

Response to the Initial Proposals of DPCR5

IPM Energy Retail Limited Response – 14th September 2009

Introduction

IPM Energy Retail Limited (IPM) is a newly established electricity supplier targeting half hourly metered medium sized Industrial and Commercial customers. The majority owner of IPM is International Power plc (IPR), who are a UK-based FTSE-100 independent power generation company with interests in over 45 power stations and some closely linked businesses around the world. With its partner Mitsui & Co., Ltd of Japan, IPR owns and operates 7% of GB's generating capacity, which represented 5.65% of the market by output in 2008.

IPM welcomes the opportunity to respond to the initial proposal for DPCR5. Distribution charges can represent approximately 25% of the total costs of supply to a half-hourly I&C customer and therefore the uncertainty over tariffs which remains at this late date represents a significant risk to be managed. This uncertainty does not affect all suppliers equally with those suppliers offering standard fixed term and fixed price products, including IPM, being particularly affected.

General overview of the initial proposals

We are encouraged at the wealth of information that has been made available from Ofgem and the logical approach that has been taken to date. As a new entrant to the supply sector we have limited resources and have not built up strong relationships with the DNOs. This has the potential to put us at a disadvantage to the larger players who may be better able to predict the outcome of these processes. We appreciate, therefore, the open approach taken and the provision of detailed information plus the financial model.

Timing of Process

In terms of timing, we have concerns over the release of the final allowable revenues and subsequent DNO tariffs. Half-Hourly customers tend to negotiate contracts at two main periods of the year, April and October. In addition, the majority of potential customers that we encounter want a fully bundled fixed price tariff. They do not understand, or have any desire to try to understand, the risks associated with changes in DUoS charges expecting their supplier to take on this exposure. The publication of tariffs in January 2010 will have precluded suppliers from using actual DUoS tariffs when pricing supply

contracts prior to this date. This late publication causes suppliers to apply a risk premium in tariffs in order to account for the uncertainty for passing through tariff increases to customers. Both of these options are unsatisfactory for customers and economically inefficient; therefore, we would support any steps to remove or reduce this uncertainty. In our view, significant benefit for customers could be achieved if DUoS Tariffs were published earlier and we would propose that DUoS tariffs should be published for at least 18 months into the future.

Magnitude of Tariff Increases

The magnitude of 'Year One' increases for the new price control period compounds the issue of timing. A smaller increase could allow suppliers to absorb costs whereas any significant step change would increase the likelihood of suppliers having to pass through additional costs to customers. Within the "Allowed Revenue and Financial Issues" document views were requested on the most appropriate way to profile revenues. Given the current economic climate we would support the smoothing of revenues to avoid customers seeing a step change in their costs in April 2010. In addition, smoothing of revenue should lead to more stable year-on-year tariffs both within and across price control periods, which should reduce the risk premium included by suppliers in fully bundled tariffs.

On a related matter, the Common Distribution Charging Methodology being led through ENA will also see significant disturbance of tariffs from April 2010. While we understand the desire to ensure charges are cost reflective, we feel that Ofgem should keep in mind some of dual impacts that these combined proposals are likely to have on charges. We would support a cap on the year-on-year increases that can be applied to any customer. This would not only limit the short term impact for customers, but should also reduce the risk premiums applied to future fixed price tariffs since the risk of DUoS charge increases would have an upper bound.

A further issue that impacts the potential year-on-year changes to tariffs is the treatment of any under/over recovery in any year. IPM realises the complicated nature of setting revenues for each control period and would welcome a longer term approach to revenue allocation by adjusting tariffs for any over/under recovery over a longer period of time than simply the following year.

Incentives

IPM supports the use of incentives on DNOs to encourage desired behaviour. We feel that incentives should be put in place but consideration should be given to the impact they have on the predictability of DUoS charge levels. If these incentives result in increased uncertainty they may actually be detrimental to customers since suppliers would need to apply higher risk premiums.

Setting of the WACC

IPM has concerns over the WACC band currently suggested by PwC. The difference between the 5.55% used in the initial proposals and the 3.5% minimum figure equates to a £2.5bn or 11% potential decrease between the initial and final proposals. With no further information available since the initial proposals were published IPM, and indeed other suppliers, may see it appropriate to model in a higher WACC figure in tariffs, which in turn increases the contribution customers will have to pay for this

IPM would welcome Ofgem giving an indication of a more realistic figure to use or the publication of a revised, narrower WACC band. Once again, it is the uncertainty resulting from the process that creates risks for suppliers.

Summary

IPM welcomes the quality of the information that has been provided in the process to date. Tariff uncertainty represents a significant risk; therefore we would encourage the provision of any additional information, before the final revenue allocation is released, that could steer industry assumptions closer to the final version, so as to minimise risk being passed on to customers.

We would strongly encourage steps to be taken to minimise the changes in customer DUoS tariffs in April 2010. Any significant step changes in tariffs could have a negative impact on UK businesses in an already difficult economic climate as well as causing significant issues for small suppliers. In addition, we would support the adoption of longer term approaches that avoid significant year-on-year disturbances in the future. This would reduce the risk associated with forecasting DUoS charges and hence reduce the risk premium that must be included in fixed price fully bundled tariffs.

Stephen Harris

Commercial Manager

DDI: 020 7320 8734

Mob: 07989 492720

Email: stephen.harris@ipmenergyretail.com

Binoy Dharsi

Commercial Analyst

DDI: 020 7320 8709

Mob: 07989 492 445

Email: binoy.dharsi@ipmenergyretail.com