

**October 2000**

**The Calculation of Annual Licence  
Fees and Licence Modifications**

**Joint consultation paper**

**Office of Gas and Electricity Markets**

**Department of Trade and Industry**

## Executive summary

This consultation paper discusses the changes that need to be made to the existing licence fee arrangements following the Utilities Act 2000. There are two main issues to consider, first the licence fee arrangements for this financial year and second the most appropriate arrangements for the future.

In respect of this financial year, licence holders have already been billed for expenditure budgeted for in March and subsequently voted by Parliament. Arrangements now need to be made to charge for certain other costs which cannot be recovered until the sections in the Utilities Act 2000 setting up the Authority and the Gas and Electricity Consumer Council have been implemented. The Secretary of State is now expected to commence these sections on or soon after 1 November. The consultation paper sets out the proposed amendments to existing licence conditions to enable these costs to be recovered in the current financial year. Such costs will generally be recovered using the existing formula for apportioning costs between licence holders. As previously indicated by DTI Ministers, the existing cap on gas licence fees will be abolished.

The existing charging system is essentially unchanged since privatisation. For next financial year and beyond it will be important to consider whether more substantial changes will be needed to reflect structural changes in energy markets and the modernisation of the regulatory regime following the Utilities Act 2000. In particular the licence fee regime needs to reflect the fact that there is now a single regulatory body for the energy sector. Any new licence fee arrangements will be incorporated in the new standard licence conditions (SLCs) for electricity licence holders, and the revised SLCs for gas licence holders. The paper identifies a number of options. First, would it be practicable or appropriate for Ofgem to try and attribute its costs to individual licence holders. This would have the advantage of placing regulatory costs where they are incurred, but would be complex to administer and might create a significant amount of instability in the level of individual licence fees. Second, it would be possible to develop the existing systems, where costs are attributed to groups of licence holders. Within each group or sector licence fees would then be set by allocating costs by means of a suitable measure of company activity. An advantage of this approach would be that it would provide a strong link between the licence fee and the level of regulatory activity within the sector. Third, it would be possible to allocate costs broadly as under the existing arrangements but using a common activity driver. Finally the paper

considers an approach which would recover all costs from the natural monopoly sectors (distribution, transmission and transportation licence holders). This would have the advantage of administrative simplicity and would not distort the development of competition. It would also fit in well with the way in which liberalised energy markets should develop in the longer term, with less regulatory intervention and the removal of price controls. Views are invited on the merits of these approaches.

Responses to this paper should arrive no later than 27 November.

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# 1. Introduction

- 1.1 The Utilities Act 2000 modernises the framework for utility regulation. The functions of the Directors General of Gas and Electricity Supply will be replaced by the Gas and Electricity Markets Authority. The combined offices of the Directors General (OFFER and Ofgas) will continue to be commonly known as the Office of Gas and Electricity Markets (Ofgem). At the same time the new Gas and Electricity Consumer Council (GECC) will be set up to provide a single body to represent gas and electricity consumers in place of the Gas Consumers' Council and the Electricity Consumers' Committees.
- 1.2 It is anticipated that the Authority and the GECC will be created by the Secretary of State in November or December, following the commencement of the relevant sections of the Utilities Act. Section 8 of the Utilities Act allows consultation, relating to the modification of the payment conditions, carried out before the creation of the Authority and GECC to be effective as if it were carried out by the Authority.
- 1.3 This consultation paper discusses the changes that need to be made to the existing licence fee arrangements following the Utilities Act 2000. There are two main issues to consider, first the licence fee arrangements for this financial year and second the most appropriate arrangements for the future.

## *The transitional year*

- 1.4 This joint Ofgem and Department of Trade and Industry (DTI) paper sets out:
- ◆ the arrangements for collecting licence fees that are not dependent on the timetable for commencing the relevant provisions in the Utilities Act;
  - ◆ proposals for recovering the costs of the GECC;
  - ◆ proposals for recovering the Secretary of State's own costs; and
  - ◆ proposed changes to licence conditions relating to the recovery of certain additional costs incurred in 2000-01.

- 1.5 Licence holders have now been invoiced for costs falling under the first heading. The remaining costs will be recovered in a second tranche. DTI Ministers and Ofgem have decided in principle to proceed with the proposed changes required to recover costs which cannot be recovered without recourse to the powers provided in the Utilities Act, and to abolish the existing licence fee cap in gas licences. The changes will be effected using the powers set out in section 8 of the Utilities Act, since the new standard licence conditions will not be in place in time to collect licence fees for 2000-01. However, the modified licence conditions have been drafted to avoid the need for further changes should there be a delay in introducing the new standard licence conditions.

### ***Subsequent years***

- 1.6 The Utilities Act introduces the concept of standard licence conditions in electricity and provides for the replacement of the existing standard conditions in gas with new standard conditions (although many of the existing conditions will be replicated). These standard conditions will be determined by the Secretary of State. Thereafter, it will be for the Authority to propose modifications. Ofgem is providing advice to the Secretary of State on the standard conditions, including the requirement to pay licence fees to the Authority. The draft standard payment condition is being consulted on separately as part of the Consultation on Standard Licence Conditions (see paragraph 2.6 below).
- 1.7 The existing licence fee arrangements currently differ substantially between the gas and electricity industries. Changes will be necessary as a result of the structural changes in the gas and electricity markets which led to the decision to create a single Authority, and the introduction of standard licence conditions that are common wherever practicable. Comments are invited on options for apportioning costs between individual licence holders, and classes of licence holder, in future years.
- 1.8 This paper does not cover licence application fees. However, electricity application fees were covered in the consultation paper published in August 2000 on Electricity Licence Application Regulations. Amended gas application regulations will be the subject of a separate consultation exercise.

1.9 Any questions about the contents of this paper should be addressed to Andrew Reed.

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1.10 Views on the proposals in this paper are invited by 27 November 2000.

1.11 Responses, preferably by e-mail, should be sent to:

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1.12 Unless clearly marked confidential, responses will be published by placing them in the Ofgem library. Respondents should take care that any information of a commercially sensitive nature is clearly marked as such and the response structured so that it can easily be removed.



## 2. Background

- 2.1 The Government undertook an extensive review of utility regulation in 1997-98. The initial conclusions were published as "A Fair Deal for Consumers – Modernising the Framework for Utility Regulation" in March 1998. The Government's proposals following consultation on the Green Paper were published in July 1998 in its "Response to Consultation" document. The Utilities Act gives effect to the Government's final proposals for the gas and electricity sectors.
- 2.2 The review concluded, inter alia, that the Offices of the Director General of Gas Supply and the Director General of Electricity Supply should be replaced with a new Gas and Electricity Markets Authority, in order to ensure that regulation can respond effectively to the convergence of the gas and electricity markets. Callum McCarthy was appointed Director General for Gas Supply (from 1 November 1998) and Electricity Supply from (1 January 1999). As an initial step towards making the regulatory system more responsive to developments in the liberalised energy markets, the Director General decided to co-locate OFFER and Ofgas in a single headquarters in London. This will bring substantial benefits in terms of increased regulatory effectiveness. There will also be benefits from sharing common services, and more efficient use of management time. The announcement by DTI of the decision to bring the two offices together as Ofgem was widely welcomed by the gas and electricity industries, consumer groups and other interested parties.
- 2.3 The Utilities Act provides for the establishment of the Gas and Electricity Markets Authority. The GECC will be set up at or about the same time. The Secretary of State expects to commence the relevant sections of the Act shortly.

### ***Prior consultation by the Director General of Gas Supply***

- 2.4 Ofgem issued a consultation document about possible changes to the gas licence fee arrangements early last year. A further paper, setting out those proposals on which the Director was minded to proceed was published in June 1999. This dealt primarily with the need to raise the existing cap on gas licence fees, in the light of an increased workload and the initial costs of co-location.

- 2.5 The responses to the consultation revealed that there was no consensus in favour of the proposal to remove the cap on income from gas licences.

***Prior consultation on licence conditions***

- 2.6 The Utilities Act provides for the drawing up of standard licence conditions for both gas and electricity. These have been the subject of two separate consultation exercises in November 1999 and February 2000. There is to be a final consultation in the Autumn.

***Key papers***

- 2.7 The appendices to this paper set out the following background information:

Appendix 1 – Licence fee arrangements for electricity, prior to the Utilities Act;

Appendix 2 – Licence fee arrangements for gas, prior to the Utilities Act;

Appendix 3 – Licence fee conditions for 2000-01 – Gas;

Appendix 4 – Licence fee conditions for 2001 – Electricity; and

Appendix 5 – Section 8 of the Utilities Act.

### 3. Costs to be recovered in 2000-01

3.1 This year represents a period of transition. Licence fee income will need to cover expenditure by the:

- ◆ Director General of Gas Supply;
- ◆ Director General of Electricity Supply;
- ◆ Competition Commission in relation to matters referred to it by the DGs;
- ◆ Gas and Electricity Markets Authority;
- ◆ Gas Consumer Council (GCC);
- ◆ Electricity Consumers' Committees;
- ◆ Gas and Electricity Consumers Council (GECC) (from 1 November); and
- ◆ Costs, including preparatory costs, incurred by the Secretary of State in relation to the establishment of the Authority and the GECC.

3.2 The assets and liabilities of the existing bodies (including licence fees already invoiced) will pass to the successor bodies, so licence fees will continue to be adjusted to reflect under or over recovery of costs in prior years.

3.3 The Authority is expected to come into being shortly. The expected level of expenditure by the Directors General and electricity consumer bodies was set out in the Ofgem Plan and Budget, sent to all licensees in March. Of the regulator's costs, 78 per cent was allocated to electricity and 22 per cent to gas. The Licence holders were invoiced in September on the basis of the latest available costings for the Directors Generals' costs and the costs of the Electricity Consumers' Committees and the Gas Consumer Council. As in previous years, the costs of the Electricity Consumers' Committees were recovered from first tier electricity suppliers. Costs incurred by the Gas Consumers' Council, which is independent of Ofgem, are determined by the Secretary of State.

3.4 Those costs which can be recovered under the existing arrangements have been invoiced using the same method as in previous years.

- 3.5 Certain costs cannot be recovered until the relevant provisions in the Utilities Act have been commenced, so this year it will be necessary to collect licence fees in two separate tranches. Once the necessary powers are available, Ofgem will issue a further invoice in respect of the following costs:
- ◆ costs incurred in preparation for the creation of the Authority which have yet to be voted by Parliament;
  - ◆ costs incurred by the Secretary of State in establishing the Authority and GECC;
  - ◆ additional costs incurred by the GECC following the commencement of section 1 and 2 of the Utilities Act 2000 establishing the GECC; and
  - ◆ any additional costs incurred by the Authority not included in the corporate plan published in March and voted by Parliament.
- 3.6 The public expenditure controls to which Ofgem, in common with all other government departments, is subject mean that it is necessary to recover expenditure in this financial year.
- 3.7 The collection of the second tranche of licence fees will require changes in licence fee conditions. Section 8 of the Utilities Act provides powers to enable the Authority to “modify any payment conditions of a gas licence or electricity licence where the Authority considers it necessary or expedient to do so in consequence of, or of preparations for, the establishment of the Authority or the Council”.
- 3.8 The Government has indicated, in its detailed consultation on reforms of gas and electricity regulation, its intention to abolish the present capping provision on gas licence fees. To reflect this and take account of the creation of the Authority and Gas and Electricity Consumer Council (GECC), the payment condition in existing licences will be amended to provide for the recovery of the total costs of the Authority, including costs recoverable as an agent on behalf of the Competition Commission, the Secretary of State and the GECC. The costs attributable to the GECC – except to the extent already covered by the funds

inherited from the GCC and Electricity Consumer Committees – will be recovered from the generality of licence holders, following the GCC model.

- 3.9 As the existing licence fee conditions do not provide powers to recover costs flowing from the changes provided for in the Utilities Act, initially the power in section 8 will be used to substitute a new licence payment condition in all existing licences.
- 3.10 In the interests of simplicity, as few changes as possible will be made in the current year. Soon after the Authority and GECC are in place, the transitional licence payment conditions set out in appendices 3 and 4 will come into effect to provide for the recovery of the additional costs of the new institutions for the remainder of the year, and certain other costs. The transitional arrangements will, of course, take account of payments already made under the existing arrangements. The Authority will continue to distinguish between costs attributable to gas and electricity companies for the remaining months of the 2000-01 financial year.
- 3.11 The licence fee arrangements for future years will be set out in the standard licence conditions, when these have been finalised and when section 31 and 81 of the Utilities Act have been commenced. Although the proposed interim licence conditions do not incorporate an end date, these will be replaced automatically with effect from 1 April 2001 subject to the new standard licence conditions being in place by the end of this financial year.

## 4. Regulatory costs

### *The Authority's costs*

- 4.1 The cost of regulation has been on an upward trend in recent years. The main factors have been:
- ◆ the introduction of competition in gas and electricity has greatly increased the number of companies with which Ofgem deals;
  - ◆ the introduction of domestic competition, and the consequent innovations in marketing, have given rise to the need to devote additional resources to consumer support and protection;
  - ◆ the reform of electricity trading arrangements has placed a heavy burden on resources; and
  - ◆ co-location and the preparatory costs of the merger of Offer and Ofgas.
- 4.2 Some of these costs are, of course, transitional, and substantial benefits in the form of improved regulation and reduced costs will feed through in future years. As competition becomes more firmly entrenched and as the industry's customer service improves the need for detailed regulation should diminish.
- 4.3 Further details are given in the Ofgem Plan and Budget for 2000/01, and the accompanying press release dated 17 March.

### *The GCC and GECC's costs*

- 4.4 These bodies, though funded through the licence fee system, are independent of Ofgem. The GCC is an executive Non Departmental Public Body funded by the DTI. The Secretary of State provides a grant in aid to the GCC. Ofgem then recovers a matching amount from licence holders. The DTI is responsible for setting the GCC budget and for monitoring expenditure against budget throughout the year. These arrangements will also apply to the GECC.

- 4.5 The additional costs to be recovered on behalf of the GECC in 2000/01 are expected to be substantial. The exact amount will depend on the allocation of start up costs between 2000/01 and 2001/02.

***The Secretary of State's costs***

- 4.6 These are costs incurred by the Secretary of State in preparation for establishing the new regulatory bodies and include the costs of the GECC task force, the recruitment of members for both the new Authority and the Council and the (possible) costs incurred when approving companies' transfer schemes (as required under Schedule 7 of the Utilities Act) and other costs associated with the establishment of the Authority and Council.

## 5. Controlling the Authority and GECC's costs

### *The Authority*

- 5.1 The legislation provides for income from licence fees to be paid into the Consolidated Fund. Since 1998 the Treasury has used its powers under the Public Accounts and Charges Act, 1891 to authorise OFFER and Ofgas to appropriate receipts in aid of the Vote. This arrangement, which enables income from licence fees and other sources to be set against gross expenditure, will continue.
- 5.2 As a non-ministerial government department, Ofgem is currently subject to the following financial controls:
- ◆ the net provision voted by Parliament. As receipts are offset against expenditure, this is normally a token amount;
  - ◆ the Departmental Expenditure Limit, agreed with the Treasury, normally corresponding to the net provision;
  - ◆ the Appropriation in Aid line voted by Parliament, authorising income from receipts to be offset against expenditure; and
  - ◆ the running cost limit, set by the Treasury, which restricts total expenditure on administration.
- 5.3 These controls mirror those to which all government departments are subject.

### *Responses to earlier consultation exercises*

- 5.4 A large number of licence holders have expressed concern that there is insufficient downward pressure on the regulator's costs. In particular, the gas companies used this argument as a reason for opposing removal of the cap on the amount which may be raised under the Gas Act 1986 (as amended). In light of the companies' reaction, the Director General of Gas Supply decided not to pursue this (or any of the other proposals) set out in the consultation paper published in June 1999. The Government has since indicated its intention to



abolish the present annual cap on licence fees of £14 million (at December 1995 prices).

- 5.5 Parliament rejected proposals to retain the cap in gas licences or to extend the current arrangements in gas to the electricity sector. Therefore we have not given further consideration to this option put forward in response to earlier consultation exercises. Ministers have also ruled out the possibility of funding the economic regulators from general taxation.
- 5.6 Concern about the cost of running Ofgem was also expressed during the passage of the Utilities Act through Parliament, and in response to earlier consultation on standard licence conditions (SLAs). Although there is no evidence that expenditure has been above the minimum necessary in order to deliver policy objectives, it is recognised that the traditional public expenditure control framework may be usefully supplemented in the case of an economic regulator mainly financed from licence fees.

### *The efficiency regime*

- 5.7 The Treasury has decided that Ofgem – in common with the other economic regulators - should be subject to an efficiency regime to supplement the normal Parliamentary controls over public expenditure. The first stage was implemented by the publication of Ofgem's draft plan and budget in November 1999.
- 5.8 Under the efficiency regime external consultants appointed by the Treasury will undertake a detailed financial review of expenditure. Their report will be submitted to the Treasury in the Autumn, to inform decisions on the level of gross expenditure. Consultants will also report regularly on operational effectiveness and value for money.
- 5.9 Under Section 4 of the Utilities Act, the Authority and the GECC will also be required to consult annually on the basis of a forward work programme (FWP). The consultation exercise will allow the licence holders, consumer groups and other stakeholders to make their views known. The Treasury will take the response to the consultation exercise into account in setting expenditure limits.

- 5.10 Expenditure limits will normally be set for the following three years, with indicative figures only for the second and third years. Each year, plans will be rolled forward for a further twelve months.

### ***Controlling the GECC's costs***

- 5.11 Concerns about the costs of the new Council were raised during the passage of the Utilities Act. As a consequence, Ministers gave a commitment that costs would be rigorously scrutinised and performance monitored to ensure that the GECC represents value for money. All Non Departmental Public Bodies (NDPBs) are subject to regular and challenging review at least every five years, taking full account of the views and needs of customers and companies and other stakeholders. The Government will ensure such a review takes place.
- 5.12 The DTI is the Department responsible for agreeing the GECC's budget and for monitoring its expenditure. The budget will be agreed at the beginning of the financial year following the publication of the Council's forward work plan (FWP). The FWP will contain a general description of the projects the GECC plans to undertake in that year; the objectives of each project and an estimate of its overall expenditure for that particular financial year. Indicative figures will be produced for the two immediately following years. The FWP will itself have been the subject of a consultation exercise prior to publication. When agreeing the budget, the DTI will know the results of the consultation exercise and will be able to take into account any views expressed.
- 5.13 At the end of a financial year, the GECC will be required to produce an annual report on its activities. This will include a report on the progress and outcomes of the projects described in the GECC's FWP for that year. The DTI is keen to ensure that the GECC's target performance outputs are both rigorous and quantifiable, and achieved.

## 6. Future years

### *Introduction*

- 6.1 Views are sought on the method for calculating licence fees in future years. The present distinction between gas and electricity regulation no longer reflects either the structure of the liberalised market or the way in which it is regulated. Many companies operate in both gas and electricity sectors, and Ofgem is now organised on a functional basis.
- 6.2 In 2000/01 Ofgem is recovering about 20 per cent of its costs from gas licence holders and about 80 per cent from electricity licence holders. This apportionment of costs to a large extent reflects the extra costs associated with the review of electricity trading arrangements. Within the regulated gas industry about 50 per cent of costs will be recovered from suppliers and 45 per cent from transporters with the remaining 5 per cent recovered from gas shippers. In electricity the proportions are about 25 percent from each of generation, transmission, distribution and supply. In gas the costs of the GCC are recovered on same basis as Ofgem's costs. In electricity the costs of the Electricity Consumer Committees are recovered only from first tier licensed suppliers.
- 6.3 It was proposed in the June 1999 consultation paper to change the allocation of charges in the gas sector to 40 per cent from suppliers, 50 per cent from transporters and 10 per cent from shippers. However this proposal fell away when licensees opposed the increase in the gas cap.
- 6.4 The essential features of the existing arrangements for allocating costs date back to privatisation. At present costs are apportioned between gas licence holders on the basis of the number of premises, while electricity licence holders are charged on the basis of the volume of energy handled. It is appropriate to consider whether the existing arrangements for calculating licence fees remain appropriate.

### *Options for the Future*

- 6.5 In order to calculate licence fees a mechanism is needed to attribute or allocate the costs of Ofgem and the GECC between licence holders. It is for

consideration whether costs should be attributed to individual licence holders or groups of licence holders, or whether licence fees should be determined by some broader principles that provide a basis for allocating costs between licence holders.

6.6 By way of comparison, both the Office of Water Services (OFWAT) and the Office of the Telecommunications regulation (OFTEL) calculate licence fees by allocating costs on the basis of the turnover of regulated companies. The structure of the energy sector dictates a more complex approach. A number of options are considered below.

**(i) Attributing Costs to Individual Licence Holders**

6.7 Ofgem is committed to understanding the factors driving the costs of regulation in the interests of sound financial control and management. Given this it would be possible to attribute and allocate costs to individual licence holders on the basis of their proportionate share of regulatory activity. However this would be difficult to administer and individual licence holders might experience sharp variations in licence fees. A decision would also need to be taken on whether fees should be calculated on the basis of past levels of activity, or on forward projections.

6.8 A more fundamental issue is whether it is appropriate to try to allocate costs on this basis. Regulatory activity is often directed at a group of companies, and there may be no way of attributing the associated costs to individual licence holders. For example, the operation of wholesale markets is affected by the actions of both the sellers and purchasers and there would remain a large element of judgement involved in deciding how to allocate the costs of regulatory activity. Therefore, in practice a substantial proportion of Ofgem's costs would need to be allocated across groups of licence holders. This would tend to undermine the concept of cost reflective charges for individual licence holders.

6.9 Nevertheless, the option of being able to attribute the costs of a regulatory investigation to an individual licence holder might have a deterrent effect with respect to behaviour that would be anti-competitive and or inconsistent with the

interests of customers. It is for consideration whether this option should be retained whatever the basic system for calculating licence fees.

**(ii) Attributing Costs to Groups of Licence Holders**

- 6.10 It would be possible to attribute and allocate costs to the existing categories of licence holder (supply, distribution\transmission\transportation, gas shipping and electricity generation). Within each sector licence fees would be determined by a suitable measure of activity, broadly consistent with certain aspects of the existing arrangements. Depending on the sector the measure of activity might be energy handled, customer numbers or turnover.
- 6.11 It would be possible to establish the proportion of costs recovered from each sector on the basis of a forecast of Ofgem's activities, perhaps for a period of 3 years. This approach would maintain a reasonably close link between the activities that give rise to regulatory work and the apportionment of costs, but at the same time give an element of stability and predictability to the system. The regular review of the proportion of costs recovered from each sector would allow changes in workload of the Authority and GECC to be taken into account. In order to provide a greater degree of flexibility than is available in the present arrangements it would be possible to include the proportion of costs recovered from each sector in a subordinate document, capable of amendment as and when necessary.
- 6.12 It would be for consideration whether to retain any distinction between gas and electricity within sectors. For instance the existing arrangements have allowed the recovery of the substantial costs associated with the new electricity trading arrangements from electricity licence holders and customers. This has tended to produce more cost reflective licence fees.

**Allocating all Costs Via a Common Activity Driver**

- 6.13 Rather than attribute costs to licence holders it would possible to allocate costs according to some common activity driver and so derive a set of licence fees. This would be similar to existing arrangements, where in gas costs are allocated on the basis of customer numbers and in electricity by energy handled.

6.14 While the existing systems have advantages in terms of simplicity in practice it would be difficult to find a common activity driver that would be reasonable to use across both industries. Energy handled would tend to shift costs on to gas companies as the final energy demand for gas is much higher than for electricity. It would be difficult to use numbers of customers as electricity generators do not supply final customers. Turnover might be difficult in the longer term as supply businesses may tend to offer combinations of household services and affinity discounts.

**(iv) Allocating all Costs to Natural Monopoly Businesses**

6.15 Another option would be to allocate all costs to natural monopoly businesses (distribution, transmission and transportation), these businesses would then be allowed to take account of the costs of the licence fees in setting their own charges. Their own charging arrangements would provide a ready-made mechanism for recovering these costs from their customers. Costs would be apportioned between natural monopolies using a suitable indicator of activity, such as turnover. There would be additional costs to the companies concerned and it would be necessary to consider adjustments in price control conditions, where these do not already provide for the pass through of these costs. Alternatively, a retrospective adjustment could be made at the next price control review. Allocating costs to natural monopoly businesses would not distort competition and would minimise administrative costs.

6.16 Under this option the costs of the GECC could be allocated using the same formula as for the allocation of the costs of the Authority. This would follow the existing model in the gas sector.

***Assessment***

6.17 At present, electricity licence fees are calculated by reference to the volume of energy, and gas by reference to the number of premises served (with imputed numbers for shippers and transporters). The creation of Ofgem and the GECC provide an opportunity to consider options for improving the existing arrangements.

6.18 In principle, cost reflective pricing might be considered the most appropriate approach, although it is not clear how practicable it would be to attribute the costs of Ofgem and the GECC to individual licence holders. Another option would be to attribute costs to the various sectors that make up the regulated gas and electricity industries. The sectoral allocation approach is also relatively complex, but would provide a link between licence fees and regulatory activity. Alternatively, costs could be allocated across all licensed companies on the basis of some generic indicator of company activity. However, it is not clear that a suitable indicator of activity can be identified. Collecting licence fees from the natural monopolies alone, and using their charging systems to spread costs across the energy sector as a whole is the simplest approach, but severs any direct link between income from the licence fee system and the incidence of regulatory activity. Nevertheless, it would not distort competition and would be straightforward to administer.

#### ***Independent Review and Penalties for Late Payment***

6.19 It is proposed that any returns in respect of the data needed to determine the licence fee payable should be subject to certification by the companies' auditors or other approved trusted third party. In the event of queries arising the Authority would require access to the companies' accounting and other records. Where payment is not made within the standard thirty days interest would be payable on the outstanding balance. Failure to make payment within a reasonable period thereafter would render the licence holder liable to enforcement action, including the possibility of further financial penalties.

#### ***Minimum Charges***

6.20 Under the existing arrangements in the electricity industry all licence holders are obliged to pay a minimum fee of £250. In the gas industry all licence holders are also required to pay minimum fees, set at £4000 for gas transporters, £800 for gas suppliers and £200 for gas shippers. It is for consideration whether to retain minimum licence fees and at what level. One option would be to set minimum licence fees at £500, the average of the existing minimum fees for gas suppliers and gas shippers.

## *Summary*

- 6.21 Views are invited on any aspect of the issues raised in this chapter and in particular on:
- ◆ whether in principle licence fees should be determined by attributing costs to licence holders on the basis of regulatory activity or whether costs should be allocated on some broader basis;
  - ◆ the advantages and disadvantages of the four options for setting licence fees identified in this chapter;
  - ◆ whether an option should be retained to attribute the costs of a specific investigations to individual or groups of licence holders;
  - ◆ whether the costs of the GECC should be recovered on the same basis as Ofgem;
  - ◆ whether existing price control conditions should be modified to allow the pass through of licence fee costs; and
  - ◆ whether minimum licence fees should be retained and if so at what level.



# Appendix 1 Electricity licence fee arrangements, prior to the Utilities Act 2000

## *The legislative framework*

- 1.1 Section 7 (1) (b) of the Electricity Act 1989 (the Electricity Act) allows for the inclusion, in all licences granted under it, of a condition requiring the payment of amounts to the Director, such as may be determined by or under the licence. The Director has used this power to recover the costs of Offer, the costs of the relevant Consumer committees and costs associated with references by the Director to the Competition Commission.
- 1.2 The requirements for a licensee to pay the licence fee is set out in the conditions of the licence as follows:
  - ◆ Condition 29 of Public Electricity Suppliers' Licences;
  - ◆ Condition 18 of Transmission Companies' Licences;
  - ◆ Condition 18 of Generators' Licences.
- 1.3 As there are no standard licence conditions in the electricity sector, the numbering of the relevant conditions may vary between licence holders.

## *Licence fee arrangements*

### **Cost Allocation Between Groups of Licensees**

- 1.4 The current arrangements provide for the Director to recover from licensees a proportionate share of the costs which are both reasonable and represent the costs of the regulatory resources consumed in regulating in the three licensing groups (i.e. suppliers, transmitters and generators). Any Competition Commission costs resulting from a reference by the Director are shared on a proportionate basis amongst the type of licensee involved.
- 1.5 The costs of consumer representation are recovered from first tier suppliers only.

- 1.6 The proportion of total recoverable costs to be paid by each group of licence holder, which forms the basis for what is commonly referred to as the licence fee (i.e. how much of the costs each licensee group should bear), is based on the volume of energy.

#### **The Basis for Determining Individual Licence Fees**

- 1.7 Each company pays a minimum licence fee of £250. Costs are then split four ways between: electricity suppliers, distributors, transmission companies and generators on the basis of the volume of energy handled. The costs borne by each category of licence holder are therefore roughly equal.
- 1.8 The accounting day is 1 April each year.

## Appendix 2 Gas licence fee arrangements, prior to the Utilities Act 2000

- 2.1 Section 7B (4)(a) of the Gas Act 1986 (the Gas Act) allows for the inclusion, in all licences granted under it, of a condition requiring the payment of amounts to the Director, such as may be determined by or under the licence. The Director has used this power to recover the costs of Ofgas, the costs of the Gas Consumers' Council and costs associated with references by the Director to the Competition Commission.
- 2.2 The requirements for a licensee to pay the licence fee is set out in the conditions of the licence as follows:
- ◆ Standard condition 32 of Gas Suppliers' Licences;
  - ◆ Standard condition 26 of Public Gas Transporters' Licences;
  - ◆ Standard condition 17 of Gas Shippers' Licences.
- 2.3 In accordance with paragraph 4 (b) of each of the standard conditions, the overall amount which can be recovered collectively from licensees, is capped at £14m (in December 1995 prices). This cap is adjusted each year for inflation, based on the movements in the Retail Price Index (RPI) from December 1995 to the following December each year.

### *Licence Fee Arrangements*

#### **Cost Allocation Between Groups of Licensees**

- 2.4 The current arrangements provide for the Director to recover from licensees a proportionate share of the Ofgas and Gas Consumers' Council (GCC) costs which are both reasonable and represent the costs of the regulatory resources consumed in regulating in the three licensing groups (i.e. suppliers, shippers, and public gas transporters). Any Competition Commission costs resulting from a reference by the Director are shared on a proportionate basis amongst the type of licensee involved.

## Appendix 3 Utilities Act 2000

### Section 8

**Modification of the standard conditions relating to payments to the Authority in the gas suppliers' licences granted and treated as granted under sections 7A(1) of the Gas Act 1986**

#### *Whereas*

- A. The Gas and Electricity Markets Authority (*the Authority*) was established on [date] under section 1 of the Utilities Act 2000 (*the Act*). Under section 3 of the Act, the Authority had transferred to it the functions of the Director General of Gas Supply and the Director General of Electricity Supply.
- B. The Director General of Gas Supply, the Director General of Electricity Supply and the Secretary of State undertook a joint consultation in respect of the modification of the licence conditions relating to payments to the Authority in [date]. Under section 8(7) of the Act such consultation is effective as if it were undertaken by the Authority.
- C. The Authority, after consultation, considers it necessary or expedient to modify the standard conditions of gas suppliers' licences.

#### *Modification*

The Authority, pursuant to section 8 of the Utilities Act 2000, hereby modifies the standard conditions of gas suppliers' licences in the manner set out in the attached Schedule.

The Gas and Electricity Markets Authority

[date]

9 Millbank

LONDON SW1

## SCHEDULE

### Proposed Modifications

1. For standard condition 32 there shall be substituted –

“ **Condition 32. Payment by licensee to the Authority**

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds a licence, the licensee shall pay to the Authority the aggregate of –
  - (a) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Director General of Gas Supply;
  - (b) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  - (c) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Gas Consumers' Council;
  - (d) an amount which is the relevant proportion of the estimated costs of the Gas and Electricity Consumer Council during the year in question;
  - (e) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other licence issued under section 7A(1) of the Act;
  - (f) an amount which is the relevant proportion of the actual costs (if any) of the Secretary of State in relation to the establishment of the Authority and the Gas and Electricity Consumer Council; and
  - (g) an amount which is the relevant proportion of the difference (being a positive or a negative amount), if any, between -
    - (i) the costs estimated by the Authority under paragraphs 2(a) to (e) in respect of the previous relevant year; and

- (ii) the actual costs of -
  - (aa) the Director General of Gas Supply;
  - (bb) the Authority (in the previous relevant year);
  - (cc) the Gas Consumers' Council;
  - (dd) the Gas and Electricity Consumer Councils (in the previous relevant year); and
  - (ee) the Competition Commission (incurred in the relevant year prior to the previous relevant year) in connection with references made with respect to the licence or any other licence granted or treated as granted under section 7A(1) of the Act.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with -

- (i) the first instalment being due for payment by 30 September in each year; and

- (ii) the second instalment being due for payment by 31 January in each year;

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the giving of notice by the Authority to the licensee (whenever notice is given).

4. In this condition –

“Authority” means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000;

“estimated costs” means costs estimated by the Authority as likely to be -

- (i) the costs of the Authority and the Gas and Electricity Consumer Council arising during the relevant year in question, including in each case the costs of establishing these bodies; and
- (ii) the costs incurred by the Competition Commission in the previous relevant year, such estimate having regard to the views of the Competition Commission;

“estimated unrecovered costs”

means costs estimated by the Authority as likely to be the unrecovered costs of the Director General of Gas Supply and the Gas Consumers’ Council, including in each case the costs of abolishing these bodies;

“Gas and Electricity Consumer Council”

means the Gas and Electricity Consumer Council established by section 2(1) of the Utilities Act 2000;

“relevant proportion”

means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority and notified to the licensee in advance of the beginning of the relevant year in question (and if notification of the principles has not occurred prior to the beginning of the relevant year in question, the principles applicable to

determine any relevant proportion shall be the principles applicable in the previous relevant year); and

“relevant year”

means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year. ”

2. In standard condition 36 the following modifications shall be made –
  - (a) in paragraph (1), delete the words “or (3)”
  - (b) in paragraph (2), delete the words “Except for the purposes of standard condition 32,”; and
  - (c) paragraph (3) shall cease to have effect.



# UTILITIES ACT 2000

## Section 8

**Modification of the standard conditions relating to payments  
to the Authority in the gas shippers' licences  
granted and treated as granted under  
sections 7A(2) of the Gas Act 1986**

### *Whereas*

- A. The Gas and Electricity Markets Authority (*the Authority*) was established on [date] under section 1 of the Utilities Act 2000 (*the Act*). Under section 3 of the Act, the Authority had transferred to it the functions of the Director General of Gas Supply and the Director General of Electricity Supply.
- B. The Director General of Gas Supply, the Director General of Electricity Supply and the Secretary of State undertook a joint consultation in respect of the modification of the licence conditions relating to payments to the Authority in [date]. Under section 8(7) of the Act such consultation is effective as if it were undertaken by the Authority.
- C. The Authority, after consultation, considers it necessary or expedient to modify the standard conditions of gas shippers' licences.

### *Modification*

The Authority, pursuant to section 8 of the Utilities Act 2000, hereby modifies the standard conditions of gas shippers' licences in the manner set out in the attached Schedule.

The Gas and Electricity Markets Authority

[date]

9 Millbank

LONDON SW1

## SCHEDULE

### Proposed Modifications

1. For standard condition 17 there shall be substituted –

“ **Condition 17. Payment by licensee to the Authority**

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds a licence, the licensee shall pay to the Authority the aggregate of –
  - (a) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Director General of Gas Supply;
  - (b) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  - (c) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Gas Consumers' Council;
  - (d) an amount which is the relevant proportion of the estimated costs of the Gas and Electricity Consumer Council during the year in question;
  - (e) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other licence granted or treated as granted under section 7A(2) of the Act;
  - (f) an amount which is the relevant proportion of the actual costs (if any) of the Secretary of State in relation to the establishment of the Authority and the Gas and Electricity Consumer Council; and
  - (g) an amount which is the relevant proportion of the difference (being a positive or a negative amount), if any, between -
    - (i) the costs estimated by the Authority paragraphs 2(a) to (e) in respect of the previous relevant year; and

- (ii) the actual costs of -
  - (aa) the Director General of Gas Supply;
  - (bb) the Authority (in the previous relevant year);
  - (cc) the Gas Consumers' Council;
  - (dd) the Gas and Electricity Consumer Council (in the previous relevant year); and
  - (ee) the Competition Commission (incurred in the relevant year prior to the previous relevant year) in connection with references made with respect to the licence or any other holder of a gas shipper licence granted or treated as granted under section 7A(2) of the Act.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with -

- (i) the first instalment being due for payment by 30 September in each year; and

- (ii) the second instalment being due for payment by 31 January in each year;

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the giving of notice by the Authority to the licensee (whenever notice is given).

4. In this condition –

“Authority” means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000;

“estimated costs” means costs estimated by the Authority as likely to be -

- (i) the costs of the Authority and the Gas and Electricity Consumer Council arising during the relevant year in question, including in each case the costs of establishing these bodies; and
- (ii) the costs incurred by the Competition Commission in the previous relevant year, such estimate having regard to the views of the Competition Commission;

“estimated unrecovered costs”

means costs estimated by the Authority as likely to be the unrecovered costs of the Director General of Gas Supply and the Gas Consumers’ Council, including in each case the costs of abolishing these bodies;

“Gas and Electricity Consumer Council”

means the Gas and Electricity Consumer Council established by section 2(1) of the Utilities Act 2000;

“relevant proportion”

means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority and notified to the licensee in advance of the beginning of the relevant year in question (and if notification of the principles has not occurred prior to the beginning of the relevant year in question, the principles applicable to

“relevant year”

determine any relevant proportion shall be the principles applicable in the previous relevant year); and

means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year. ”

2. Standard condition 18 shall cease to have effect.

# UTILITIES ACT 2000

## Section 8

### Modification of the standard conditions relating to payments

### to the Authority in the public gas transporters'

### licences granted and treated as granted under

### sections 7 of the Gas Act 1986

#### *Whereas*

- A. The Gas and Electricity Markets Authority (*the Authority*) was established on [date] under section 1 of the Utilities Act 2000 (*the Act*). Under section 3 of the Act, the Authority had transferred to it the functions of the Director General of Gas Supply and the Director General of Electricity Supply.
- B. The Director General of Gas Supply, the Director General of Electricity Supply and the Secretary of State undertook a joint consultation in respect of the modification of the licence conditions relating to payments to the Authority in [date]. Under section 8(7) of the Act such consultation is effective as if it were undertaken by the Authority.
- C. The Authority, after consultation, considers it necessary or expedient to modify the standard conditions of public gas transporters' licences.

#### *Modification*

The Authority, pursuant to section 8 of the Utilities Act 2000, hereby modifies the standard conditions of public gas transporters' licences in the manner set out in the attached Schedule.

The Gas and Electricity Markets Authority

[date]

9 Millbank

LONDON SW1

## SCHEDULE

### Proposed Modifications

1. For standard condition 26 there shall be substituted –

“ **Condition 26. Payment by licensee to the Authority**

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds a licence, the licensee shall pay to the Authority the aggregate of –
  - (a) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Director General of Gas Supply;
  - (b) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  - (c) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Gas Consumers' Council;
  - (d) an amount which is the relevant proportion of the estimated costs of the Gas and Electricity Consumer Council during the year in question;
  - (e) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other licence granted or treated as granted under section 7 of the Act;
  - (f) an amount which is the relevant proportion of the actual costs (if any) of the Secretary of State in relation to the establishment of the Authority and the Gas and Electricity Consumer Council; and
  - (g) an amount which is the relevant proportion of the difference (being a positive or a negative amount), if any, between -
    - (i) the costs estimated by the Authority paragraphs 2(a) to (e) in respect of the previous relevant year; and

- (ii) the actual costs of -
  - (aa) the Director General of Gas Supply;
  - (bb) the Authority (in the previous relevant year);
  - (cc) the Gas Consumers' Council;
  - (dd) the Gas and Electricity Consumer Council (in the previous relevant year); and
  - (ee) the Competition Commission (incurred in the relevant year prior to the previous relevant year) in connection with references made with respect to the licence or any other licence granted or treated as granted under section 7 of the Act.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with -

- (i) the first instalment being due for payment by 30 September in each year; and

- (ii) the second instalment being due for payment by 31 January in each year;

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the giving of notice by the Authority to the licensee (whenever notice is given).

4. In this condition –

“Authority” means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000;

“estimated costs” means costs estimated by the Authority as likely to be -



- (i) the costs of the Authority and the Gas and Electricity Consumer Council arising during the relevant year in question, including in each case the costs of establishing these bodies; and
- (ii) the costs incurred by the Competition Commission in the previous relevant year, such estimate having regard to the views of the Competition Commission;

“estimated unrecovered costs”

means costs estimated by the Authority as likely to be the unrecovered costs of the Director General of Gas Supply and the Gas Consumers’ Council, including in each case the costs of abolishing these bodies;

“Gas and Electricity Consumer Council”

means the Gas and Electricity Consumer Council established by section 2(1) of the Utilities Act 2000;

“relevant proportion”

means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority and notified to the licensee in advance of the beginning of the relevant year in question (and if notification of the principles has not occurred prior to the beginning of the relevant year in question, the principles applicable to

determine any relevant proportion shall be the principles applicable in the previous relevant year); and

“relevant year”

means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year. ”

- 2 In standard condition 27 the following modifications shall be made –
  - (a) in paragraph (1), delete the words “or (3)”
  - (b) in paragraph (2), delete the words “Except for the purposes of standard condition 26,”; and
  - (c) paragraph (3) shall cease to have effect.

## Appendix 4 Utilities Act 2000

### Section 8

Modification of electricity [supply / transmission / generation ] licence

granted to [ X Y Z Limited ] (*the licence*) under

section [6(1)(a) / (6(1)(b) / 6(1)(c) or 6(2)] of the Electricity Act 1989

#### *Whereas*

- A. The Gas and Electricity Markets Authority (*the Authority*) was established on [date] under section 1 of the Utilities Act 2000. Under section 3 of the Utilities Act 2000, the Authority had transferred to it the functions of the Director General of Gas Supply and the Director General of Electricity Supply.
- B. The Director General of Gas Supply, the Director General of Electricity Supply and the Secretary of State undertook a joint consultation in respect of the modification of the licence conditions relating to payments to the Authority in [date September 2000]. Under section 8(7) of the Utilities Act 2000 such consultation is effective as if it were undertaken by the Authority.
- C. The Authority, after consultation, considers it necessary or expedient to modify licence condition [number] of the licence.

#### *Modification*

The Authority, pursuant to section 8 of the Utilities Act 2000, hereby modifies licence condition [N] in the licence in the manner set out in the attached Schedule.

The Gas and Electricity Markets Authority

[date]

9 Millbank

LONDON SW1

## SCHEDULE

### Proposed Modifications

1. In licence condition [1] the definition of "the Director" shall be modified by inserting the words "subject to Condition [N]," after the word "means,".

2. For licence condition [N] there is substituted -

" **Condition [X]. Payment by Licensee to the Authority**

1. The Licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.

2. In respect of each relevant year at the beginning of which the Licensee holds a licence, the Licensee shall pay to the Authority the aggregate of –

- (a) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Director General of Electricity Supply;
- (b) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
- (c) an amount which is the relevant proportion of the estimated unrecovered costs (if any) of the Relevant Consumers' Committees;
- (d) an amount which is the relevant proportion of the estimated costs of the Gas and Electricity Consumer Council during the year in question;
- (e) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other licence issued under section [6(1)(a) / (6(1)(b) / 6(1)(c) or 6(2)] of the Act;
- (f) an amount which is the relevant proportion of the actual costs (if any) of the Secretary of State in relation to the establishment of the Authority and the Gas and Electricity Consumer Council; and
- (g) an amount which is the relevant proportion of the difference (being a positive or a negative amount), if any, between -

- (i) the costs estimated by the Authority under paragraphs 2(a) to (e) in respect of the previous relevant year; and
- (ii) the actual costs of -
  - (aa) the Director General of Electricity Supply;
  - (bb) the Authority (in the previous relevant year);
  - (cc) the Relevant Consumers' Committees;
  - (dd) the Gas and Electricity Consumer Council (in the previous relevant year); and
  - (ee) the Competition Commission (incurred in the relevant year prior to the previous relevant year) in connection with references made with respect to the licence or any other licence issued under section [6(1)(a) / (6(1)(b) / 6(1)(c) or 6(2)] of the Act.

3. The amounts determined in accordance with paragraph 2 shall be paid by the Licensee to the Authority in two instalments, with -

- (i) the first instalment being due for payment by 30 September in each year; and
- (ii) the second instalment being due for payment by 31 January in each year;

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the Licensee shall pay the amount due within 30 days from the giving of notice by the Authority to the Licensee (whenever notice is given).

4. In this condition the definition of "Director" in licence condition [1] shall not apply.

5. In this condition –

“Authority”	means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000;
“estimated costs”	means costs estimated by the Authority as likely to be -  (i) the costs of the Authority and the Gas and Electricity Consumer Council arising during the relevant year in question, including in each case the costs of establishing these bodies; and  (ii) the costs incurred by the Competition Commission in the previous relevant year, such estimate having regard to the views of the Competition Commission;
“estimated unrecovered costs”	means costs estimated by the Authority as likely to be the unrecovered costs of the Director General of Electricity Supply and the Relevant Consumers’ Committees, including in each case the costs of abolishing these bodies;
“Gas and Electricity Consumer Council”	means the Gas and Electricity Consumer Council established by section 2(1) of the Utilities Act 2000;

“relevant proportion”

means the proportion of the costs attributable to the Licensee in accordance with principles determined by the Authority and notified to the Licensee in advance of the beginning of the relevant year in question (and if notification of the principles has not occurred prior to the beginning of the relevant year in question, the principles applicable to determine any relevant proportion shall be the principles applicable in the previous relevant year); and

“relevant year”

means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year. “

## Appendix 5 Section 8 of the Utilities Act, 2000

8. – (1) In this section “payment conditions” means-
- (a) in relation to a gas licence, conditions included in the licence by virtue of section 7B(4)(c) of the 1986 Act: or
  - (b) in relation to an electricity licence, conditions included in the licence by virtue of section 7(1)(b) of the 1989 Act.
- (2) The payment conditions of a gas licence or an electricity licence may (without prejudice to the generality of the provisions mentioned in subsection (1)) require the payment by the licence holder of sums relating to any of the expenses mentioned in subsection (3).
- (3) Those expenses are-
- (a) the expenses of the Council; and
  - (b) the expenses of the Secretary of State in relation to the establishment of the Authority and the Council.
- (4) The Authority may, in accordance with this section, modify any payment conditions of a gas licence or an electricity licence where the Authority considers it necessary or expedient to do so in consequence of-
- (a) the establishment of the Authority or the Council; or
  - (b) the abolition of any office or body mentioned in section 1(3) or 2(3).
- (5) Where the Authority modifies any payment conditions of a licence under subsection (4) it may make such incidental or consequential modifications as it considers necessary or expedient of the other conditions of the licence.
- (6) Before modifying the conditions of a licence under subsection (4) or (5) the Authority shall consult the licence holder.
- (7) The powers of the Authority under subsections (4) and (5) may not be exercised after the end of the period of two years beginning with the commencement of this section.

The Secretary of State may give directions to the Authority for the purpose of securing that sums relating to any of the expenses mentioned in subsection (3) are included in the sums payable by virtue of payment conditions in gas licences and electricity licences; and the Authority shall comply with any such direction.