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Andrew MacFaul
Head of Better Regulation
Ofgem
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BY E-MAIL

27th September 2010

Dear Andrew

<u>Ofgem's Five Year Strategy 2011-2015</u>

I am writing on behalf of Contract Natural Gas Limited (CNG), who is retaining me to deal with this matter. Thank you for allowing us to make this response at this time.

CNG is a relatively small gas-only supplier, sharing with many other suppliers the 6% of the industrial and commercial market which is not supplied by the Big 6. The vast majority of our customer base is small and medium sized enterprises. We seek to provide a high quality service to our customers and need to keep a tight rein on costs to be able to compete effectively against our rivals in the market who have significantly more resources at their disposal.

This year, a suite of UNC modification proposals has been raised following a review of credit arrangements. Reviewing the papers from the process revealed that, while participation was open to all users, the issues were considered by parties on whom the provisions are likely to have little impact. The entities that have been involved are either the monopoly network operators, who have the ability to recover bad debts through the price control mechanism, or large shippers who either hold or have parent companies that hold blue-chip credit ratings and who have associated suppliers that benefit from a weak independent supply sector. The shippers (and suppliers) for whom the modifications are likely to be significant are independent entities, such as CNG.

This raises a question which we think is worthy of Ofgem's attention in the near future – what impact do the credit arrangements in the industry have on the ability of suppliers, and particularly smaller suppliers, to compete in the gas and electricity markets?

A number of the UNC proposals made the case for removing or tightening credit management arrangements in ways that go beyond the existing best practice guidelines for network operator credit cover. We would suggest that any tightening (or relaxation) of credit arrangements should be following an Ofgem-led review of the best practice guidelines, rather than preceding one. We appreciate that the events since the publication of the guidelines have raised questions about the appropriateness of the existing credit management arrangements. However, as the review group itself recognised, the network operator credit arrangements are part of a bigger picture including relationships with other industry entities. In addition, one of the principles behind the best practice guidelines is that the credit arrangements must not be unduly discriminatory or prevent the promotion of competition.

Each party in the industry needs to act responsibly and make arrangements to satisfy the credit requirements of its counterparties. However, the existing credit arrangements in the industry are a major barrier to expansion, and increasingly so in the current economic environment. It is striking that while there are many licences granted, around 95% of the industrial and commercial market remains supplied by the Big 6 suppliers.

As well as the credit requirements of the monopoly distribution network operators, counterparties in the wholesale market, many of whom will also be associated with one of our competitors, have their own credit requirements. Existing credit requirements in the wholesale market are inefficient, as they require duplicate credit cover arrangements to be established with each counterparty. The complexity of security arrangements also tends to favour dealing with a single counterparty in the wholesale market, so weakening the liquidity and depth of the market.

We would therefore urge Ofgem to include in its plan a wider review of credit related issues. This could consider whether there should be a central credit facility that could cover the arrangements needed both by the network operators and by counterparties in the wholesale market. We have in mind something akin to the bond that travel agents are required to lodge if they wish to be members of ABTA. The size of the bond is revenue related and provides a resource that can be drawn on if an agent fails financially. The bond helps to ensure that the agent's customers can continue with their travel arrangements or are reimbursed the cost of their travel arrangements.

Developing a central credit facility could help to create a broader understanding of a party's overall financial health and reduce credit risk, as network and wholesale market liabilities could be considered together. Placing credit requirements with a central body could also enable wholesale market trading with a number of counterparties, improving the efficiency of that market.

Inefficient or unduly onerous credit arrangements will inhibit suppliers from competing vigorously in the market to the detriment of all consumers. We would therefore suggest that the interaction between the credit arrangements in the industry and competition should be a high priority for Ofgem.

We would be happy to discuss this matter further with you.

Yours sincerely

Arthur Probert

c.c. Jacqui Hall, Managing Director, Contract Natural Gas Limited
Tim Jones, Finance Director, Contract Natural Gas Limited