

DPCR5 Response
Electricity Distribution
Ofgem
9 Millbank
London SW1P 3GE



04 June 2009

Dear Sirs,

Electricity Distribution Price Control Review - Methodology and Initial Results Paper

Please find to follow the response from Opus Energy Limited to the above proposal. Our response is relating to your two questions below.

Chapter 2: Overview of FBPQ forecasts; Question 1: *What are your views on the DNO cost forecasts presented in this chapter?*

Chapter 10: Managing uncertainty; Question 2: *What risks should be covered by specific mitigation mechanism, by a general type of opener, and which should be left to the DNOs to manage?*

Summary

We are supportive of Ofgem's analysis and critique of the cost forecasts put forward by the DNOs. It is apparent that the DNOs' forecasts are heavily based upon views of economic indices which, due to the turbulence of the UK's economic climate, are now out of date and as a consequence overstate likely increases in costs and the recovery of customer demand.

We also believe that the process has a serious flaw by omitting to regulate how DNOs translate the Allowed Revenue into individual DUOS tariffs.

Along with this response, Opus has provided evidence that over the last DPCR period, the variances in DNOs' individual tariffs from year to year were extremely erratic with revenue recovery wildly swing from one sector of the market to another.

Taking into account the fact that (i) the DPCR process is a rigorous and lengthy examination of forecast costs, and that (ii) the demand split between sectors (ie domestic, SME, Half Hourly) varies only slowly over time, Opus considers this erratic variance in tariffs to be inexplicable and unnecessary. It is highly problematic for independent and new entrant suppliers who will typically offer products to a niche sector of the market (rather than supplying to a portfolio with an industry-average mix of customer types). This is particularly the case for suppliers, such as Opus, who offer services to only the business sector, where customers request contracts with prices fixed across more than one year.

Consequently, Opus proposes that Ofgem imposes an additional regulatory restriction on DNOs that prohibits individual DUOS tariff from varying from one year to the next by more than [X] % of the variance in total Allowed Revenue over the same period.

View on future demand

There is still considerable uncertainty over the timing and extent of recovery and hence we welcome Ofgem's scrutiny of the heavy RPE element of the DNOs' forecasts.

Across the industry, there has been a noted reduction in customer demand, estimated by the National Grid to be have peaked at nearly 6% as a year on year reduction between October 08

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and February 09¹. The data provided by DNOs showing units distributed, and system maximum demand reflect this². We consider that this reduction in demand is being driven by (i) energy efficiency driven demand reduction arising from a growth in environmental concern; (ii) price driven demand reduction following high retail prices throughout 2008 and (iii) recession driven demand reduction arising from decreased business operating activity.

The first of these drivers is likely to continue to reduce customer demand, whilst the second may lead to continued reduced demand if customer behaviour has been permanently changed by 2008's high retail prices. Only energy demand reduced by the third factor (ie recession) will recover to its original levels, and the timing of this will depend on how quickly the economy recovers. The forecasts provided from the majority of DNOs of future units distributed, and of future system maximum demand are optimistic in their view of demand recovery, and hence we consider that they may overstate investment required.

Erratic Duos Tariffs

Opus proposes that Ofgem imposes an additional regulatory restriction on DNOs that prohibits individual DUOS tariff from varying from one year to the next by more than [X] % of the variance in total Allowed Revenue over the same period.

The uncertainty and the related financial risks created by the volatility of DUOS tariffs are unnecessary and apply disproportionate against suppliers operating in a single market sector. In the end the unnecessary volatility of duos charges is detrimental to the customer who wishes to fix his price.

As an example, the table below shows the change year on year of the duos tariff designed to recover revenue from the majority of small business customers (profile 3) in one particular area. Against this is also shown the change in Actual / Forecast Total Cost for the same DNO, provided as part of the FPBQ process. As can be seen, the changes to the DNO's costs, year on year, bear no relation to the variance in charges incurred by Opus.

Comparison of SME Tariff to Cost input to Allowed Revenue for one DNO area

		2005/06	2006/07	2007/08	2008/09	2009/10
Non-Dom UR Tariff for Profile Class 3						
Standing Charge	p/day	21.580	21.660	17.245	17.545	22.092
Unit Rate	p/kWh	1.400	1.410	0.909	0.874	1.271
Annual Cost*	£/Annum	£ 78.77	£ 79.06	£ 62.94	£ 64.04	£ 80.64

% Variance Year on Year

Charge to Opus for Profile 3 SMEs	+0%	-20%	+2%	+26%
DNO's Total Cost (incl RPEs & workforce renewal)^	+4%	+9%	-1%	-0%

*Assumes 15,000 per annum consumption

^Taken from 'Main FPBQ Summary for publishing Final.xls'

As can be seen from the table, this particular tariff (which is used for the bulk of SMEs in this area) changed over a three year period by more than 20% up and 20% down.

¹ NG's Summer Outlook Report (<http://www.nationalgrid.com/uk/Electricity/SYS/sumOutlook>)

² Figures 2.4 and 2.5 of the DPCR5 Methodology and Initial Results Paper

Conclusion

The erratic variances in Duos Tariffs are unnecessary and create disproportionate risks for suppliers operating in a single market sector.

Consequently, Opus proposes that Ofgem imposes an additional regulatory restriction on DNOs that prohibits individual DUOS tariff from varying from one year to the next by more than [X] % of the variance in total Allowed Revenue over the same period.

Yours sincerely,

Louise Boland
Director

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