

November 1999

Initial Proposals on Standard Licence Conditions

A Consultation Paper

CONTENTS

1.	FOREWORD	1
2.	INITIAL PROPOSALS	4
2.1	Background	4
2.2	Existing Licensing Arrangements	4
2.3	Proposed Arrangements	5
2.4	Standard Licence Conditions	8
2.5	Special Licence Conditions	10
2.6	Licence Modification	11
2.7	Separation of PES Supply and Distribution	11
2.8	New Electricity Trading Arrangements (NETA)	12
2.9	Industry Agreements and Codes	13
3.	SUPPLY LICENCES	14
3.1	Electricity Supply Licences	14
3.1.1	Application and Structure	14
3.1.2	Social Obligations	14
3.1.3	Trading Activities	16
3.1.4	Metering	17
3.1.5	Non-discrimination	19
3.1.6	Consumer Councils	21
3.1.7	Deemed Contracts and Last Resort Supply	22
3.1.8	Provision of Services	22
3.1.9	Revocation Provisions	23
3.1.10	Industry Agreements and Codes	23
3.2	Gas Supply Licences	23
3.2.1	Non-discrimination	24
3.2.2	Social Obligations	24
3.2.3	New Provisions	25
3.2.4	Licence Fees and Revocation Provisions	25
4.	ELECTRICITY DISTRIBUTION LICENCES	26
4.1	Application and Structure	26
4.2	General Obligations	27
4.3	Security and Safety of Supply	28
4.4	Additional Obligations	28
4.5	Metering	29
4.6	Ring-fencing Provisions	30
4.7	Duty to Connect	30
5.	GAS SHIPPING AND TRANSPORTATION LICENCES	32

5.1	Shipping	32
5.2	Transportation	32
5.2.1	Removal of Geographic Exclusivity	32
5.2.2	Metering and Meter Activities	32
5.3	Licence Fees and Revocation Provisions	33
6.	ELECTRICITY GENERATION AND TRANSMISSION LICENCES	34
6.1	Scottish Trading Arrangements	34
6.2	Transmission Licences	35
6.2.1	Compliance with EU Directive 99/92/EC (the "IME Directive")	35
6.3	Generation Licences	35
7.	NEXT STEPS	37

1. Foreword

The Government has confirmed its intention to introduce legislation, in this Parliamentary session, to modernise the framework for utility regulation. Detail of the Government's proposals for legislation in respect of gas and electricity were set out, following consultation, in a paper published by the Department of Trade and Industry (DTI) in October 1999¹.

The proposals will have a significant impact on both gas and electricity licences. The Government makes it clear that the new primary duty, which will be introduced by the Utility Bill, to protect the consumer interest has a number of elements that the Secretary of State and the regulator will need to consider when proposing licence conditions. There will be a new licence to distribute electricity and the public electricity supply and second tier supply licences will be brought together into a single type of supply licence. Other amendments to electricity licences will also be necessary to implement the New Electricity Trading Arrangements, powers for which will be included in the Bill. In addition the Government intends to adopt in electricity, as it did in gas, the concept of standard licence conditions. These standard conditions will be determined and published by the Secretary of State. Ofgem will advise Government on what standard conditions it might be appropriate to include in each type of licence, but the formal decision to make the standard conditions and the form of the conditions rests with the Secretary of State.

This document sets out Ofgem's initial views on the necessary changes to all types of electricity and gas licences. These are predominantly changes resulting from powers which will be included in the Bill. In proposing these changes, a number of assumptions have had to be made with regard to the drafting of the relevant licence conditions. This is because draft clauses of the Bill and Government's policy intentions in respect of secondary legislation have not yet been published. When these are available some further amendments to the proposed licence conditions may be required. In addition other changes will be needed as a result of related Ofgem consultation processes on amendments to licences arising from the Bill including, for example, New Electricity

¹ "A Fair Deal for Consumers, Modernising the Framework for Utility Regulation, The Future of Gas and Electricity Regulation – The Government's Proposals for Legislation" October 1999.

Trading Arrangements. Other changes will also arise from consultation processes on policy issues being addressed by Ofgem before the conditions are finalised.

This document addresses the three key issues to be decided in developing the licence framework. These are first, whether there is a need to have geographic specific licences; second, what conditions are required in the new electricity distribution licence and electricity supply licence; third, what obligations should become standard conditions and which should remain special conditions. Further detailed work will need to take place in the light of comments on the initial views in this paper and other associated consultations.

Chapter 2 discusses the background to the legislation and the key issues regarding the licence framework. Chapters 3 - 6 deal with the proposed policy in respect of the standard conditions of each type of licence. Chapter 7 then sets out the next steps. Copies of the draft standard conditions of each type of licence will be available on Ofgem's website at www.ofgem.gov.uk. Initially the electricity distribution and supply licences will be available, followed shortly by all other electricity and gas licences.

Views on the issues raised in this paper, and the detail of the draft standard conditions, are invited by **Wednesday 22 December 1999**. Responses should be sent to:

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Unless clearly marked confidential, responses will be published by placing them in the Ofgem library.

2. Initial Proposals

2.1 Background

In March 1998 the Government published a Green Paper "A Fair Deal for Consumers: Modernising the Framework for Utility Regulation". This set out proposals for securing a long-term stable and effective regulatory framework for the gas, electricity, telecommunications and water industries. Publication of "A Response to Consultation" followed in July 1998 setting out the Government's proposals for legislation.

A consultation paper on "The Future of Gas and Electricity Regulation", published in October 1998, considered more detailed issues in gas and electricity regulation. In the light of responses to this document, the Government set out its proposals for legislation for gas and electricity regulation in "The Government's Proposals for Legislation" paper of October 1999. The Government has now confirmed that this legislation will be introduced in this Parliamentary session.

2.2 Existing Licensing Arrangements

Both the existing gas and electricity legislation prohibit the carrying on of certain specified activities unless authorised either by licence, exemption, or in the case of gas, an exception. The prohibited activities are the supply, shipping and transportation of gas and the generation, supply and transmission of electricity. Consequently the relevant Acts provide for licences and exemptions to be granted in respect of each of these separate activities. The power to grant gas licences presently rests with the regulator whilst the power to grant electricity licences can be exercised either by the Secretary of State or by the regulator acting under a general authority given by the Secretary of State. Paragraph 23 of the DTI's October 1999 consultation paper outlines the Government's intention to remove the Secretary of State's powers to grant electricity licences. This will bring the Electricity Act provisions in line with the Gas Act provisions.

For gas transportation, shipping and supply and for electricity generation and transmission there is only one type of licence that can be granted. However, existing legislation for electricity supply licences provides for there to be two types of supply licence; one granted to public electricity suppliers in respect of their authorised areas (known as a public electricity supply (PES) licence) and the other which is granted to any other person who wishes to supply electricity (known as a second tier supply

licence). A PES licence is effectively that which was granted upon vesting to one of the successor companies corresponding with the fourteen Area Electricity Boards which existed before privatisation and relates to a specific geographical area (authorised area) and includes a number of obligations which were required because of the monopoly position of the PES in electricity distribution and supply at the time of vesting. A second tier supply licence is that granted to any other person wishing to supply electricity, including a PES wishing to supply outside its authorised area, and includes a fewer obligations.

2.3 Proposed Arrangements

The DTI's October 1999 paper indicated that the Government had decided that the licensing regimes in gas and electricity should be aligned as far as possible in recognition of the growing convergence of the gas and electricity markets and increasing integration of firms operating in them.

In electricity, to facilitate further competition and transparency, there will be a new licence to distribute electricity and a single type of supply licence to replace the existing public electricity supply licence and second tier supply licence. Whilst generation and transmission licences will remain in place, these will be subject to some consequential amendments. In gas, it is not intended to change the types of licence available for the time being namely gas transportation, shipping and supply. However, the Government has indicated that it intends in the Utility Bill to introduce powers to enable it by secondary legislation to:

- remove the need to have a licence to undertake an activity that is currently licensable; and
- introduce a requirement for a licence to undertake a particular activity, which is associated with an existing licensable activity.

Paragraph 30 of the DTI's paper indicates that the scope of the power to introduce a new type of licence would be tightly restricted and could only be used in relation to commercial activities connected with existing licensable activities. This power could only be used either with the consent of those currently carrying out the activity in question or following a reference to the Competition Commission, where the Commission had concluded that it was in the public interest.

The electricity supply licence will continue to include conditions in respect of both customer facing and industry facing activities i.e. compliance with certain industry codes and agreements. However, it is intended that licensees may appoint agents to carry out these industry facing activities, and that such agents will not normally need to be licensed in order to do this.

There will also be minor and consequential changes from the legislation, for example, the regulator will be referred to as "the Authority".

At present there is a small but significant difference in the scope of regulation afforded to smaller gas and electricity customers. In gas, further regulatory protection is afforded via legislation and licences to "domestic" customers defined by reference to a consumption limit i.e. any customer using 73,200 kWh or less per year. In electricity, many regulatory functions focus on a category of customer known as "designated" customers. Designated customers comprise all domestic customers (that is all customers at premises used wholly or mainly for domestic purposes regardless of consumption) and those business customers (with some exceptions) having a consumption of 12,000 kWh or less per year. Both gas and electricity supply licences include detailed obligations relating to the terms of contract for these small customers.

In keeping with the general objective to align, wherever possible and practicable, the present gas and electricity provisions, the Government is proposing to focus the requirements of regulatory protection on small customers (Section 4.2, paragraph 77 of the DTI's October 1999 paper). The definition of small customers will not be included in the Bill. The Secretary of State will be given a power to define such customers using secondary legislation. Present assumptions are that the definition of small customers for legislative purposes will include all domestic customers (that is, all customers at premises used wholly or mainly for domestic purposes) irrespective of consumption plus some business customers as defined by reference to appropriate consumption limits. In electricity, suppliers to small chains of businesses which are party to multi site contracts are excluded from the definition of small customers and Ofgem considers it appropriate to mirror this in gas licences. However, this may need to be revisited when the detail of the secondary legislation which will define small customers is made known.

For consistency purposes this document will use the term small customers rather than the terms designated or domestic to mean those customers to be given additional regulatory focus.

Some licensees may choose to supply only larger customers and licence conditions relating to small customers will not therefore apply to them. However, it is recognised that customers' circumstances and consumption levels may change over time. For example, a business customer whose consumption was within the small customer defined limit when he took out his supply contract may find that his consumption increases during the life of that contract. Existing electricity supply licences provide for these circumstances to ensure that a change in a customer's consumption does not automatically cause a supplier to be in breach of its licence. Once a customer is determined (by the supplier) as being outside the scope of the definition, he remains in that position, regardless of any change in consumption, until a new supplier is required to determine the customer's status. If a customer has been determined as being within the scope of the definition at the start of his contract and his circumstances change, then he can be re-assessed to determine whether he now falls outside the scope. It is anticipated that similar provisions will continue for electricity suppliers and be introduced for gas suppliers.

Given the Government's proposals, there are three key issues for Ofgem to consider in developing the licence framework.

First, whether there is a need to have geographic specific licences. At present in electricity there are distinct licences for England and Wales and for Scotland. These were originally put in place to reflect the structure of the industry at vesting. In addition, geographic specific licences are presently also granted to PESs in respect of their authorised areas. Ofgem is of the view that retaining separate licences for different parts of the country is unnecessary. In practice most companies operate on a Great Britain wide basis and most conditions apply across Great Britain. It therefore seems sensible to have Great Britain wide licence structures. Licences will however, in some cases such as that of the successors of the PESs, need to provide for some regulatory requirements only having effect by reference to a geographic area or to dominance in a particular market. It will of course always be open to companies to seek licences with a restricted

geographic scope and licences will provide for relevant obligations relating to settlement to be applied depending on where the licensee is trading.

Second, Ofgem needs to consider what obligations are required in the new distribution licence and electricity supply licence. Establishing standard conditions for electricity licences is not simply a matter of transposing existing conditions of licences into a standard form. Ofgem has already given thought to, and consulted on, the conditions it considers appropriate to distribution and supply in the context of the changes to Midland Electricity plc's licence following the purchase of the Midlands supply business by National Power. Ofgem intends to follow this general approach, but further consideration needs to be given to metering activities and to other issues arising from the legal separation of the PES supply and distribution functions.

Third, Ofgem needs to consider what obligations should become standard conditions which can be modified by majority consent in each type of licence, as opposed to special conditions in individual licences where the agreement of the individual licensee or reference to the Competition Commission is required before a change can be made. Ofgem's general approach is that all conditions appropriate for all licensees of a particular type should become standard conditions. Special conditions are likely only to be necessary for some licensees to provide further regulatory protection or to promote competition. Some special conditions will include price controls. This document however, deals primarily with the proposed standard licence conditions. This issue is discussed further in the next two sub sections.

2.4 Standard Licence Conditions

The Government intends to adopt in electricity, as it did in gas, the concept of standard licence conditions. It is envisaged that there will be a single set of standard conditions for each type of licence. These standard conditions will be divided into groups. Not all groups of standard conditions will necessarily apply to all licensees.

The DTI's October 1999 paper (Section 3.5) makes it clear that it is intended to structure the licences around the key activities they govern by means of grouping together all of the standard conditions that relate to these key activities. Where appropriate therefore, it is intended to group together standard conditions with respect to the industrial and

commercial sector, small customer sector, and obligations falling on the former public electricity suppliers.

In the first instance the standard conditions to be included in each type of licence will be determined and published by the Secretary of State. Once the standard conditions are in place, it will be for the Authority to propose modifications.

On granting a licence it is intended that the Authority will have the power to issue a direction applying particular groups of standard conditions to each licensee. So, for example, an electricity supplier intending to supply only in the industrial and commercial market would not have the group of standard conditions relating to small customers applied. The Authority will also be able to reverse any such application/disapplication, with the licence holder's consent, subject to being content that the licence holder satisfies the relevant necessary criteria. For instance, if a licensee wants to supply small customers, he must notify the Authority in advance so that the relevant group of standard conditions can be applied, and for example, the licensee can produce codes of practice etc. It is intended that this power will be limited to disapplying or reapplying groups of standard conditions rather than individual conditions within these groups. This power will be given effect through a new standard licence condition enabling the Authority to issue such a direction.

The direction will state the date from which the licensee will be obliged to comply with the relevant group of standard conditions. Where the Authority wishes to direct that some groups of standard conditions apply to particular licensees because of their market position he will in certain circumstances consult before he issues such a direction.

Ofgem will be proposing to the Secretary of State the standard conditions to be included in electricity transmission, generation, distribution and supply licences and, where necessary, revised standard conditions for gas transportation, shipping and supply licences. In establishing the standard conditions there is a need to reflect policy decisions taken in the context of the Bill as a whole. These policy decisions are set out in the DTI's October 1999 paper. In addition, the proposed standard conditions need to reflect other licensing proposals on which Ofgem is consulting or has consulted separately, for example modifications resulting from Ofgem's Social Action Plan.

2.5 Special Licence Conditions

As explained above electricity licences will mainly consist, as gas licences already do, of standard conditions. However, not all licensees will have exactly the same obligations. As well as determining which groups of standard licence conditions should be applied under the licence, the Authority will identify some obligations that will be appropriate only to individual licensees. These non-standard obligations will take the form of special licence conditions.

Special licence conditions already impose obligations on gas licensees. BG plc, for example, has obligations, under special licence conditions in its transportation licence, in respect of its unique responsibilities for:

- pricing for LNG storage;
- balancing responsibilities in the gas market; and for
- provision of an emergency service.

However in gas, where there was only one national player before the industry was opened to competition, special conditions apply only to that company.

In electricity it is envisaged that some supply and distribution licensees, particularly those that evolve from the present PESs, will require additional obligations in the form of special conditions. For example, for ex-PES supply and distribution licensees there will be a need for special licence conditions relating to price controls.

Special conditions may also be appropriate in certain circumstances for other distributors. For example some distributors may wish to have the powers under Schedules 3 and 4 of the Electricity Act 1989 afforded to them (as referred to in paragraph 59 of the DTI's paper). These schedules enable the Authority to confer rights relating to street works and compulsory acquisition of land. This would be exercised by the Authority through special licence conditions for such individuals.

Although transmission licences will have some standard conditions, given that, at least initially, there will only be one transmission licensee in England and Wales and two transmission licensees in Scotland, special conditions will form a large part of these licences.

2.6 Licence Modification

At present, changes to electricity licence conditions are made with the consent of the individual licensees, or, where consent is not forthcoming, by reference to the Competition Commission. In gas, however, standard licence conditions may be modified collectively where a sufficient percentage of the relevant licensees consent. As previously indicated, the Government has decided to extend the concept of standard licence conditions to electricity. It also intends that there should be the same mechanism for collective licence modification in both gas and electricity. However, this mechanism will not be the same as that in the existing gas legislation which requires the regulator to secure the active consent of 90 percent by number and volume of gas transported, shipped or supplied by the affected licence holders.

The Government has indicated its view on how collective modification of standard licence conditions should operate in future. Under its proposals, only those licensees who object to a proposal made by the Authority and make a representation to the Authority will be deemed to have voted against it. The Authority, when determining whether the necessary level of consent has been achieved, will count only those objections by licence holders in whose licences the relevant conditions are operative. Blocking minority thresholds will be established by statutory instrument. Details of the Government's proposals are set out in Section 3.6 of the DTI's October 1999 paper, including proposals to consult on the level of the new blocking minority thresholds and on the relevant basis for determining the market share of each licensee.

2.7 Separation of PES Supply and Distribution

The Government's October 1999 paper (Section 4.1, page 12) identifies the separation of electricity supply from distribution as a key policy objective. Legislation will provide for a new prohibition on the activity of distribution without a licence or exemption. It will also provide a bar on the same legal entity holding both a supply and a distribution licence. Ofgem has separately undertaken a consultation on licence conditions requiring operational, managerial and informational separation of the distribution business.

While many of the conditions in the new distribution and supply licences will be similar to existing PES conditions, there will be a number of important changes. In reallocating PES obligations to the new supply and distribution businesses, it will be important to secure that there is no scope for confusion as to respective responsibilities.

Licence changes necessitated by National Power's purchase of Midlands Electricity plc's supply business (on which Ofgem consulted in March and on general separation proposals in May 1999) have, to an extent, provided a model for the conditions needed to implement separation. However, there are some changes to the conditions relating to metering and meter services that are explored in more detail in sections 3.1.4 and 4.5. As the process of business separation will take time to complete, it is considered appropriate for the relevant licence conditions relating to managerial and operational separation to continue to apply to ex-PES distributors after the concept of separate licences is introduced.

Ex-PES distribution businesses will be subject to a licence condition broadly similar to Conditions 14 and 14A in Midlands Electricity plc's PES Licence as set out in Ofgem's May 1999 consultation paper. These will require the distribution businesses to treat information received or generated by that business as confidential and establish full managerial and operational independence of that business. A compliance officer must be appointed to monitor compliance with this condition.

2.8 New Electricity Trading Arrangements (NETA)

Ofgem and DTI have jointly published a document² setting out conclusions on the New Electricity Trading Arrangements. The trading arrangements are designed to be more efficient and provide greater choice for market participants whilst maintaining the operation of a secure and reliable electricity system. The proposals are based on bilateral trading between generators, suppliers, traders and customers. They include:

- forwards and futures markets (including short-term power exchanges), which evolve in response to the requirements of participants, that will allow contracts for electricity to be struck over timescales ranging from several years ahead to on-the-day markets;
- a Balancing Mechanism in which NGC, as System Operator, accepts offers of and bids for electricity to enable it to balance the system; and
- a Settlement Process for charging participants whose contracted or declared positions do not match their metered volumes of electricity.

² The New Electricity Trading Arrangements, Ofgem/DTI Conclusions Document

A number of changes will be required to licences, other regulatory instruments and key industry documents before the new arrangements can be put in place. It is proposed that a change co-ordination condition would require the licensee to endeavour to ensure that the changes to a number of specified documents requested as a result of NETA (and as a result of other proposed changes to legislation and licences – see section 2.9) are secured and implemented. An overview of such changes can be found in Ofgem's July consultation paper, "The New Electricity Trading Arrangements" a copy of which can be found on the Ofgem web site at <http://www.ofgem.gov.uk>. Hard copies are available from the Ofgem library. Ofgem will shortly consult on the changes to the licence conditions resulting from NETA.

2.9 Industry Agreements and Codes

The proposed changes to legislation and to licences will have a profound effect on a large number of industry agreements and codes. Industry agreements, such as the Master Registration Agreement, will need to be amended to reflect the proposed legislative and licence framework.

Each industry agreement has its own change control processes, which usually include determination of disputes or appeals by the regulator. However, Ofgem proposes that relevant licences will include a change co-ordination condition requiring licensees to take steps to procure the necessary changes to industry agreements, codes and other documents resulting from the legislation and licence changes.

3. Supply Licences

This Chapter describes the initial changes we consider appropriate to provide for standard conditions in electricity and gas supply licences in light of the Government's proposals for legislation.

3.1 Electricity Supply Licences

The present distinction between PES supply and second tier supply is to be removed. The geographically mutually exclusive "authorised area" structure presently facilitated by the existing PES licence will no longer be necessary or appropriate.

Given the present position of PES suppliers and the proposed continuation of price restraints for these suppliers it is likely to be appropriate to make some distinction between, at least initially, ex-PES suppliers and other suppliers. The draft licence is structured so as to facilitate and recognise such a distinction.

3.1.1 Application and Structure

Draft standard conditions for the new single electricity supply licence are primarily based on the present conditions of the second tier supply licence and the supply section of Midlands Electricity plc's "separated" PES licence. In line with the Government's proposals to adopt a more flexible approach to the licensing structure the standard conditions of the supply licence are grouped, as discussed above, to enable groups of conditions to be applied by the Authority as appropriate.

3.1.2 Social Obligations

In line with the approach presently adopted relating to the scope of regulatory protection and the Government's proposals to focus on small customers, certain standard licence conditions will only be operative for those suppliers who wish to supply in the small customer market. Such suppliers will need to have received a direction from the Authority enabling them to supply such customers and thereby be required to comply with additional licence requirements in respect of these customers. With the exception of deemed contracts and last resort supply provisions all the conditions in this section of the licence are those that presently apply, in some shape or form, to electricity suppliers operating in the small customer market.

Existing supply licences include a condition³ describing the procedure for the modification of certain conditions known as the “Contract Terms Conditions”. Effectively this procedure provides for the Contract Terms Conditions to be modified using a weighted vote formula (as outlined in the condition). Given that the new legislation will provide for a collective modification procedure in respect of standard licence conditions, as described in section 2.6, this condition is no longer required and has therefore been removed.

The new single supply licence will continue to include all the conditions presently contained in electricity supply licences which confer protection for small customers as standard conditions. These include conditions on:

- the duty to supply;
- social obligations and codes of practice;
- the terms of supply contracts;
- standards of performance payments;
- the information to be provided to customers; and
- the marketing activities of suppliers.

On 5th October 1999 Ofgem published a Framework Document describing progress towards the development of a Social Action Plan to ensure efficiency, choice and fairness in the provision of electricity and gas to disadvantaged customers. The Plan, which responds to a Government request in its March 1998 Green Paper “A Fair Deal for Customers”, includes proposals for a number of licence changes to improve protection for disadvantaged customers. The draft standard licence conditions envisage that these modifications will have taken place by the time standard conditions are determined by the Secretary of State and therefore encompass the proposed amendments.

These include amendments to licence conditions on methods of payment, energy efficiency advice services to vulnerable customers and debt and disconnection for which Ofgem will shortly be publishing formal proposals under the procedures in Sections 11 and 23 respectively of the Electricity Act 1989 and Gas Act 1986. Additional areas for licence amendments on which Ofgem is or will be consulting are

³ Revision of the Contract Terms Conditions

improvements in the provision of pricing information to customers by electricity and gas suppliers and the revision, following a review, of debt blocking and assignment arrangements relating to customer transfers.

Ofgem has already proposed, in advance of the new legislation, to introduce a new condition to second tier electricity supply licences to cover Energy Efficiency Standards from April 2000. Under the new legislation Government will be taking new powers to set future Energy Efficiency Standards for gas and electricity suppliers. This is expected in due course to supersede the proposed new licence condition. Other initiatives and reviews under consideration by Ofgem are also likely to lead in the due course to licence condition amendment proposals which will need to be included in the new licences.

Existing gas and electricity supply licences contain an obligation relating to the marketing activities of suppliers. These require suppliers to:

- select and train staff effectively;
- contact each customer who has entered into a supply contract as a result of a marketing visit or call to ensure that the customer understands and is content with the contract he has entered into;
- have an appropriate complaints handling procedure which provides for the payment of compensation to customers; and
- report on performance.

In both gas and electricity licences the marketing condition will cease to have effect on 31 March 2000 unless the regulator, following consultation, considers it appropriate for the condition to continue. Ofgem intends to consult on the continuation of the marketing condition and on its terms. It is therefore included in the standard conditions of both gas and electricity supply licences in its present form, until the outcome of the proposed consultation is known.

3.1.3 Trading Activities

In addition to standard conditions mentioned above other standard conditions which are to be operative for all electricity supply licensees include the industry facing activities i.e. compliance with industry codes and agreements and other general settlement obligations which need to apply to all licensees. The majority of these conditions derive

from the existing second tier supply licence. New conditions emanating from NETA as outlined in Chapter 2 will also apply.

3.1.4 Metering

As a consequence of separating PES supply and distribution functions, present obligations on PESs in relation to the provision of metering and meter reading services will be divided between the new supply and distribution businesses, subject to certain amendments designed to recognise the development of competition in these areas. Chapter 4 provides more detail on the proposed distribution licence obligations.

The existing PES licence places an obligation on PESs to provide five separate metering and data services, namely, meter provision, meter operation, data retrieval, data processing and data aggregation. In providing these services, a PES must neither discriminate between any persons (including between itself and any other persons) nor restrict, distort or prevent competition in the supply of electricity. PESs are also required to undertake each of these services in the most efficient and economic manner practicable having regard to the alternatives available.

Following separation, it is envisaged that the ex-PES supply businesses, like all other suppliers, will be responsible for ensuring that all five metering and meter reading services are provided to their customers. The principal issue for consideration in these proposals is the extent to which the ex-PES supply businesses should bear additional obligations that reflect their ownership and/or control of the incumbent meter reading businesses.

If competition in meter reading services develops satisfactorily, it may be sufficient to rely solely on the powers available to Ofgem under the Competition Act 1998. This was the basis upon which we consulted in May 1999, and remains Ofgem's preferred solution.

Notwithstanding Ofgem's May 1999 proposals, concern has been expressed by meter readers and second tier suppliers that such an approach may not be consistent with achieving effective competition in meter reading. Concern centres on the dominant position inherited by PES meter reading businesses together with the existence of barriers to entry into meter reading, including that associated with joint ownership of

meter reading and supply. Against this background, it has been suggested that in order to ensure competition develops satisfactorily it might be desirable to continue to impose obligations on the ex-PES supply businesses beyond separation, only removing those additional obligations when competition in meter reading services became effective.

Ofgem has considered two alternative ways in which this could be done. We invite views on the following options, or any other alternatives designed to address the concerns raised.

Option 1 - Retain all existing data services obligations

It would be possible to transfer all existing PES licence obligations in respect of meter reading, data processing and data aggregation services to the ex-PES supply businesses. This could be achieved relatively easily, and would be consistent with Ofgem's proposals to place the meter reading businesses with the supply businesses. On the other hand, it may not, in itself give new entrant meter reading companies a real opportunity to win ex-PES supply business contracts.

Option 2 - Retain the minimum obligations necessary for effective competition

It may be preferable to continue to oblige the PES supply businesses to meet specific requirements designed simply to prevent anti-competitive behaviour in respect of their meter reading businesses. These requirements might be limited to two specific existing obligations. First, the ex-PES meter reading business (via its supply business licence) would be required not to discriminate between any persons (including between itself and any other persons). Second, the ex-PES supply business would be required to undertake meter reading services in the most efficient and economic manner practicable having regard to the alternatives available. The intention of this second obligation would be to prevent PES supply businesses relying solely on their own meter reading business when more economic alternatives were available. In effect, this obligation would be designed to require the ex-PES supply businesses to go out to competitive tender in purchasing its meter reading requirements.

This approach would have the advantage of preventing the incumbent meter reading businesses from discriminating to the detriment of other suppliers, and competition in supply more generally. It would also provide a real opportunity for other meter reading companies to win the business of the ex-PES supply businesses.

As noted above, Ofgem's present proposals are based on reliance on the Competition Act 1998. On this basis, all meter reading obligations are removed from the ex-PES supply businesses' licences. Nonetheless, we would welcome views on the alternatives described above before finalising our approach.

There will be an additional licence obligation on ex-PES suppliers to provide non-discriminatory access to a system supporting prepayment metering, as previously set out in Ofgem's separation consultation papers.

3.1.5 Non-discrimination

Existing gas and electricity supply licences contain conditions relating to non-discrimination in the supply of the relevant fuel. In brief, the relevant conditions provide that suppliers shall not show undue discrimination or undue preference in the supply market in which they have a dominant position. Although the principles behind the provisions in gas and electricity are generally the same, there are a number of differences of substance, of drafting and of application.

In gas, the provisions are included via a standard condition, which applies where the licensee is dominant in the market. The same principle is adopted in electricity, whereby the licence condition is included in all supply licences and applies to those licensees who the Authority has determined to be dominant. Both conditions recognise that different requirements should apply as competition develops. That is, the conditions become less restrictive as competition is established.

In gas, where a supplier is in a dominant position in the market for the supply of gas, the supplier is prohibited from showing undue preference or exercising undue discrimination against any person or class of persons. It also prevents a dominant supplier from setting charges which are unduly onerous or predatory, where unduly onerous prices exceed costs by significantly more than other suppliers' prices exceed

their costs in the same market⁴, and where predatory prices are below avoidable costs and are likely to have the effect of unfairly excluding or limiting competition.

Notwithstanding these requirements, where competition is established, a supplier may supply or offer to supply gas to all, or a class of, customers in an area on terms which are reasonably necessary to meet those of its competitors provided that it does not set predatory or unduly onerous prices to any customers in that area. Classes of customer are defined according to the circumstances of supply. For the purposes of the domestic gas market, an area must contain no less than 100,000 domestic premises.

The condition does not apply when a pricing policy by the supplier is considered to be in the public interest. In the event that the Authority and the company do not agree that a pricing policy is in the public interest, the matter is referred to the Competition Commission for resolution.

Provisions in the electricity licences are similar to those in gas subject to a number of significant differences. First, electricity dominant licensees are only explicitly prevented from setting predatory terms in the market in which they are dominant rather than any market (as in gas). Second, for the purposes of defining a market in electricity, an area must contain no less than 50,000 domestic premises. Third, in electricity there is no means by which a pricing policy can be exempted from the condition on public interest grounds.

In terms of process, British Gas Trading Limited is required to give 3 months' notice of a change to the terms on which it is prepared to enter a contract where competition is established. This requirement is set out in Special Condition 3A of British Gas Trading Limited's supply licence. PESs are required to give 28 days' notice of any new terms of supply. The Authority may issue a counter-notice to prevent the introduction of new terms where he determines further consideration is required to assess whether the terms breach the provisions of the relevant licence conditions.

Given the increasing convergence of the two industries, Ofgem considers it sensible to align the licence provisions governing non-discrimination. In considering alignment,

⁴ If this is not manifestly the case, then charges are only unduly onerous if other gas suppliers would be prepared to offer lower prices.

Ofgem will also need to consider the impact of future supply price regulation and, in particular, the widespread availability of "dual fuel" supply.

It is our intention that non-discrimination provisions will form part of the standard conditions. Therefore the existing relevant conditions, including those in gas, have been incorporated into the draft licences in their present form. However, it is envisaged that they will be subject to some change prior to the standard conditions being finalised.

Ofgem intends to issue a consultation letter on this issue.

3.1.6 Consumer Councils

As mentioned in paragraph 20 of DTI's October 1999 paper the Government has announced its intention of establishing a single, national consumer council to represent the interests of gas and electricity consumers. To reflect this intention, the draft standard licence conditions make reference to the Energy Consumers' Council (although this may not be the organisation's eventual title).

At present all electricity supply licences oblige licensees, who supply in the small customer market, to meet with the Relevant Consumers' Committee upon request. The PES licence provides that the licensee shall meet up to a maximum of six times a year but at least once a year. The second tier supply licence provides that the licensee must meet, on request, at least once a year. Gas supply licences take a slightly different approach and oblige licensees (who supply small customers) to provide the present Gas Consumers' Council with details of the arrangements it will have in place in liaising with the Council on handling complaints etc.

With the creation of a new national consumer council, the separation of electricity supply and distribution and the general policy intention to align the gas and electricity provisions (where possible and practicable) it is considered appropriate to revise licensees' obligations in respect of these conditions. Section 2.4 of the DTI's paper sets out the role of the Consumer Council. Given the enhanced status, powers and wider role of the national Council, Ofgem is not convinced that existing licence obligations in respect of the Council are necessary. They have therefore been removed from the proposed standard conditions. However, this represents very much an initial opinion and we would welcome views on how best the relationship between the new council and licensees could be managed and what requirements, if any, should be included in licences given the proposed revisions in the legislation.

3.1.7 Deemed Contracts and Last Resort Supply

New legislation will make provision for deemed contracts to exist in electricity as they do presently in gas. It is likely that deemed contracts will apply only in respect of small customers. Similarly, there is provision for last resort supply to apply only to small customers. To help facilitate the manner in which deemed contracts will work and ensure that customers being supplied under deemed contracts are not subject to onerous terms of supply, the electricity supply licence will include a standard condition. This will set out the pricing methodology for deemed contracts and be based on the existing gas supply licence standard condition. This provides amongst other things that deemed contract terms shall not be unduly onerous; that suppliers shall submit copies of their deemed contracts to the Authority and that customers shall be appropriately informed of the deemed contract that under which they are supplied and the terms and conditions of that contract.

Introducing the concept of deemed contracts in electricity supply also helps to alleviate some of the present difficulties associated with the revocation of a supplier's licence for example on insolvency. At present if such a situation arises it is possible that some affected customers may not take appropriate action to secure supply from another supplier. This poses a potential financial burden on all other market participants who may have to bear the costs of that supply without the customers being liable to pay for it. With the introduction of deemed contracts it is now possible for the Authority to direct a nominated supplier to supply those customers under a deemed contract. A new standard condition outlines the process for the Authority to nominate a licensed last resort supplier to supply customers of another supplier where that other supplier's licence is revoked. It also requires the nominated licensee to comply with such a direction; carry out certain activities, for example secure appropriate meter readings in respect of the last resort supply; and to ensure that charges associated with last resort supply are recovered accordingly and appropriately.

3.1.8 Provision of Services

As mentioned earlier some standard conditions will only be necessary for a special category of electricity supplier. Initially it is considered that these obligations need only apply to ex-PES suppliers who, because of their position in the market, are able to provide certain services that cannot be provided by other suppliers. At present these conditions include an obligation for such suppliers to provide top up and standby supplies of electricity, prepayment meter services and exempt supply services. These

provisions may be subject to change in light of other developments in the industry, for example, from the New Electricity Trading Arrangements.

When considering the divisions required for Midlands Electricity plc's PES licence it was concluded that the provision of prepayment meter services (i.e. the infrastructure necessary for prepayment meters) was a supply business function and responsibility. In accordance with Ofgem's previous papers on separation it is considered appropriate that those supply businesses that presently have responsibility for providing the infrastructure continue to do so under licence obligation. This section of the licence therefore includes such a condition.

3.1.9 Revocation Provisions

At present the revocation provisions of a licence are included as a term of the licence. This makes it extremely difficult to amend these provisions, as terms of licences can only be amended by revoking the licence and issuing a new one. Amendments to the revocation provisions are normally only required to reflect consequential changes in other legislation which impacts the revocation provisions. Revoking a licence and issuing a new one to reflect such changes is not considered desirable for reasons of cost or best use of resources both from Ofgem's perspective and from a licensee's perspective. To help alleviate some of these difficulties the revocation provisions have been incorporated as a standard licence condition. This approach is to be adopted for all electricity and gas licences i.e. generation, distribution, transmission, transportation, shipping and supply.

3.1.10 Industry Agreements and Codes

As stated in section 2.9, Ofgem proposes to include a change co-ordination condition requiring licensees to take steps to procure the necessary changes to industry agreements, codes and other documents resulting from the legislation and licence changes.

3.2 Gas Supply Licences

The policy of alignment of electricity provisions with those already existing in gas (Section 2.3 of the DTI's paper) will mean that, compared with the changes to electricity licences, there will be relatively few alterations in the gas supply licences. However the structure of the gas licences will require some change to adopt the flexible approach to licensing outlined in the Government's proposals. At present in gas the terms of the

licence, rather than the standard conditions, determine whether the licensee is able to operate in the domestic market. To enable the Authority to direct that certain standard licence conditions are to apply to the individual licensee (or are to be disapplied once they have been applied), it is necessary to split the standard conditions into sections in the same manner and order as will be done for electricity licences.

3.2.1 Non-discrimination

Again, as outlined in section 3.1.5 above, there may be some further amendments to the standard conditions relating to non-discrimination following Ofgem's proposed consultation.

3.2.2 Social Obligations

Although the mechanism of deemed contracts is to be extended from gas to electricity, it will apply only to those defined (by Statutory Instrument) as 'small consumers' as explained in Chapter 2 and section 4.2.7 of the DTI's paper. Accordingly, the provisions of paragraph 8 of Schedule 2B of the Gas Act and the corresponding parts of Standard Condition 4, which permit an election to increase the ceiling for deemed gas contracts, will be deleted, as will the associated provisions for a supplier of last resort to customers outside the definition of "small".

Standard Condition 6 (Special Customer Payment Claims) is to be deleted. Its purpose was to allow suppliers to recover the additional costs arising from their serving a disproportionate number of disadvantaged customers. The condition was not due to be invoked until the end of this year and no longer reflects market conditions. The Social Action Plan, on which Ofgem is currently consulting, will introduce new obligations on gas suppliers, to improve service to disadvantaged groups. There is more detail on the Social Action Plan, in section 3.1.2. As mentioned in section 3.1.6, Ofgem believes that the provisions relating to the relationship with the Consumer Council are unnecessary, although views on this point are welcome.

Also, changes needed to industry agreements, codes and other documents will be covered by a licence condition as explained in section 2.9.

3.2.3 New Provisions

There is to be a new licence condition requiring the establishment of complaints handling procedures to bring gas into line with electricity as referred to in paragraph 96 of the DTI's paper.

Provision is also to be made requiring dominant suppliers to provide regulatory accounts for their supply business. It is proposed that the provision to require suppliers to provide advance notice of price changes will be included in the standard conditions but will be applied by the Authority according to the market position of the supplier. Mirroring the position in electricity, Ofgem considers it appropriate to require suppliers to print the 'M' number (meter point reference number) on customers' bills. This will be done in a similar way to that in which electricity suppliers are required to print the Supply Number; that is, in accordance with a direction to be issued by the Authority.

3.2.4 Licence Fees and Revocation Provisions

As noted in the DTI's "Proposals for Legislation" paper (October 1999) it is envisaged that the present capping provision on gas licence fees will be abolished. To reflect this and align the gas and electricity provisions the condition of payment of fees will be amended to provide for the recovery of the total costs of the Authority and the new Energy Consumers' Council. The condition itself will not go into detail on the methodology to be used for calculating such fees. Instead this will be provided to licensees by separate notification under the licence conditions. In addition, there will be a general provision to enable the Authority to recover regulatory costs incurred during the transition period.

As stated earlier in 3.1.9, the revocation provisions of gas supply licences will now be incorporated as a standard condition, rather than a term, of the licence.

4. Electricity Distribution Licences

The Bill will provide for a new prohibition on electricity distribution. This will require companies engaged in the distribution of electricity to be authorised by licence or exemption. Paragraph 53 of the DTI's paper explains the present thinking on the type of distributor that may be authorised by exemption rather than by licence. This Chapter considers the standard conditions that may be included within a distribution licence. These provisions relate mainly to the safety and security of supply and the effective operation of the distribution network.

4.1 Application and Structure

Present assumptions are that there will only be one type of distribution licence. That is the Act will not differentiate between the present PESs, who own/operate regional distribution systems and are licensed via the PES licence and owners/operators of other distribution systems, who are not presently subject to regulation.

It is however expected that the concept of groups of standard conditions in the licence, as explained in Chapter 2, would help to facilitate any necessary distinction that may need to be made between the present PES distributors (ex-PESs) and other distributors. It is proposed that all distribution licences contain the same groups of standard conditions. Ex-PES distributors will, given their position in the market and the nature of their present licence obligations, be subject to certain licence conditions that other distribution licence holders will not. It is also envisaged that there will be a need for special additional conditions which will apply (at least initially) to ex-PESs but that these will not be standard conditions, for example conditions imposing price restraints.

Many of the conditions included in the draft of the new distribution licence originate from the present PES licence. However, as indicated above, some of these conditions will apply only to ex-PES distributors whilst others will apply to all distributors.

Ofgem has previously consulted on Midlands Electricity plc's existing PES licence, which was split into three sections following the sale of its supply business to National Power. The structure of that licence is such that it highlights those obligations which presently apply to Midlands in relation to its distribution activities. The proposals here are based in the main on the distribution obligations in that licence.

To implement certain conditions applying to certain distributors, the approach outlined in paragraphs 35 and 36 of the DTI's October 1999 paper, the draft distribution licence is split into three sections, as described in general terms below.

4.2 General Obligations

Standard conditions which will apply to all distributors include:

- a requirement to offer terms for use of system and retain established connections on a non-discriminatory basis;
- a requirement to prepare and publish charging statements in respect of these services,
- obligations to maintain an efficient distribution system;
- compliance with various industry agreements and codes; and
- customer service and social obligations.

As indicated in section 3.7, Ofgem would welcome views on whether the relationship between the new Consumer Council and licensees should be included as a standard condition in distribution licences.

Standard conditions relating to the interpretation, application and revocation of the licence will also be operative for all licensees. As explained in Chapter 3 on supply licences the revocation provisions of the licence are now included as a standard condition rather than a term of the licence.

In addition to the standard conditions set out above, there will be a need for a number of new conditions. For example, Ofgem considers it appropriate to include a condition achieving compliance with a direction to be given by the Authority in relation to the preparation and revision of a long term development statement such as is required in the gas transporter's licence. There will also be conditions emanating from the proposed New Electricity Trading Arrangements as mentioned in Chapter 2 on which there will be further consultation.

Paragraph 59 of the DTI's October 1999 paper explains that a statutory duty to offer terms for connection (on all licensed distributors) will be set out in the Bill. This

statutory duty to connect will encompass a duty to provide an initial connection, to maintain that connection, and, where required, to modify that connection. Section 4.7 below expands further on this duty and certain circumstances in which it will not arise. Ofgem proposes to continue to include in distribution licences obligations regarding connections. For example, the obligation to retain an established connection will continue to be required via a standard licence condition.

4.3 Security and Safety of Supply

Standard licence conditions are also considered appropriate for all distributors in respect of disadvantaged customers. It is not necessary to limit these obligations to small customers in the same manner as is proposed for supply licences as distributors cannot elect only to distribute to certain categories of customers in the same way that suppliers can. The draft standard conditions incorporate the changes proposed in Ofgem's consultation document issued in October 1999 "Social Action Plan – Framework Document". The existing PES licence contains conditions relating to the provision of an enquiry service for security and safety of supplies, the provision of distribution services for persons who are of pensionable age, disabled or chronically sick and a Code of Practice on procedures with respect to site access. These conditions will, where relevant, apply to distributors. For example, it is appropriate that all distributors should establish and operate a safety and security of supply service in respect of the distribution systems they operate. There is a corresponding obligation on suppliers to inform customers of the appropriate contact details for this service.

4.4 Additional Obligations

Some standard conditions need only apply to a sub-set of distributors. It is considered that, at least initially, this sub-set of distributors will be those companies who continue to carry out the distribution activities of the present PESs (ex-PES distributors).

Distribution licences will not be issued in respect of mutually exclusive geographical areas, that is, there will be no "specified premises" schedule. However, some of the additional obligations will only need to apply in relation to a specified geographical area. The draft licence refers to this area as the Distribution Service Area. It is envisaged that each PES's present "authorised area" will form its new Distribution Service Area.

The main additional obligations are those which are necessary to ensure that the services which are presently provided by PESs, in their capacity as distributors, continue to be provided. The majority of these services are those which were required to

introduce, and subsequently facilitate, competition in the supply of electricity. These obligations relate to the provision of registration systems, data transfer systems and certain metering and data services. No changes are proposed to the present licence requirements in respect of the provision of registration systems and data transfer systems. As mentioned above in relation to supply licences, it is intended that distribution licensees preparing charging statements for use of system, connection, meter provision, meter maintenance and other services should first consult with potential users of the relevant service. It is proposed in the draft distribution licence that such charging statements will be required to be sent to the Authority in advance of the new charges taking effect and that the Authority will have a right of veto. However, views would be welcome on whether this approach is necessary for all such charging statements. A number of changes are proposed in respect of the provision of metering services as a result of Ofgem's previous consultation paper and proposals on separation.

4.5 Metering

In its May 1999 consultation document on separation of businesses, Ofgem concluded that it was appropriate for PES distribution businesses to be responsible for providing, on a non-discriminatory basis, services relating to the provision of meters and maintenance of meters. It was also concluded that the distribution business should operate a tender process for the provision of a meter reading service in its Distribution Service Area. This proposal was designed to provide additional protection for second-tier suppliers against the background of the continued integration of the incumbent supply and meter reading businesses. Ofgem has recently issued a separate consultation on the necessary licence amendments required to implement this proposal. The draft standard licence conditions reflect the draft licence obligation set out in this recent consultation.

As stated in section 3.1.4, it is envisaged that supply businesses generally will have responsibility for ensuring metering and data services are provided. It is for consultation precisely what, if any, additional obligations in respect of meter reading, data processing and data aggregation services should be included in the ex-PES supply businesses' licences. Views are welcome on the options described in section 3.1.4.

Existing PES obligations to provide a pre-payment meter infrastructure service will not be included in the distribution licence. As indicated in section 3.1.4, this will be a standard condition of the supply licence that will apply to ex-PES suppliers.

4.6 *Ring-fencing Provisions*

Ofgem considers that a number of financial ring-fencing provisions may need to be in place, via licence conditions, for PESs. Ofgem has recently made a number of licence modifications further to strengthen the provisions and adequately to reflect the company structure of each such supplier.

It is Ofgem's intention that these safeguards need to continue for transmitters, ex-PES distributors and BG plc who provide energy networks. Ofgem has recently consulted on the ring-fencing provisions it considers relevant for BG plc in its capacity as a public gas transporter. In addition, Ofgem has previously announced its intention to introduce ring fencing provisions into NGC's transmission licence. The Scottish transmission licensees have given assurances about both how their restructuring will fit the relevant criteria and their acceptance of ring fencing conditions in relation to their distribution businesses. Given the separation of supply and distribution it would therefore be appropriate to include ring-fencing provisions as standard conditions for, at least initially, ex-PES distributors. In line with this thinking the present draft of the distribution licence includes many of the provisions which presently apply to each of the PESs' licensed regulated businesses. Further consultation on ring fencing provisions is proposed.

4.7 *Duty to Connect*

Although the duty to connect will be encompassed in legislation, the DTI's October 1999 paper (paragraph 59) explains that this duty will not arise in circumstances where the making of a connection requires the powers under Schedules 3 and 4 of the Electricity Act 1989 and where the distribution licence holder does not have these powers at its disposal by virtue of his licence. At least initially, we expect to provide the relevant powers to all ex-PES distributors and these will apply at least in respect of their Distribution Service Area. This means that all areas of Great Britain will be covered. Other distribution licensees who wish to have such powers, and consequentially the duty to connect obligation, can apply for them subject to satisfying the Authority as to certain criteria.

5. Gas Shipping and Transportation Licences

5.1 *Shipping*

No major changes to the gas shipping licence are proposed. Government has indicated that it considers it would be premature to remove gas shipping from the scope of licensing. However, the Government's proposed legislation will permit the Secretary of State to remove activities from regulation, where appropriate (see Chapter 2). The future of gas shipping as a licensed activity could therefore be addressed at a later date, after the usual process of consultation.

5.2 *Transportation*

Ofgem is intending to amend the gas transporter licence (from which, for consistency with the changes being made in electricity, the word 'public' will be removed) to contain ring-fencing provisions, in respect both of finance and disclosure of information. As with the gas supply licence, as stated in section 3.2.2, references to Special Customer Payment Claims (in Standard Condition 10) will be deleted. Similarly, any reference to the mechanism for election to increase the ceiling for deemed gas contracts above 73,200 kWh will be deleted. Ofgem also intends there to be a new provision for establishing complaints handling procedure, in gas transporters' licences as well as electricity distribution licences. This reflects the Government's proposals indicated in paragraph 96 of the DTI's October paper.

The condition relating to a long term development statement will remain and will be replicated in electricity distribution licences.

Ofgem considers that information regarding 'M' numbers and associated addresses should be made available by transporters, at no direct charge, to gas suppliers and shippers, mirroring the position in electricity. Also, an enquiry service similar to that provided by BG plc as a gas transporter and electricity ex-PES distribution companies will be required by a new licence condition in gas transporters' licences. Aligning gas and electricity provisions will also require gas transporters to ensure that data held on the supply point administration system should be of a reasonable quality (complete, unique, accurate and maintained in co-operation with shippers and suppliers) such that a supplier can accurately determine the correct meter point reference number for any address.

Ofgem is conducting a separate consultation on BG plc's Liquefied Natural Gas storage facilities. Ofgem has recently proposed the possible auction of storage assets to reflect the value of the service to shippers. This will impact on transporter licence conditions.

5.2.1 Removal of Geographic Exclusivity

The gas transporter licence will continue to specify an area within which the transporter is authorised to operate, but this area will no longer be geographically mutually exclusive as indicated in paragraph 47 of the DTI's paper on proposals for legislation. Given this removal of geographic exclusivity, Ofgem can envisage that there may be geographic areas where transporters have overlapping obligations. To this end, it is proposed that licence conditions will cover additional duties to consult with and provide information to all other transporters whose areas overlap. To ensure safety is not compromised (where transporters conclude agreements with respect to responsibility for safety between overlapping transporters) the transporters involved will be required to have a single point of contact for customers for the reporting of safety matters.

Additionally, with regard to any proposed licence extensions, it is expected that licence conditions will require the transporter to notify:

- unlicensed (shipping) companies with which it deals in the area of the extension;
- other transporters which operate in that area; and
- the Health and Safety Executive.

Gas transporters will be expected to take on, within their licensed areas, the general duties and powers set out in sections 9 and 11 and Schedules 3 and 4 of the Gas Act. A special condition will apply to BG plc should it need to have any powers or duties which do not apply to other transporters. Alternatively, this might be a standard condition appropriate to all dominant transporters and, again, views are welcomed.

5.2.2 Metering and Meter Activities

Ofgem has consulted on its proposals for gas metering and meter reading twice over the past year and intends to publish final proposals before the end of this year. The final

proposals are likely to seek to establish separate price controls for BG plc's metering and meter activities, and to establish a more transparent regime for regulating metering charges. To the extent that these proposals affect standard licence conditions for gas transporters, the present draft licences may be amended.

5.3 Licence Fees and Revocation Provisions

As stated in 3.2.4 above, the present capping provision for gas licence fees will be abolished and the condition will be amended as previously outlined. As explained in 3.1.9, the revocation provisions are to be incorporated as a standard condition of the licence.

6. Electricity Generation and Transmission Licences

One important function of the new legislation is to introduce the New Electricity Trading Arrangements (NETA) as discussed in Chapter 2. Introduction of NETA will necessitate a number of changes to the conditions of existing generation and transmission licences in respect of England and Wales which will be the subject of a separate Ofgem consultation. In addition, the proposals to implement revised Scottish Trading Arrangements as set out by Ofgem in its October 1999 paper "Review of Scottish Trading Arrangements" will also require further changes to generation and transmission licences.

6.1 Scottish Trading Arrangements

Whilst no specific powers are proposed in the Bill in relation to Scottish Trading Arrangements, Ofgem has consulted on proposals to reform the way electricity is traded in Scotland as referred to above. That paper proposed a number of changes including:

- the robust separation of supply and generation from distribution and transmission;
- a Scotland-wide basis of trading, compatible with, new electricity trading arrangements being developed for England and Wales, including the creation of a single system operator for Scotland separate from the transmission, generation and supply activities of the two Scottish companies; and
- separation of the interconnector between Scotland and England from other assets of Scottish Power and a new basis for determining both access to the interconnector and the charges to be paid for its use.

Ofgem expects to publish its further proposals shortly. Subject to the outcome of that consultation, further changes to relevant standard licence conditions may be made. This is likely to include several modifications to the generation and transmission licences to underpin the present interim trading arrangements and facilitate competition on the transmission and distribution networks. Modifications may also be required in the transmission licence relating to the auctioning of the interconnector, the establishment of a separate interconnector business and an independent system operator, and the proposed requirement to use an agent to provide system operator, interconnector and settlement functions.

6.2 Transmission Licences

As explained earlier, it is proposed that each type of licence be capable of being Great Britain wide. This intention applies equally to transmission licences. It is therefore expected that transmission licences, which will continue to be based on mutually exclusive geographical areas, will contain some standard conditions, for example, system access and financial ring fencing. Obligations that may be suitable to incorporate as standard conditions include:

- requirement to offer terms for use of system;
- payment of fees;
- revocation provisions; and
- provision of information to the regulator.

However, at least initially, transmission licensees may be operating in slightly different market environments with different settlement requirements. It may therefore be appropriate to structure the licence so that certain conditions only apply where the licensee is trading only in Scotland or only in England and Wales.

However, transmission licences are likely to include a number of special conditions including obligations relating to price controls.

6.2.1 Compliance with EU Directive 99/92/EC (the "IME Directive")

Ofgem will be consulting shortly on changes to the present transmission licences to facilitate compliance with the EU Directive. These changes will include the need to ensure robust managerial separation of the transmission system operator from other activities not relating to the transmission system and improved transparency of criteria to access interconnectors.

6.3 Generation Licences

Ofgem envisages that many of the existing conditions of a generation licence will become standard conditions. These include:

- Compliance and Industry Agreements and Codes;
- Payment of Fees;
- Provision of information to the Authority;
- Compulsory Acquisition of Land; and

- Powers to carry out street works.

Some changes will be necessary to ensure consistency with other types of licences, for example the revocation provisions will become a standard licence conditions (as explained in Chapter 3 on electricity supply licences). Changes arising from NETA will also be incorporated as discussed in Chapter 2.

Some existing generators have additional conditions relating to non-discrimination provisions and obligations to provide accounting information. It is for further consideration as stated earlier, precisely how these obligations will continue within the revised licence structure. The present thinking is that these provisions could form standard conditions that apply only to a sub-set of generation licensees.

7. Next Steps

This paper sets out Ofgem's initial views on standard licence conditions. It is intended to promote discussion and comment. Further work will, of course, be required in the light of the comments received, other consultations, the publication of the proposed Bill clauses and relevant proposals for secondary legislation. Ofgem will then consider what amendments may be necessary. Appropriately amended standard conditions will be provided to the Secretary of State who will be responsible for determining and publishing the standard conditions in line with the proposed timetable for the Bill.

Any questions about the contents of this paper should be addressed to Amanda McIntyre:

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Views on the issues raised in this paper and the detail of the draft standard conditions, are invited by **Wednesday 22 December 1999**. Responses should be sent to:

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Unless clearly marked confidential, responses will be published by placing them in the Ofgem library.