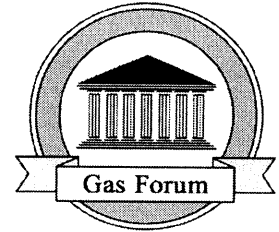


The Gas Forum



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Dear Sir,

Ofgem's three year strategy 2005-8

The Gas Forum welcomes the opportunity to contribute towards the development of Ofgem's next three year strategy and offers the following views in the structure you requested. Naturally, the comments provided relate to the shipper and supplier view of the gas industry.

The Gas Forum has welcomed the use of impact assessments for significant industry changes and supports their continuing development. The introduction of a cost control for Ofgem is also supported as it should reinforce a cost control discipline on the regulator. Many Gas Forum members consider that Ofgem has created difficulties for the industry with many initiatives and consultations overlapping each other. It will be important in the coming years to ensure that projects are better prioritised.

1. Key challenges facing the industry in the short to medium term

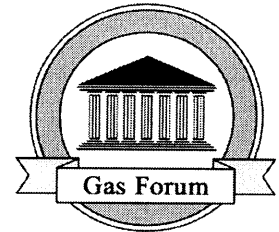
1.1 The most significant challenge faced by the industry is the degree of "churn" and uncertainty arising from the continuing extent and scope of proposed and actual change. Gas Forum members are not resistant to change per se, indeed they foresee the pace continuing into the coming year, however they are very concerned that it should not act to increase the complexity and operational costs of the regime.

In the past year the gas industry has implemented the Reform of Gas Metering Arrangements (RGMA) and been subject to very significant amounts of work on proposed changes such as the potential sale of distribution network businesses and possible reforms in exit, offtake and interruption arrangements. The extent of change is costly to the industry and appears to be crowding out investment decisions that would otherwise be made individually by competing industry participants. When changing gas industry processes, the costs of changing IT systems form a significant proportion of the total costs incurred by shippers and suppliers who are also particularly concerned with the lack of transparent governance of IT changes.

Gas Forum members are concerned that increased complexity, uncertainty and displacement or deferral of investment decisions by individual companies all act to reduce effective competition.

1.2 The Gas Forum agrees that maintaining security of supply is also a key industry challenge in the short to medium term as the UK transforms from being a net gas exporter to a gas importer with the decline of the UKCS. Industry commentators have suggested that supplies may be

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tight especially if there is a very cold winter in the next few years. However we have already seen the industry respond by investing in capital projects to bring in new sources of gas.

2. Action the Authority should take

2.1 The Authority's key task should be to ensure that the principles of Better Regulation are adopted throughout Ofgem. In all cases, Ofgem should ask itself "is this work necessary?" and, if yes, "is it necessary now?". As we set out above, we are concerned that extensive change is undermining effective competition between shippers and suppliers. Ofgem should concentrate on ensuring that it takes action only where necessary. With the market being competitive, Ofgem should allow the industry to take the lead in initiating change and become more reactive, allowing energy markets to be more similar to other competitive markets.

Market participants face many difficulties in combining commercial, technical and regulatory expertise when responding to proposed industry change. Interactions between IT, commercial and regulatory issues at the detailed operational level take time to resolve, so market participants need time before they can accurately respond to Ofgem with an educated estimate of how a proposed change will impact their business. Therefore the Gas Forum calls for Ofgem to take account of concurrent industry developments and increase consultation periods where necessary.

While recognising that such a policy may slow down industry change, the Gas Forum suggests that it would also make future change more equitable. Short timescales for consultation disproportionately impact on smaller market participants, who are not able to justify the amount of regulatory resource required to respond to all developments that may materially impact their organisation. Organisations such as network monopolies and regulatory agencies have greater resources than some commercial organisations operating in a competitive environment. Such organisations may find themselves swamped by the greater resources of participants who may be able to influence the regulatory environment at their expense.

2.2 Gas Forum members are concerned with Ofgem's implied definition of contestable markets, and have noted Ofgem's philosophy that the opening up of contestable markets will always create value in the long term. Market participants see little value created while considerable costs are incurred by market participants as formerly regulated monopolies are opened up to competition.

The introduction of competition or the market mechanism into former monopoly markets is subject to diminishing returns, and may have reached the stage where with current technology further disaggregation of the industry will result in a destruction of value greater than the small potential economic benefits of further competition. The continuation of price-regulated monopoly services, supported by comparative regulation, may be most consistent with an efficient industry design. Ofgem should therefore focus on how it can work to improve the customer experience by facilitating effective competition between suppliers.

2.3 We consider that a stable investment climate is key to ensuring on-going security of supply through diverse sources of gas. We consider the current regime to have robust arrangements in place to deal with any potential difficulties. It is important for the Authority to demonstrate its confidence in the market by allowing it to work. With respect to security of supply issues, we consider that Ofgem should focus on a monitoring role as there is no requirement for it to take further initiatives in this area.

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3. Priority Areas of work for the Authority

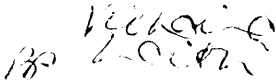
3.1 The priority for the Authority and Ofgem should be to concentrate on areas where ongoing work is necessary (such as price controls), investigating where complaints have been made and deciding on whether to approve (or not) changes proposed by the industry in line with its Gas Act responsibilities.

Provision of a stable, predictable regulatory framework that allows the market to work and to propose change is key. We see little value in continuing to look for ways to reduce the scope of the areas covered by the natural monopolies. These activities are often justified on the grounds that Ofgem wants to withdraw from regulation but we consider that realistic and demonstrable withdrawal means the regulator minimising its own involvement in initiating change.

We would welcome a clearer vision of the direction that the Authority expects the industry to develop and where it considers that it should be taking a lead. It can appear that Ofgem has a view in mind of how it would like areas to develop but there is no overall picture available to the industry.

The Gas Forum would welcome the opportunity to discuss any part of this consultation and looks forward to continuing to work with Ofgem over the coming years.

Yours,



Angela Love
Chair, Gas Forum