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RPI-X@20 consultation – Networks
Ofgem
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24th April 2009

Dear Sirs

Regulating Energy Networks for the Future: RPI-X@20 Principles, Process and Issues

This consultation response has been produced on behalf of Contract Natural Gas Limited (CNG), who is retaining me to deal with this matter. 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. This response is not confidential and may be placed in your library and on your website.

We agree with widening the scope of the review to look at the objectives and boundaries of regulation and with the primary themes of focusing on consumers' needs and delivering a sustainable energy sector. However, as part of this, the project needs to consider more fully the interactions between network operators, suppliers and consumers. The Energy Supply Probe Initial Findings report noted the lack of a competitive fringe to the Big 6 suppliers. The role of the network operators in contributing to this situation needs to be addressed.

Network companies are service providers to suppliers and shippers, but the relationship is governed by complex procedures. Most consumers are unwilling or unable to address this complexity, so for suppliers and shippers to provide a good service to their customers, they have to manage a significant degree of complexity, with consequences for the development of the energy supply markets:

- The complexity of the price controls is not limited to the review process, but also leads to difficulties forecasting future network charges. This is particularly an issue in the SME market, where disaggregated pricing is less prevalent.
- The complexity of industry codes and charging structures provides advantages to larger companies (such as one of the Big 6 suppliers, or participants that are part of larger groups) with the resources to manage relationships with network operators.

In the same way that the Industry Code Governance project is explicitly considering issues related to smaller participants and the Energy Supply Probe is considering what action to take to address the barriers to entry and expansion, an objective of this project should be that the framework developed facilitates effective competition between suppliers, including the development of a vibrant competitive fringe.

Credit cover arrangements provide an example of the relevance of this objective to the project. The present arrangements protect the network operators, who provided they act reasonably are able to recover any shortfalls through the price control, and distance them from any market-related risk. Small suppliers, who often do not have public credit ratings, are curtailed from expanding their businesses by the combination of a lower unsecured credit limit and the additional costs of any secured credit required. It seems peculiar that the potential for competition is stifled by arrangements to protect monopolies.

Regardless of whether this objective is adopted or not, alternative means of sharing this risk need to be considered within the visionary phase of the project.

Ofgem's prevailing philosophy has been to reduce the scope of monopoly activities. We would suggest that when looking at the balance of risks and rewards, Ofgem also need to look at the interactions along the supply chain and consider whether competition between suppliers can be more effectively promoted through expanding network operators' roles.

For example, credit cover for counterparties in the wholesale market is a major barrier to entry and expansion of smaller suppliers. 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 or the ABTA bond is set up, 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 a party such as xoserve in gas or Elexon for electricity and drawn on by counterparties if a small supplier experiences difficulties. We have suggested £0.5 million, as this would be a non-trivial amount for a potential supplier to raise and so reduces the risk of small suppliers taking an irresponsible approach to their energy procurement. 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.

We would be happy to discuss these ideas further with you when appropriate.

Yours sincerely

Arthur Probert

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