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BY E-MAIL

11th June 2012

Dear Joanna

Mitigating Network Charging Volatility

I am writing on behalf of Contract Natural Gas Limited (CNG), who is retaining me to deal with this matter. Thank you for enabling us to make this response at this time.

CNG is an independent gas-only supplier to the industrial and commercial market. The vast majority of our customer base is small and medium sized enterprises. Like other independent suppliers, we did not start with a significant incumbent customer base have built the business on high quality service and competitive pricing.

Network charging volatility is a major concern and a risk that can at present only be mitigated by including a risk premium in the prices we offer our customers. We therefore strongly support the development of alternative mechanisms to mitigate this risk. We also concur with the conclusion that the critical issue is the predictability of network charges, rather than stability of those charges.

We note that information on future years is published under the current regulatory arrangements, however these arrangements do not require a network operator to make any commitments about charges in future years. As such, the forecasts cannot be applied in pricing models with any level of confidence.

Going forward, we agree that a combination of the options presented will be needed to address this issue – there needs to be both an improvement in information and a rebalancing of risk.

At present it is possible to secure energy prices for up to three years, but we are unable to secure network charges for the same period of time. We appreciate that the network companies face uncertainties, most significantly the volumes delivered over their networks; however the network companies' revenues are secured through the price control arrangements, whereas suppliers have no such certainty.

While there is some use in publishing the information laid out in the consultation document, the key information for customers, and so for us to be able to pass on to customers, is the level of charges and the reasons for the changes in charges. We would propose building on the existing charge publication arrangements so that, as well as publishing the charges for the forthcoming year, indicative charges are publishing for the following year.

Alongside this, we would propose that, to provide the predictability sought, the network operators have a limit on their ability to increase the indicative charges published for the following year. From the data published in chapter 2 of the consultation paper, we would suggest that this limit is set at 3%. For the avoidance of doubt we are not suggesting this is a limit on the change in charges from year to year – network companies could suggest greater changes when first publishing the charges for the following year.

In addition to these measures to improve the predictability of charges, we would propose that the network operators provide a commentary on the changes in charges, identifying the factors contributing to the changes. This should be written with end customers in mind, so that suppliers do not need to interpret the data for their customers.

We are concerned about the proposals to allow changes to charges intra-year. Suppliers have to rely on the accuracy of the charges calculations made by network operators and the consequences of the network operator making an error should be borne by the network operator. Similarly, changes to charge methodologies can be scheduled to co-incide with the beginning of the charging year and should not require an intra-year adjustment. Charge reductions resulting from errors or changes in methodology could be permitted, but any increases must be deferred. To do otherwise would undermine the predictability sought and return the risk of increases in charges to suppliers.

We believe that the argument about increasing the cash-flow risk to network operators is overplayed, when compared with the cash-flow risks experienced by suppliers, and ultimately customers. Regardless of when allowed revenue is recovered, the network operators are monopolies that have assured revenues as a result of each price control settlement. Suppliers and their customers do not have the luxury of this security. The network operators should have a greater incentive to provide predictable charges, so they give due regard to the consequences of changing their charges on the customers who are their ultimate paymasters.

With regard to the lag with which factors are built into charges, we believe that the key point is to place as strong an incentive as possible on the network companies to forecast accurately the future path of charges. Accordingly, we would expect the final impact of incentive rewards, penalties and uncertainty mechanisms to appear in charges at least two years after the events that have created the changes. This does not prevent the network companies taking these factors into account in the meantime, as they can build appropriate forecasts into their charges. The network companies are the most appropriate party to bear these risks, as they have the most information available to them and the ability to mitigate these risks. Network companies that have accurate forecasts will have lower cash-flow risks, while poorer forecasters will incur greater cash-flow risks. We would also suggest that, as part of the information they provide in future, they should make their assumptions public.

We would be happy to discuss these matters further with you.

Yours sincerely

Arthur Probert
c.c. Jacqui Hall, Managing Director, Contract Natural Gas Limited