appropriate to provide exemptions to Transporters to be able to make changes within year as this would undermine confidence in the Stability & Predictability of arrangements.

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

We note Ofgem's concerns that the existing arrangements actually incentivises intra-year charge changes and would welcome any proposals that avoid this perverse incentive

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?

We agree that two years is preferential, ie an adjustment for over or under recovery in year t impacts network charges in year t+2. This would both improve Predictability and remove the need to estimate the adjustment when setting charges and true-up later.

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

We have not identified any

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

GE would support the introduction of a Licence condition to incentivise NWO's to minimise the risk of errors and believe this should apply to all NWO's.

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?

GE recognises the benefit of the proposed 2 year lag as it would provide at least 1 years advance notice of any expected change in charges.

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

We have not identified any

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

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?

We believe the benefits of Option 5 outweigh the drawbacks

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?

We have not identified any

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

We have no views

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?

GE agrees with the alignment of the proposals to the start of the next price control period which is less than 10 months from now.

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

GE would like to see proposals implemented ahead of the start of the next price control period as failing to do so would mean having to continue to be exposed to volatility for the next 3 years

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