first:utility

October 24, 2012

GB Markets
Ofgem
9 Millbank
London
SW1P 3GE

Gas Security of Supply Significant Code Review - Proposed Final Decision

Dear Sir/Madam,

Please find First Utility's response to the above consultation below.

First Utility agrees with the spirit of the proposed final decision and agrees that security of supply is a main issue facing the market over the next 3-5 years. However, we have some concerns regarding the risks facing smaller suppliers in relation to their larger competitors should Ofgem proceed with implementation. In reviewing the proposed final decision, we do not believe that smaller suppliers' portfolios have been appropriately considered in the decision to transfer costs to the industry without equal consideration of market share. Therefore, although First Utility agrees with the concept of managing supply interruptibility within the cash-out arrangements, we do have a few concerns with the methodology of the proposed final decision. These concerns are outlined below.

Transfer of risk

It is First Utility's belief that the proposed final decision allows for a greater mitigation of risk by the Big 6 and I&C suppliers than the smaller suppliers, as smaller players who supply mainly domestic consumers do not have portfolios containing many large industrial daily metered sites to manage risk in the same way as their larger competitors. Therefore, under the proposed new cash-out arrangements, a smaller supplier must simply hope that the larger suppliers have sufficient interruptibility contracts, storage and diversity of supply to limit the risk of a GDE. If the proposed reforms' aims are to ensure that risks are transferred to those better able to manage them, then the aforementioned uncertainty poses a greater risk for smaller suppliers as they are unable to manage the risks in the same way as their larger counterparts. Additionally, the levels of gas demand for non-daily metered sites that make up a greater proportion of the portfolios of the smaller suppliers are more variable and hence create more risk of being short in the event of a GDE.

Exclusive pricing

Although it has been determined that £20 per therm is a reasonable estimate of domestic VoLL by London Economics, First Utility is concerned about the impact that this amount would have across smaller suppliers in the event of a GDE as this could be fatal for a smaller player. This, in conjunction with the fact that smaller players without half hourly accreditation are unable to arrange interruptibility contracts to help avoid a GDE, appears to create an imbalance of risk between larger and smaller suppliers. In addition, it can be argued that cash-out capped at £20 per therm could have the unintended consequence of creating a perverse incentive to deliver supply to the GB market in the event of a GDE at a price closer to the cap than may have been the case without a cap. Again, we feel that this would have more of an impact on a smaller supplier, with the attendant resulting effects upon both competition and consumer choice should a GDE result in the exit from the market of one or more smaller suppliers due to their significantly lesser ability to hedge this risk and absorb any costs that might result.

Interruptibility contracts will increase

An increase in the number of interruptibility contracts as a result of the proposed final decision seems unlikely as we would have thought the proposed guarantees of VoLL payment around firm load shedding would make it less likely that industrial consumers would be interested in agreeing an interruptibility contract with the relevant DNO. In addition, we feel that a guarantee of this nature (particularly if priced at £20 per therm) is likely to lead industrial consumers to place an increasingly higher value on their interruptibility than might be economically efficient for DNOs to accept.

Please do not hesitate to contact me should you have any questions or require any further information.

Best regards,

Jamie Linton

Regulation & Compliance Analyst

Jamie.linton@first-utility.com