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Dear Iain

RESTRICTIONS ON SELF-SUPPLY

You have invited comments on the issues set out in Ofgem's recent paper proposing to end the self-supply restriction contained in the licence of most of the ex-PES supply companies.

LE Group plc, which holds both generation and supply companies within its corporate structure, supports this proposal on the basis that competition is the best protector of the consumer interest. Removing the restrictions would be a further welcome signal of Ofgem's commitment to reduce the regulatory burden on companies operating in competitive markets.

In particular, we are clear that the competitive nature of the energy markets as a whole, the fact that competition there has developed and increased over time, the increased liquidity in the trading markets, the lessening of barriers to entry, and the ongoing reductions in the market shares of both generators and ex-PES suppliers, all combine to make any continuation of the self-supply restrictions unnecessary.

The highly competitive nature of the electricity sector is clearly shown in the generation market by a Herfindahl-Hirschman Index equal to 960, and in the supply market by customers switching from the incumbent supplier at a rate of 55,000 a week, so that 32% of customers are now with a supplier other than the incumbent in the average ex-PES supply area. OTC trading liquidity has increased from 280GW a year pre-NETA to 960GW a year.

We agree with Ofgem that there is little evidence to suggest that removing the restrictions will adversely affect current levels of competition in the generation and supply markets. We also believe that Ofgem's Competition Act powers will operate as an effective and more appropriate constraint on any potential abuse of market power by vertically integrated companies. The prospect of penalties of up to 10% of turnover for up to three years

for infringements is a particularly strong deterrent to vertically integrated companies, which typically have a high turnover to profit ratio in this highly competitive sector.

Ofgem's analysis of the non-enforceability of the restrictions under the new trading arrangements is realistic. Regulatory obligations that cannot be enforced, or can only be enforced at a cost that is disproportionate to the benefit achieved, bring regulation into disrepute. It is also appropriate that suppliers should be able to purchase wholesale electricity on a single portfolio basis and not for each area separately. The other significant reason for ending the restrictions is that, since not all electricity suppliers with generation affiliates (such as BGT) are subject to them, they may be market-distorting to a material extent.

We are aware of the view that the future effects of unrestricted self-supply may change existing market structures and, in particular, produce over time a more concentrated and less competitive wholesale market. However, as Ofgem has said, the concerns about the level of competition in supply and generation that the restrictions were designed to mitigate have reduced substantially in recent years.

We believe that these positive developments are more likely to continue than be halted or reversed if restrictions on self-supply are removed from suppliers' licences. In any event, Ofgem's ongoing activities of market surveillance and market analysis, backed up by its powers under competition law, should be sufficient to guard against any possibility that the impacts of unrestricted self-supply could distort or disrupt market operations.

We hope that this response is helpful and would be pleased to discuss any aspect of it with you if you wish.

Yours sincerely

R B

Roger Barnard
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