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Ms Rachel Fletcher
Consumer Markets
Ofgem
9 Millbank
London SW1P 3GE

Dear Ms Fletcher.

Re:Non-domestic supply market review: consultation.

Until three months ago I had a business advising companies on the purchase of gas and electricity, my clients covered various sectors of industry with both multi site companies on firm supplies contracts and single sites with interruptible contracts. I am no longer in this business as I found it impossible to provide the quality of service my clients deserve.

The reason for this failure is that the gas market has become dominated by a small number of vertically integrated companies who are all using the same pricing mechanism. A similar but less acute phenomenon exists in the electricity market.

Pricing Mechanisms.

Every I&C customer is quoted a price based upon the quoted indices, IPE, Heren or Spectron, as would be expected these indices are virtually identical otherwise there would be significant arbitrage between them.

The use of a single index price by all suppliers is in effect a legalised cartel, the delivered price of gas is built up from the wholesale quoted price at the NBP adjusted for seasonality of usage to which is added the transportation costs (published by NG) and then the quoting company adds a margin for risk premia and administration plus profit. The net effect is that the only significant variable is the wholesale quoted price.

The key issue is that this price is set by a minute volume of trade, every supplier will freely admit that in excess of 70% of all gas delivered into the UK market is bought on fixed price contracts. We then have a marginal quantity of gas which is traded on the market the volume traded falling dramatically as we move further forward from day ahead to week ahead, month ahead and so on. It is the price of this marginal volume of gas which is used to price virtually all I&C contracts.

Whilst it is impossible to prove any market abuse, the opportunity exists as long as, a trade of a mere 25,000 therms in a single position can affect the index price applied to many many I&C contracts there is reason to believe that these trades may be made in order to affect the contracts about to be placed.

Unfortunately when tackled about this practice of all suppliers using the same mechanism they are consistent in maintaining solidarity with all other supplier and refusing to offer prices based upon any other system.

One is obliged to ask the question used in the court of ancient Rome by Cicero, Qui Bono? (Who benefits) Certainly not the customer.

Market Innovation.

During the second and third quarters of 2005 there was a significant shift in terms of suppliers being prepared to offer contracts based upon month ahead prices to ever smaller consumers. This was seen as a positive change enabling customers to in the non-intensive sectors to gain access to the market. Unfortunately as the year has progressed particularly during the period of rocketing prices in November these products have been withdrawn. We are now back in the situation where customers are offered at best a six month fixed price.

Market Segmentation.

Whilst there appears to be a significant level of competition in the gas market this is unfortunately an illusion. As suppliers in any market would, companies will set there stall out for particular types of customer, for example a supplier is free to consider only customers using in excess of several million therms per year as being his desired market. This is apparently what has happened and as a consequence an invitation to tender produces ever smaller numbers of respondents. This is particularly serious in the case of significant multi-site operations where it is sometimes impossible to get more than two companies to offer to supply. Local authorities and public services, such as the NHS, find this a particular problem as there are rules defining what a legitimate tender is.

Necessity for a review.

A review looking into the above practices is in our opinion necessary the question of the lack of competition in the gas forward market whereby all companies use the same pricing mechanism is anticompetitive.

A market where only a fraction of all trades are recorded and published leaves it open to under the counter trades, trades between affiliates and any number of other practices which can affect the index. We would like you to investigate the introduction of a system whereby all trades were recorded through a single reporting system. We would also like to see in place a punitive system as exists in the USA whereby false reports are heavily penalized.

The coincidental parallel movement of the gas and electricity market indices is also a cause for concern; the supply demand dynamics of the two markets are similar but surely not identical. In the electricity market we again have a price being set by very low traded volumes affecting huge volumes sold to customers which we believe are traded between suppliers and generators on longer term fixed price agreements.

As we have mentioned above we believe that the review should cover all sectors of the market (particularly for gas) including an analysis of the customer profiles of various suppliers. This is how we may determine whether real competition exists or whether we have a number of suppliers who have divided the market up into small sub sectors so that competition is minimized.

Brokers

There a number of brokers who as well as charging customers take a commission from suppliers. Frequently the customer is unaware of the conflict of interest assuming that the broker is going out to all possible suppliers when they may only obtain prices from those suppliers who are willing to pay commission. We believe that this is an abuse of the market especially when broker’s mark-ups exceed supplier’s margins by a considerable amount. We believe that this practice needs to be controlled and a utility supply agreement should be treated as a financial instrument. If this were the case it would only be necessary for all suppliers to be required to insert in every agreement the phrase. “Your broker/consultant will receive £x p.a. or y p per unit for arranging this agreement”

Yours sincerely,

M. H. Gammie