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30 January 2002

Dear

LICENCE FEES: 2001-02

As many of you will know from the Corporate Plan presentation given on 23 January, we are proposing a minor change to the allocation of costs relating to prior years, to be recovered in the current financial year.

Under the previous licence condition covering the payment of licence fees, there was a cap on the total amount recoverable from the gas industry, which could only be raised with the agreement of 90 per cent of licence holders. Experience demonstrated that it was impossible to create a broad-based consensus in support of an increase in the cap. This led to an under recovery of costs from the holders of gas licences.

This cap was contained in all gas licences. DTI indicated in "A Fair Deal for Consumers" published in October 1999 (paragraph 17) its intention to remove this cap. This was achieved as part of the introduction of the new Standard Licence Conditions under the Utilities Act.

The licence fee for the current year includes an adjustment of £7.5m in respect of the under recovery of gas related costs in previous years as a result of the cap on the sums which we were permitted to recover from holders of gas licences. Although we signalled our intention to collect this income last year in a second licence fee tranche in January 2001, we decided to defer this. In the event DTI did not issue the new standard licence condition until October 2001 and consequently this element could not in any case be collected until the current financial year.

We had originally proposed to draw a line under the old licence fee system, as soon as the new Standard Licence Conditions (SLCs) made under the Utilities Act were in place. This would imply spreading the adjustment across all licence holders paying licence fees under the new arrangements. On reflection, we have concluded that it would be more equitable to allocate

those costs that could not be recovered from the gas companies in prior years as exceptional costs to be recovered solely from the gas sector. This reflects the policy set out in the "Principles" paper that costs clearly attributable solely to gas or electricity should be recovered from that sector of the industry. We therefore propose to issue separate invoices for:

- (a) those costs properly attributable to the current financial year (£55.7m); and
- (b) costs attributable to the shortfall created by the gas "cap" (£7.5m).

Invoices under the first heading will be issued on 30 January. The note enclosed with the invoices separately identifies the apportionment of these amounts between individual licence holders. The balance of £7.5 million will be collected once we have considered responses to this informal consultation.

Comments are invited by 12 February, and should be sent to me at roy.field@ofgem.gov.uk

Yours sincerely,

ROY FIELD
DIRECTOR, FINANCE