Good morning Diego,

We as a company have been following closely this review since it was called by the Right Honorable Edward Davey MP. We advise corporates on their energy exposures helping to identify and manage risk actively and providing web tools that can clarify the opaqueness prevalent in the energy markets, particularly in the Power and Gas markets.

The report commissioned by yourselves for the last review published by BDO is extremely detailed and highlights many good initiatives, some which have been implemented already, all helping towards an objective that you, OFGEM and the Minister are targeting for these markets,one of transparency and market force led. that you. However, the conclusions and potential solutions appear to be from a pure accounting point of view. Hence why the conclusions are correct but the remedy is not such an issue as suggested. We at NRGConsulting are all ex-traders and sales people from the power and gas markets. We have traded with these counterparties over the years. Below we briefly outline our remedies to those questions which require inside knowledge of the market and leave the accounting issues to such experts as BDO.

Question 2: Do you have further information on the appropriateness of the companies' transfer pricing policies beyond BDO's detailed findings? Is there more that could be done to provide reassurance in this area? Rebuilding consumer confidence:Improving the transparency of energy company profits

A standard transferable pricing mechanism, ie moving the risk from one entity to another within a company,is a very simplistic basis for operating. It takes no consideration of the market conditions at that moment in time, the size of the trade nor maturity of the deal. It is not a mechanism to move profit offshore as concluded by BDO but can be a way of disguising the true cost to the consumer. The purchasing unit should be seen as a customer and treated in such a way by the central hedging unit of the Energy company. No customer whether internal or external of a bank would agree to a standard spread for everything. There are other ways to execute trades not mentioned in the analysis which could be more cost effective to the purchasing department. The percentage mentioned by BDO seem high but without the exact specific maturity of the trades it is difficult to quantify. Unlike BDO we believe you can quantify this using a web based tool we have designed. British Gas mention they hedge two seasons forward, one of the reasons given for the recent price hike by Ian Peters the MD of British Gas Business, a calculation can be used to proved the appropriate slippage required by the central hedging team.
The complexities of pricing physical contracts with embedded optionality such as swing options, toll agreements, volumetric trades can all be priced and benchmarked on a common basis. External valuations in the Power and Gas market have moved on significantly since the BDO report was published in 2011 and updated more recently.

Question 3: What information could the companies usefully provide on their trading functions that would improve the transparency of the profits in their generation and supply businesses? What are the costs and benefits of including the trading function in companies' Statements? How possible is it to distinguish between trading for hedging and speculative purposes?

Most of the energy companies provide guidance that appears to specific on the hedging practices they employ for this side of the business in their accounts. However, when investigated further hedging policies change from year to year such as the percentage hedged forward. An example is British Gas appear to call the one year forward market very well over the last couple of years. Varying their forward hedged book appropriately.
The trading function must be included in the company statement as a separate entity. It allows external parties to understand the VAR given to these departments which is the basis for understanding the risks they are allowed to undertake in monetary terms.
A first step would be to force them to publish the number of days they exceed this VAR amount either positively or negatively. This is not time consuming as they already have the figures and will reassure the public by giving a very clear picture of the size of the risks the trading businesses of the Big 6 Energy companies. Most Banks publish this figure particularly the US Investment Banks who also

operate in these particular commodity markets. There are other public enhancing measures that could be brought into force.
Differentiating between hedging and speculating - traders at other entities do this all the time. We read the reasons why it would be difficult but the reality is it is more than possible if one or two simple steps were taken.

Question 7: How else could Ofgem or the energy companies themselves improve confidence in the energy markets?

Measures already being taken by yourselves such as, to open up the market to new entrants and less tariffs are a start.
Certain components of the Gas and Power markets are outside the control of the energy companies and OFGEM when these move negatively for the general public this should be communicated better and quicker. The Energy companies have managed to create such a lack of trust and confidence between themselves and the general public that this will take many years to reverse. But again there are measures that can be taken over the next few months which could enhance their standing considerably.However it is much easier to destroy a reputation than build one. We note that this was one of British Gases main objectives in one of their recent company reports.

We believe you have fixed a time-scale for reporting back of the reviews for April 2014 but our experience has shown in recent history that by then a potential opportunity to resolve rising prices for 2014/2015 may have been missed whilst other external factors set to impact these markets could reshape the landscape that making any conclusions partially obsolete.

We at NRGConsulting.eu have experience in challenging Big Utility companies and succeeding where many others have failed. Below is a link showing in more detail a case in Spain.

http://www.icis.com/heren/articles/2013/04/23/9661875/power/edem/spanish-electricity-utilities-could-face-new-domestic-coal-legal-case.html

NRG successfully assessed the Spanish Coal Producers (Carbunión) against Top Spanish Utilities:

Spanish High Court rejected interim legal appeal lodged by the Spanish Utilities according to the order published on April, 30th. Carbunion countered an appeal lodged at Spain's high court from utilities Endesa, Iberdrola and Gas Natural Fenosa to end their obligation to buy domestic coal for electricity generation. NRG provided expert opinion to Carbunion. The obligation of purchasing the coal to the utilities comes from a decree law passed in 2010 forcing utilities with plants able to burn domestic coal to buy this coal for electricity generation on the grounds of security of supply since 2010.

We maybe young but our track record shows that by utilising our experience (we used to trade with these counterparties in the power and gas markets), we understand how they trade in the OTC Energy markets. That knowledge allows us to look for specific information within the mountain of data that the Big 6 Utilities provide and analyse this with our Energy tools to give opinions on the likelihood of different events/scenarios.

Therefore we would welcome the opportunity to elaborate more on our capabilities and how we could work in conjunction with your review team in trying to provide a solution that allows the UK Power and Gas markets to become as transparent and market force led as other energy markets.

Regards

Seamus Hoole

NRG Consulting UK
seamus.hoole@nrgconsulting.eu
07584 678354
www.nrgconsulting.eu/en