Gas Charges Update 2019/20

You may have seen from the latest Corona Energy invoicing that there has been some change in the daily charge costs, and this has raised some questions from customers. In some cases, these changes in the daily charge have been quite significant, and this is a cause for concern for YPO too.

I would like to explain why this has happened, what the ongoing situation is, and what YPO are doing to redeem the situation and limit future exposure for customers.

As previously notified, the gas wholesale market over the course of the last year has exhibited unprecedented volatility and sustained price increases. There are a number of reasons for this, including continued Brexit uncertainty having an effect on the strength of sterling, but the key driver was the ongoing effect of the "Beast from the East" weather event in early 2018, caused by a polar vortex drawing freezing air across Europe from Siberia.

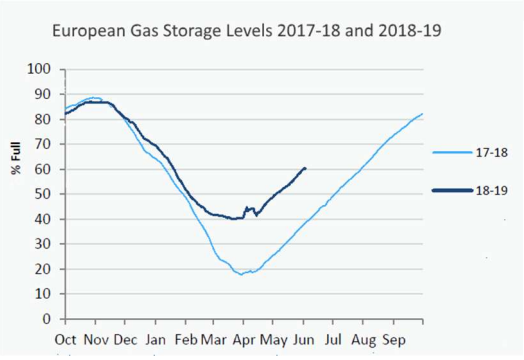
You may recall that this "once in 100 years" cold weather system made the national news as wholesale gas market prices spiked dramatically for a couple of days, and a warning was issued that the UK could risk running out of gas. Mainland Europe and a large part of Asia was affected from January to March, with parts of Germany and Austria buried under 16 feet of snowfall.

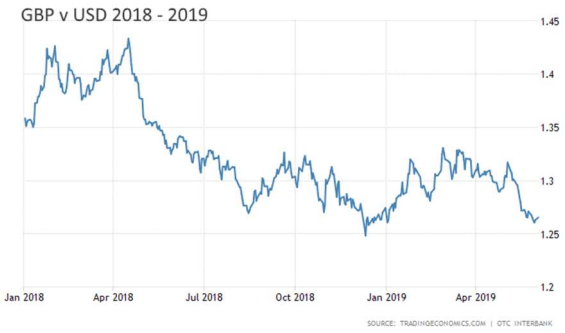
What wasn't reported as widely was how this would bring longer-term impact for gas consumers and drive higher pricing for all customers, irrespective of the supplier.

The demand for gas during this period far outstripped available supply levels and this led to gas storage reserves being used heavily to meet this demand. By the end of the Winter, gas storage levels were severely depleted across the European zone. These stores would need to be replenished in order to provide resilience against further winter demand and shortages.

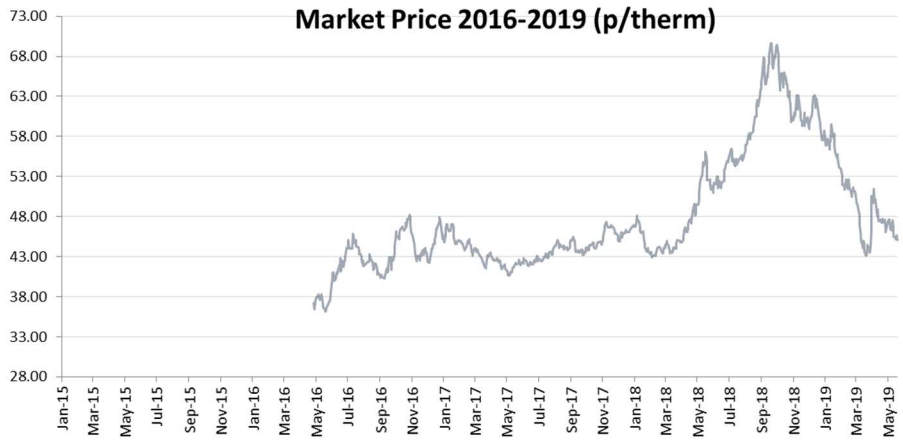
During the summer 2018 trading periods, when pricing is traditionally expected to be advantageous, global demand increased to replenish the storage levels in readiness for the Winter period ahead. Gas pricing rose significantly beyond normal expected levels as demand in the market remained high, and as we moved into the winter period from September onwards pricing in the market rose sharply and remained consistently high when compared to the pricing patterns observed in previous years. Our trading partners in Corona Energy stated recently that they had never seen the gas market behave in such a way, resulting in up to a 15% increase in delivered gas pricing through the flex strategy.

The first chart below shows how European storage levels were affected last year and how they are being managed this year (with over 20% higher stock levels year-on-year which results in lest cost pressure on the forward curve in the wholesale market). The second chart shows the effect of Brexit uncertainty weakening the Pound against the US Dollar across the 2018/19 trading period.





The chart below shows how the market has behaved since the trading period of the current gas framework began. Last year's sustained market increase is clearly evident.



However, YPO's Flex gas strategy also includes a "cash-out" element, meaning that up to 25% of the total basket volume is held over from the previous year's purchases in order to attempt to deliver more value from purchase within the year of delivery. Generally, the market delivers better pricing the closer the commodity is bought to the point of use, so this strategy was introduced 3 years ago to allow YPO to deliver added benefit to customers.

YPO sets a benchmark price for the unbought volume of gas and adds this into the customers' pricing at the start of the year, then aims to beat that benchmark price to deliver added benefit back to customers in the form of a reduction in the following year's pricing.

This strategy has previously worked well, delivering consistent benefit since it was first applied. In 2017/18, for example, this strategy delivered over £1Million worth of savings to customers from a more favourable market, and this completely negated the increase in costs from the UIG (Unidentified Gas) charges. However, for this year, the conditions affecting the market have worked against the strategy.

The benchmark value set for 2018/19 pricing, whilst at a level that appeared to be fair and achievable when compared to trading thresholds in the market in previous years, proved to be too low with the benefit of hindsight. The market rose quickly in summer 2018 and then sustained the high pricing over the Winter 2018 period. This meant that the benchmark pricing fixed in March 2018 for the 2018/19 billing year didn't recover sufficient charges to purchase the cash-out gas volume. As these additional costs weren't finalised until the period end, the total amount to recover wasn't known.

The Flex cash-out requires that any under-recovery of charges are apportioned into the following year's daily fixed charge, based on the quantity of gas consumed by each supply point in the year, known as the Annual Quantity or AQ. This is where the changes to the fixed charge have originated and ensures that only the correct amount of under-recovery of charges is applied to customer bills. Daily charge costs will then revert back to the standard pass through levels in 2020/21.

YPO appreciate that these additional, unplannable costs are of concern to customers, but we would like to give reassurance that YPO and Corona Energy are taking steps to reduce risk of this situation repeating.

We are currently reviewing the trading strategies, with the dual aim of protecting customers from the effects of another severe weather event and also deliver additional value from next year's gas contract pricing. Gas trading into the 2020/21 period is already well underway and is achieving forecast pricing so far that is at least 10% lower than the current commodity costs, and as stated previously the daily charges will revert to the previous pass-through levels next year.

We will also ensure that customers receive regular reports throughout this trading year on the buying performance and forecast pricing to ensure that you are well informed, have more visibility over trading performance and can plan future budgets accordingly from this information. We will also ensure that this reporting includes the cash-out position so this this can be monitored too. We are currently working with Corona to define this reporting, make sure it can be presented in an easy to understand manner, and aim to release updates every two months as a minimum.

I hope this explains the circumstances that contributed to this situation and gives confidence that YPO are committed to minimising future risk from market volatility and working hard to deliver more value to customers.

Rob Clark
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YPO