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Consumer Markets
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Dear Rachel Fletcher

Non-domestic supply market review: consultation

I refer to the letter from Philip Davies of 11 November 2005 seeking views on whether Ofgem should conduct a review of the gas and electricity supply markets for non-domestic customers.

Shell Gas Direct (SGD) is a licensed supplier supplying a range of industrial and commercial customers (I&Cs) from small businesses to public sector multi-site contracts to large industrial consumers of gas. SGD does not hold a domestic supply licence.

SGD does not consider that a review of this market is necessary. A review of this type at this time would replicate many of the questions that have been asked by DG Comp in its investigation into the gas and electricity across Europe, including in the UK. Until this work is complete, we consider that further activity would result in an unnecessary duplication inconsistent with Ofgem's stated aim of minimising the burden of regulation.

Recent issues raised

We have read the papers by Cornwall Consulting CC and Stephen Littlechild regarding the difficulties being experienced in the I&C markets. We note that the focus of both is the electricity market; with Professor Littlechild's only looking at this market. The views expressed may not, therefore reflect gas market issues. When considering whether to take any review forward, Ofgem will need to be clear about whether both markets exhibit issues to the same extent to both require review. This will avoid unnecessary activity being created for gas I&C suppliers. We note that Ofgem's July 2003 review demonstrated a much higher degree of entry and competition in the gas market than in electricity.

Some of the issues raised by Cornwall Consulting and Prof Littlechild may need to be addressed; but we understand that actions are already underway: As mentioned in Philip Davies' letter, Prof Littlechild's first recommendation on entry arrangements in electricity is already being considered. Ofgem may wish to review again the credit arrangements it put in place which introduced barriers for smaller suppliers. The

problems with metering in electricity are now being replicated in gas following the implementation of RGMA. We recommend that instead of a review of I&C supply, Ofgem should commission an independent review looking at whether metering competition is, or ever will, deliver benefits to consumers given the administrative costs and related complexity that it has introduced. We understand that after the publication of Prof Littlechild's paper, there has been a further review of the cash out arrangements through COWG in electricity with the aim of simplifying the arrangements. Prof Littlechild's recommendations on licence conditions were in respect of domestic licence conditions and therefore would not form part of any review of the I&C supply market. Further more, we understand that these issues are being considered as part of Ofgem's programme reviewing the supply licence conditions. We note that Ofgem's August document on the supply licence review specifically referenced reducing barriers to entry as part of the remit for that work. Another review would only replicate activities already underway.

Specific issues

SME market

SGD supplies small and medium sized enterprises (SMEs). We are aware of the concerns that some SMEs have raised, particularly those at the smaller end of the market. We understand that many of the concerns raised by these businesses relate to the loss of protection that they had when Ofgem implemented a change to the definition of a domestic consumer. Previously, "domestic" was defined by a volume threshold (2,500 therms pa in gas) which included many small businesses. This definition is retained for operation of the gas market (ie "small supply point" in the Uniform Network Code). The new definition was introduced as part of the Utilities Act 2000 implementation but it is within the licences, not the Act. We expect that the definition of domestic will be reviewed as part of the Supply Licence Review, to see whether the new definition gives the protection that small businesses consider themselves to need.

Pricing

The introduction of a traded market in gas has led to the traded market being used as the benchmark for pricing of the wholesale gas costs in supply contracts. For many larger customers, this is explicitly based on published price reporters (eg Heren). The forward price used in many contracts would be the one published on the day that the contract is agreed and/or signed. The approach of using market prices for the commodity component of gas supply contracts is one that customers and Ofgem advocated when the gas market was over-supplied. Like all commodity markets, the prices can go up as well as down in response to supply/demand fundamentals. The published traded prices provide an independent measure against which the opportunity cost of other pricing approaches will be compared. We note that Ofgem is already getting involved in wholesale gas market issues and any review of the I&C market should not add to this activity.

Customers can also track published transportation prices: medium smaller I&C customers in particular have seen sustained increases in transportation prices over the last few years, particularly those in the London DN. As part of the upcoming gas transportation and distribution price controls, we expect that Ofgem will do analysis on the trends in transportation prices for the various market segments. NTS firm and interruptible customers have also seen substantial transportation rises.

A sufficient margin is required in any market to avoid excess exit from that market which would lead to concentration. In addition to wholesale gas costs, transportation charges and margin, suppliers need to costs which have been rising over the past few years. These include increased credit costs; risk transferred to suppliers from the gas transporter; the costs associated with metering competition; and the costs of implementing the DN Sales project and associated increased on-going costs. Increased margins are largely associated with these increases in costs of supplying customers; not increased profits.

Service

Shell Gas Direct is surprised by the suggestion that there is insufficient focus on service. SGD considers one of its key competitive strengths is its record on service. SGD has been number 1 in service in Datamonitor's annual surveys for 6 years. It is for customers to decide whether they wish to prioritise service quality when they choose their supplier.

Other

SGD is aware of some misconceptions by customers regarding how the market works. This may be the source of some of their concerns. We would recommend that Ofgem does more to educate I&C customers regarding the workings of the market, the regulations that apply, and information that is available. We have noted that customers have stated that they do not know transportation charges (these are published); partial interruption is not available in gas (it has been for many years); etc.

Conclusion

SGD does not consider that there should be a review of I&C supply in gas or electricity. We consider that this will replicate work already underway by regulatory bodies, including Ofgem. We recommend:

- Ofgem ensures that the definition of domestic is included within the supply licence review with the aim of considering whether SMES should be offered the protection by using a volume threshold. This could also address some issues with difficulties switching suppliers.
- Ofgem commissions an independent review of the gas metering arrangements introduced through RGMA. This should look at its impact on costs to supply; data quality; barriers to entry etc and examines whether this is potential for benefits to be realised.
- Issues raised by consultants and other groups are addressed through activities already underway by Ofgem and other regulatory bodies; further separate work does not appear to be warranted at this time.
- If Ofgem does consider it necessary to undertake a review, that it minimises the burden it places on the industry by such a review. Specifically, we request that no further workgroups are set up which cannot be easily resourced by smaller suppliers.

If you would like to discuss any of the above, please feel free to contact me on 020 7934 3316.

Yours sincerely

Tanya Morrison

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