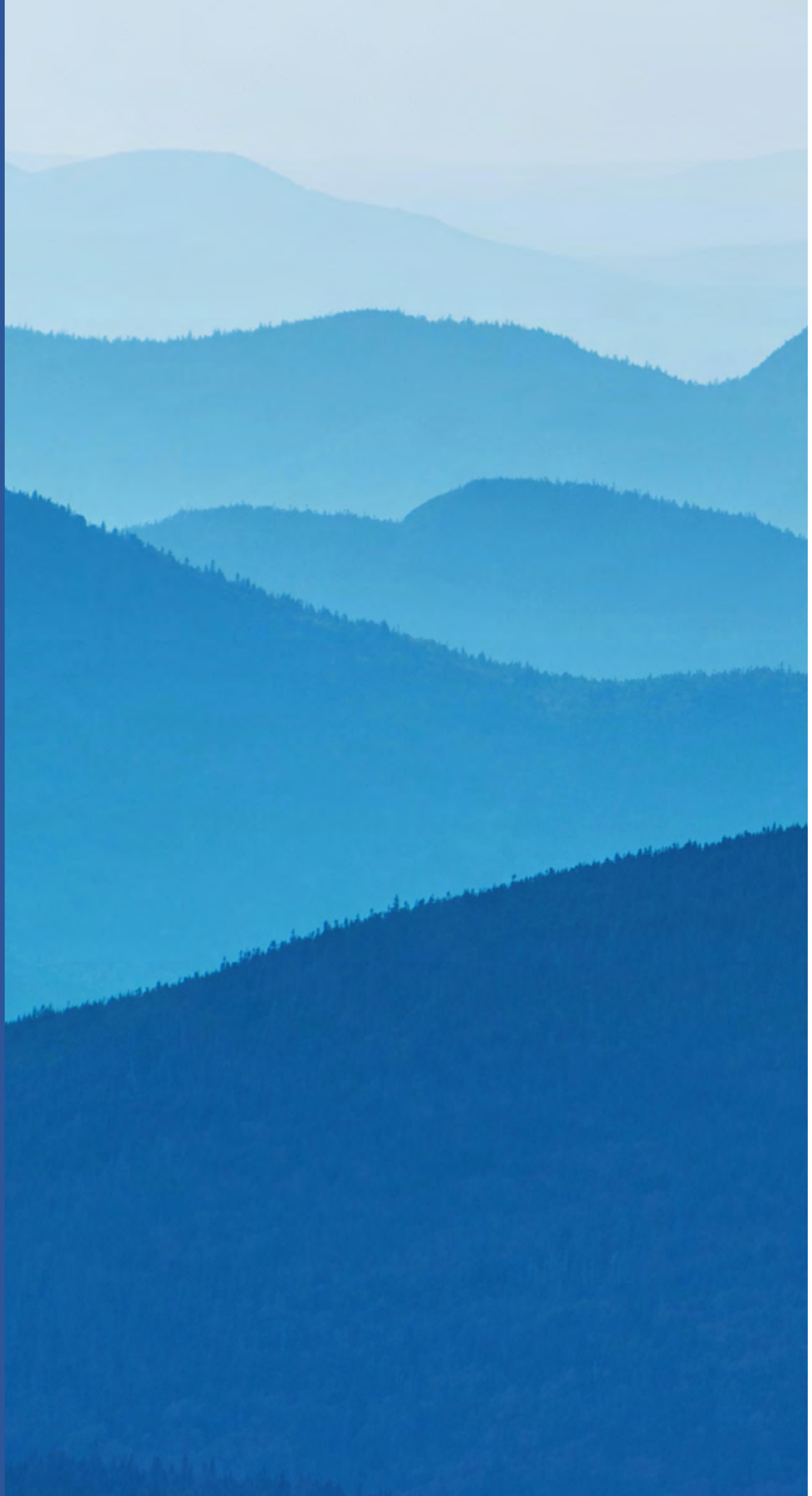
Inenco Insight

December 2021



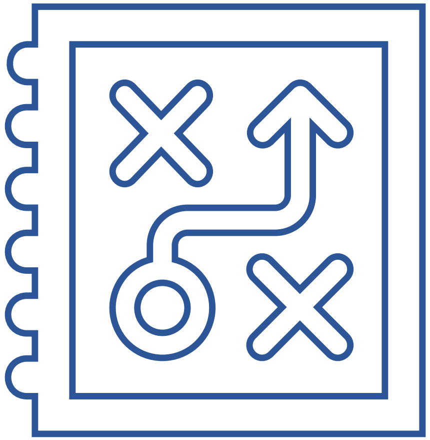
Welcome to the first in our planned regular update on key supplier, market and regulatory news. Our intention is to use this as the vehicle by which to keep you regularly updated and provide the insight you would expect from your energy management and sustainability partner.

Contents

1 The Impact of Rising Unidentified Gas (UIG) Charges

We have seen a significant increase in Unidentified Gas (UIG) charges with rates now 2000% higher than November last year. Due to the mechanism used to define these charges there is a lack of pre-warning and they do form part of billing rates.

Although UIG rates may dip next year they are still likely to remain at historically high levels and may not have been budgeted for – particularly as suppliers can pass through these increases mid-contract and some have started to do so. Below, we explain the background and context in more detail.



The Background

Project Nexus was a large UK Gas industry project that was implemented in 2017. The project replaced the previous central IT system and introduced new read and settlement processes. One of the significant consequential changes was the replacement of the Unallocated Gas (UAG) process with an Unidentified Gas (UIG) process.

The new UIG process was designed with the intention of providing a more accurate view of the volume of unidentified gas. Before Project Nexus implementation, an independent expert calculated, in advance, the volume of unidentified gas for the non-domestic sector using available information. This was then charged out to suppliers in accordance with market share by volume.

Since Nexus implementation the total amount of unidentified gas is derived daily from a formula that subtracts shrinkage, DM (Daily Metered) allocations and Non-Daily Metered (NDN) estimates from the total gas input into the system. The amount of gas that is then "missing" is the Unidentified Gas (UIG) volume.

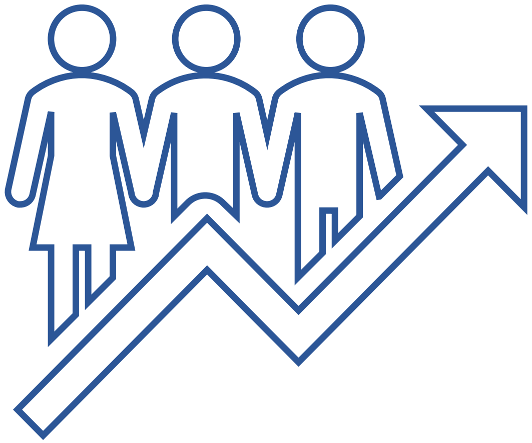
1 The Impact of Rising Unidentified Gas (UIG) Charges (continued)

What has happened?

Since implementation we have seen significantly higher than anticipated levels of UIG across the industry, resulting in a higher charge for which suppliers -and in turn customers need to account. UIG is also unexpectedly volatile which has further compounded the issue.

Shippers and suppliers get very short notice of what the value will be, so use the day ahead and within day market to buy the UIG gas which is needed to ensure the system is balance. If they did not, they would have to pay the relevant SMP (system margin price) price in cash out. The first estimate they get of what it will be is the day before, but it will then change within day as well. When looking forwards at what UIG costs would be, the forward market is the best proxy.

Market Future UIG costs are estimated at the forward priced at the prevailing market price. The market has increased dramatically in the second half of 2021 which means a similar UIG volume would now cost considerably more. Further changes would be dependent on product class and how individual supplier pricing works.



2 Impending Changes to Gas Transportation Charges

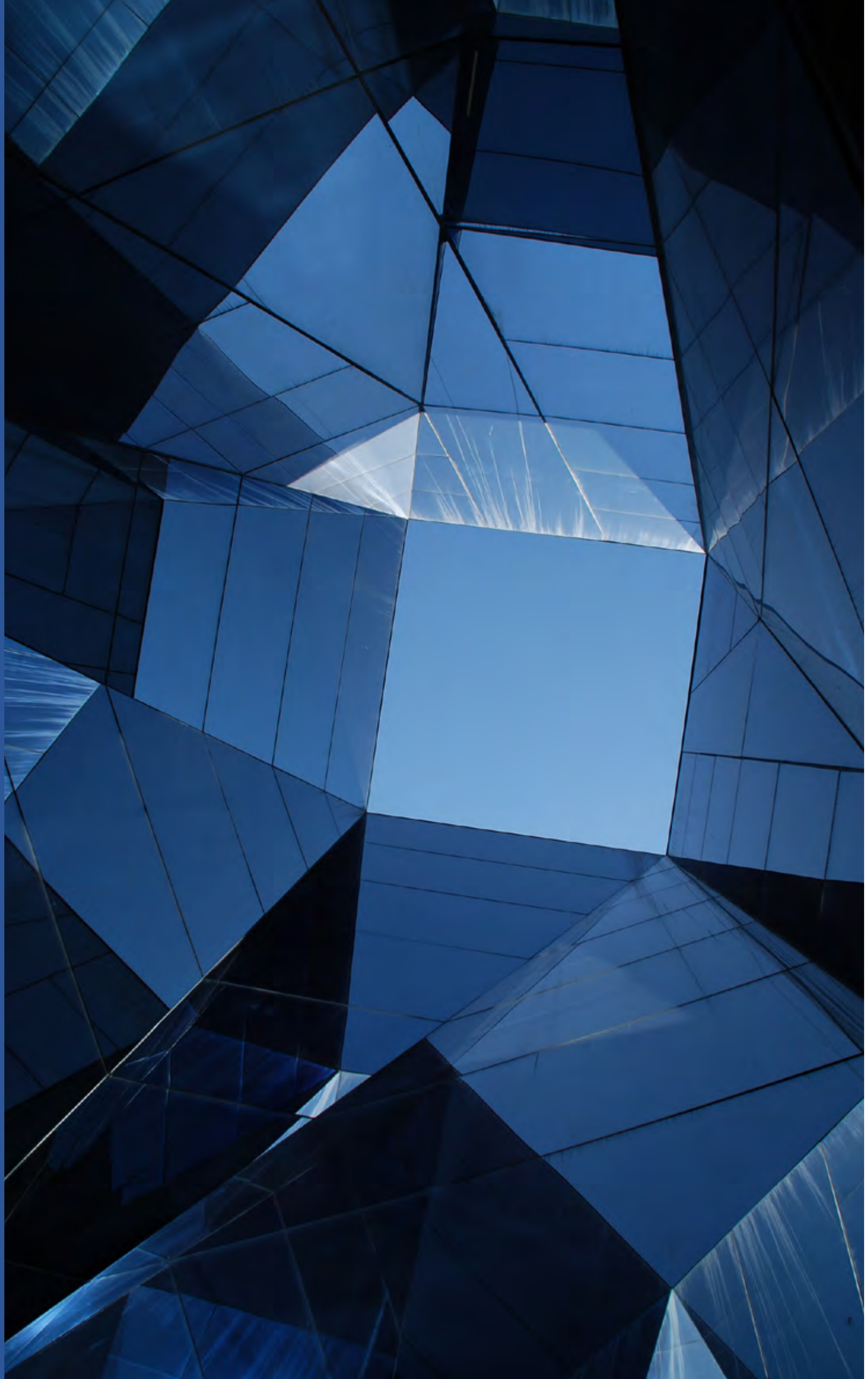
The Indicative April 2022 Gas Transportation charges were published on 1st Nov. These charges make up most of the Gas Standing Charges for each supply. Historically the average April increase for these charges has been similar to inflation rates. But this time we are seeing a very large increase around the country.

See table below:

Network	Indicative Rate Increase
East of England	44.1%
London	39%
North West	40.8%
West Midlands	41.7%
Northern	39.7%
Scotland	39.2%
Southern	33.8%
WWU	29.3%

The Actual Rates will not be finalised until 31 Jan 2022 (60 days' notice), but we believe it is unlikely that these increases will be reduced. Each supplier can deal with these changes in their own way, but they are likely to be passed on to those on flex contracts. Clients that are on fixed rates from 1st Oct 2021 may find that the supplier tries to apply some sort of reconciliation as they seek to recover the monies that will now have to pay out to the Network Operators listed above.

So why is this happening? The vast majority is because of the Supplier of Last Resort (SOLR) issues as so many suppliers have gone into liquidation in the last year. Each of the transportation charge documents we have seen are quoting about 27-30% is because of the impact of SOLR. Other factors are the very high gas costs which have an impact on the "cost" of shrinkage which needs to be recouped.



3 Changes To The Eligible Use of Red Diesel

Last year the Government decided to change some of the eligibility criteria for using Red Diesel and from 1st April 2022 some equipment such as back-up generator and fork lift trucks may be required to pay full duty of any diesel used. In some cases this will require tanks to be flushed to remove traces of the red diesel.

HMRC has prepared some draft guidance that is available here that we would encourage you to read if you think you will be impacted https://www.gov.uk/government/publications/reform-of-red-diesel-entitlements/reform-of-red-diesel-and-other-rebated-fuels-entitlement

We would encourage you to develop a plan to consume their your existing stocks of red diesel prior to next April (unless you are still eligible to use after that date).

4 Time to Prepare for SECR?

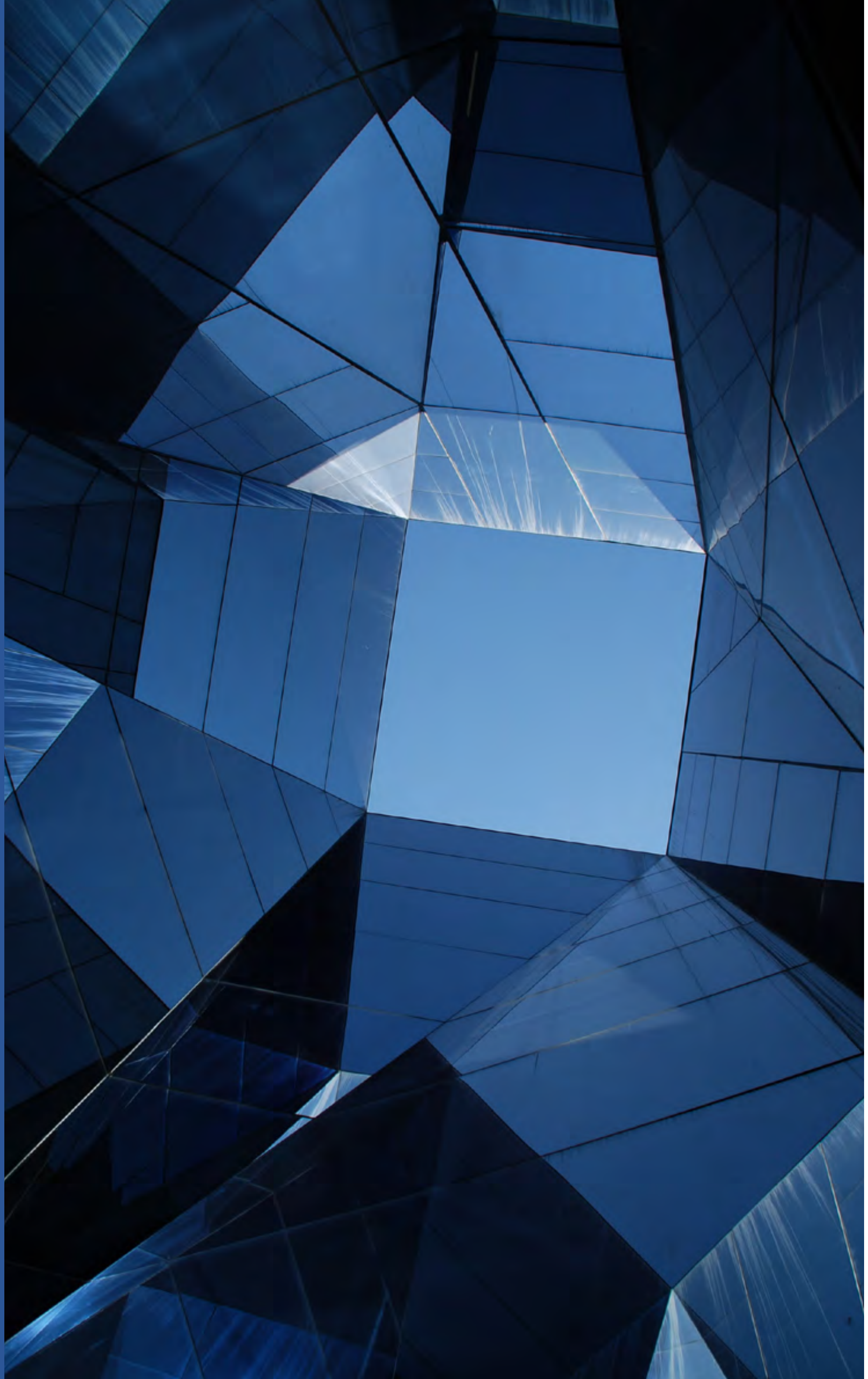
For many organisations their new financial year starts in April and with it the requirement to prepare the mandatory elements of reporting for Annual Reports. We would advise you to get ahead of the curve where possible in collating the required data for your Streamline Energy & Carbon Reporting (SECR. As a brief reminder, SECR has been introduced to make carbon reporting more transparent and to aid the goal of achieving a carbon net zero target and is a legal requirement for all eligible organisations.

Who needs to report?

All quoted UK-incorporated companies on the main market of the London Stock Exchange regardless of Full-Time Equivalents or turnover. If a large non-quoted UK Company or LLP, you must report on SECR if you meet two out of the three specified requirements. The requirements are turnover of £36 million plus, a workforce of 250 people or more, or a balance sheet of £18 million or greater. If you are reporting at group level, you must include any subsidiaries if they meet the criteria. Captured subsidiaries are not required to report in their own annual report if they are included in the group report. Subsidiaries under the threshold can be excluded.

What needs to be reported?

Large UK incorporated unquoted companies & LLPs must submit their energy consumption and emissions arising from UK electricity, gas, and transport. UK incorporated quoted companies must report as above, plus all onsite emissions (e.g., refrigerants, industrial gas emissions, fuel oil, LPG, coal etc) and overseas operations. Finally, organisations must report on the actions they are taking to increase energy efficiency.



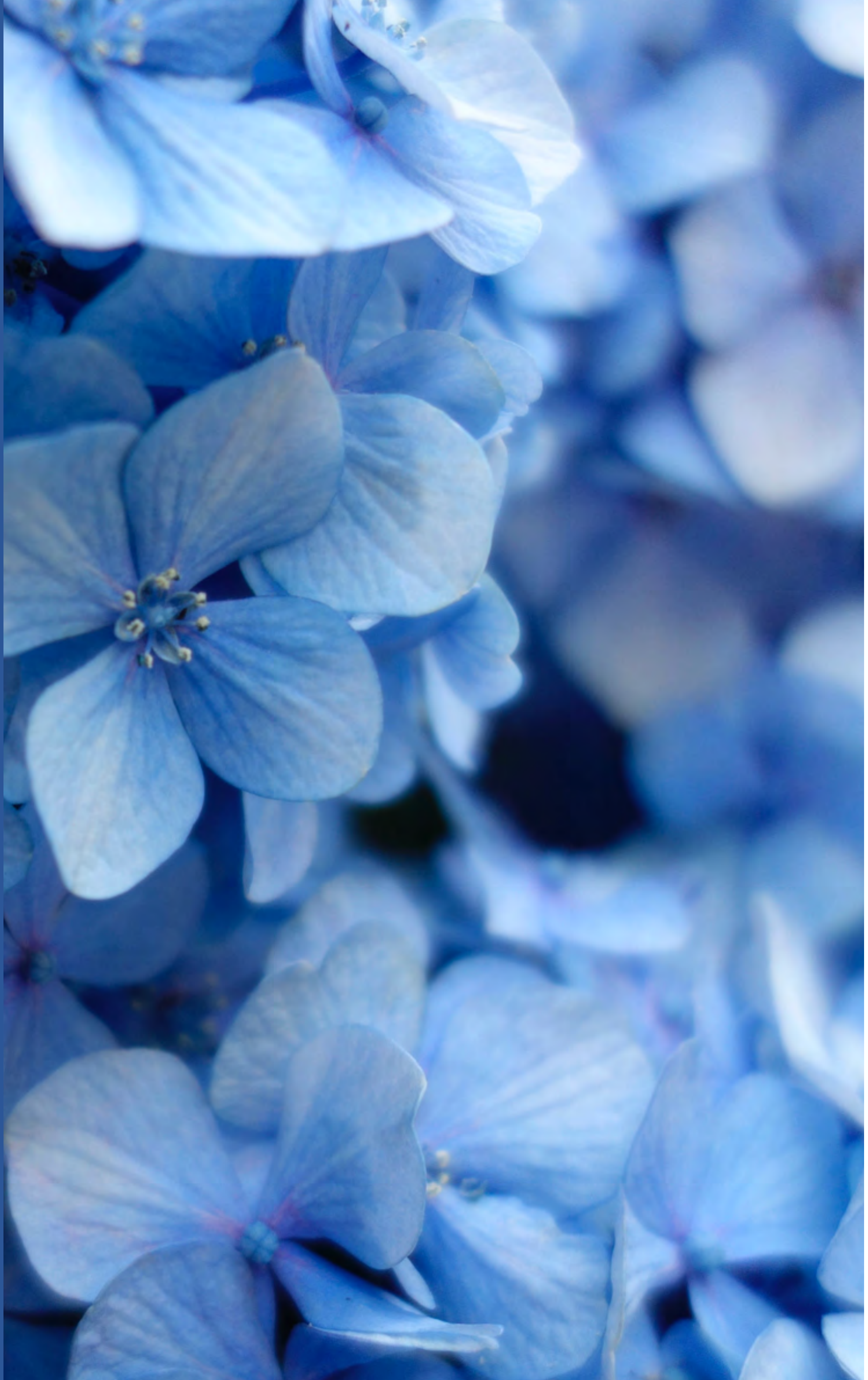
4 Time to Prepare for SECR? (continued)

Benefits & Penalties

By completing SECR you will be lawfully compliant and avoid any unnecessary fines and penalties that come with non-compliance. Completing SECR will contribute to your environmental sustainability policy and provide you with a platform to improve your sustainability credentials. As with most mandatory legal policies, penalties are a given. Penalties can come in the form of fines for late submissions or lack of submission. Further reluctance will result in the organisation being struck off the companies register, resulting in organisational and brand damage.

To find out more please refer to our detail SECR Guide https://www.inenco.com/wp-content/uploads/2021/11/SECR-Pack.pdf

A SECR report may be your first involvement with carbon reporting, and you will find that the level of reporting for carbon or more correctly Green House Gas emissions will increase markedly over the coming years. Inenco has been developing enhancements of the SECR reports to provide you with the necessary services to establish your emissions reduction pathway to NET ZERO and the wider Sustainability challenges.



5 Contracting and Planning Ahead

While it may be of little comfort to those struggling with prices now, the events of the last 18 months have demonstrated the importance of having a proper energy strategy in place. The energy market works in cycles of around five years, so taking the pay-as-you-go approach means you stand to benefit once in five years.

By contrast, those who planned ahead, listened to advice and understood the market and took out a three-to-five-year contract early last year are now not just well insulated against the high prices at the moment, but also paying a record low.

Our Head of Procurement Services, Stuart Lea, recently undertook an extended article with Manufacturing Management to discuss the issues that are equally applicable to other business sectors. Please read more here https://www.manufacturingmanagement.co.uk/features/a-growing-crisis

6 The start of the Triad Season

It's that time of year again when we are now in the midst of the Triad season. Although the triad mechanism is due to disappear from April 2023 – it will remain with us for the next two winters.

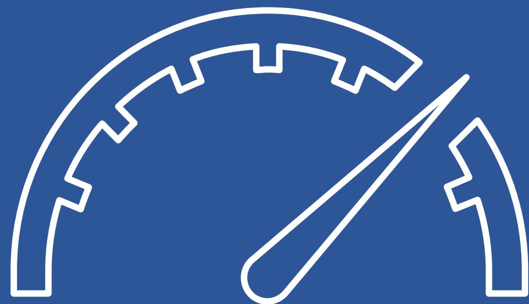
Firstly, a brief reminder of what Triads are – they are the method used to set the price for the amount energy consumers pay for National Grid's TNUoS (Transmission Network Use of System) charges. This charge is based on the average consumption for three half-hourly periods over the winter (hence the term 'Triad') when the transmission network is operating at its highest loads.

The challenge is to try and predict when the Triads will occur and then to take action to reduce demand during those periods. The Triads can only occur between November and February and must be separated by at least 10 days. However, a statistical analysis of previous Triad periods shows that they normally happen between 5pm and 6pm and, most commonly on Mondays and Thursdays in December and January. There are a variety of factors which cause peaks in National Grid demand, such as air temperature, wind speeds, darkness and working patterns for consumers.

How to manage Triads?

Most energy managers will be aware of Triads, how they are calculated and how to manage their energy over the winter period. However, Triads can be unpredictable. Setting up to receive alerts for predicted Triad periods is a good first step to ensure that when a Triad is predicted, all non-essential energy is turned down or turned off completely. For example, a manufacturing company could suspend production, re-arrange the production times, or start a stand-by generator if other options aren't available to them.

If you have a contract with pass through transmission charges, you need to be vigilant when it comes to the Triads this winter season.



6 The start of the Triad Season (continued)

What else to look out for?

Large businesses can be hit by other peak charges which coincide with Triads such as red band DUoS (Distribution Use of System) and Capacity Market charges. These charges are paid by the end user and appear on energy-only contracts listed as itemised charges.

The reason for this is that the distribution network costs and the costs of reserving capacity from power stations are both dependant on peak network demands. The highest demands invariably happen around 4pm to 7pm on weekdays when businesses are still operating, but people are also returning home and switching on appliances such as ovens. The philosophy has therefore been to place the majority of costs onto consumers who use electricity at these times.

To help reduce these costs, load management is key – reducing your load at peak times can help with overall costs. Optimising your available capacity level is another common way of cost reduction, alongside checking your DUoS charges against published rates in order to identify overpayment.

Please do speak to your usual Inenco contacts if you need any more detail on the issues we have covered in this edition or email **enquiries@inenco.com**

Better Business, **Greener World**