

Neil Barnes
Ofgem
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Dear Neil

Energy Supply Probe – Initial Findings Report

Thank you for the opportunity to comment on your initial findings. I am responding on behalf of Contract Natural Gas Limited (CNG), who is retaining me to deal with this matter for them. We are happy for this response to be published.

CNG is a small but growing gas supplier and gas shipper and has been operating in the non-domestic segment of the market for over 14 years. Many of their customers are small and medium-sized enterprises and they recognise many of the comments made in the chapter on small business customers.

We believe that some radical actions are appropriate to counter the portfolio and scale benefits enjoyed by the Big 6 suppliers, so that a vibrant competitive fringe can develop. To this end we offer proposals to facilitate competition between gas suppliers by addressing three particular problems faced by small suppliers wishing to expand their business – supplier transfers, credit requirements and data quality.

Objections to Supplier Transfers

From a separate exercise, we would concur with the evidence presented about the extent of objections to customer transfers. This presents a greater issue for smaller suppliers, who do not have the incumbent customer base of the Big 6 that can fund the development costs of starting and growing a supply business.

Different operating standards, efficiencies and attitudes from objecting suppliers mean that resolving objections often requires manual workarounds and divert resources from more valuable activities. If the objecting supplier is already established, such as is likely with one of the Big 6 suppliers, objecting can also damage the reputation of a small incoming supplier at one of the earliest points of contact with the customer.

We support the proposal for a code of practice to govern the objection and switching process and believe it should include the following elements:

- Escalation arrangements for addressing long-standing objections;
- Verification required for letters of authority;
- Verification required for changes of tenancy; and
- Timescales for processing changes of tenancy.

We would also propose that the switching process should be positively biased to encourage small suppliers. Specifically, we would propose that a rule is introduced which prohibits a supplier with a market share above a defined threshold from instigating an objection to a transfer to a supplier whose market share is below the threshold. To reduce any incentive to fragment supply operations, the threshold calculation would be undertaken at a group level. We appreciate that setting the threshold could have a significant impact and propose a level of 3% to offer smaller suppliers an incentive to grow a business to reasonable size without unduly distorting the market. To facilitate the operation of this rule, xoserve would publish a list of those suppliers with market shares above the threshold and processes governing the supply point administration systems could include a check for whether an objection would be permissible.

For the avoidance of doubt, we envisage that objections could still be raised for transfers between two suppliers both with market shares above (or below) the threshold.

Credit Cover Requirements

Our experience is that credit cover requirements are the biggest single barrier to the expansion of small suppliers. This operates in two ways:

- Counterparty security required to deal in the wholesale market; and
- The higher cost of security required of small suppliers (unless they have the backing of a company with an appropriate credit rating).

Smaller suppliers with smaller balance sheets have less capacity to develop credit lines with multiple sources of wholesale gas. This can curtail their ability to offer competitive prices. To counter this economy of scale, we would suggest that a scheme similar to the Financial Services Compensation Scheme, where each shipper would be required to contribute, for example, £0.5 million, or have equivalent assets set aside, for a common fund, which could be administered by xoserve and drawn on by counterparties if a small supplier were to experience difficulties. We have suggested £0.5 million, as this would be a significant amount for a potential supplier to raise and so reduces the risk of small suppliers taking an irresponsible approach to their energy procurement. We believe such an initiative would enable small suppliers to deal with a variety of players in the wholesale market and could encourage the trading of smaller quantities more suitable for smaller suppliers.

With regard to the credit requirements of the network operators, we would suggest that Ofgem revisit the principles relating to credit cover. The consequence of the current arrangements is that small suppliers, who often do not have public credit ratings, are curtailed from expanding their businesses by the combination of the lower unsecured credit limit and the additional costs of any secured credit required.

It seems to us peculiar that the potential for competition is stifled by arrangements to protect the monopolist network operators, who provided they act reasonably are able to recover any shortfalls through the price control. In addition, suppliers who are part of groups that also include the network companies will benefit indirectly from the credit rating afforded to the group as a result of the steady cash flows for the network

operator. We note that four of the Big 6 suppliers have associated network operators. Given these circumstances, we would urge Ofgem to review and amend the network operator credit cover arrangements so that small suppliers do not have to pay more for credit cover than one of the major suppliers.

We believe that this will not have a material effect on the risk profile, and so cost of capital, for the network operators, due to the low market share of small suppliers.

Data Quality

It is our experience that the quality of data in the industry databases is deteriorating. As with objections, poor data quality can have a greater impact on the reputation of an incoming supplier if it causes problems with the transfer or with billing in the first few months of supply. Actions are needed to provide stronger incentives on suppliers to maintain and improve data quality in the central systems, rather than companies developing local workarounds.

We would propose that a data quality audit is undertaken promptly and that a programme of spot checks is implemented thereafter, so that suppliers pay more attention to data quality. If necessary, this could be backed up by financial penalties or a name and shame campaign.

We would be happy to discuss these proposals further with you when appropriate. If you have any questions, please contact me on 07814 009762.

Yours sincerely

Arthur Probert

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