

# **Gas and British Gas plc**

Volume 2 of reports under the  
Gas and Fair Trading Acts



MONOPOLIES AND MERGERS COMMISSION

# **Gas and British Gas plc**

Volume 2 of reports under the Gas and Fair  
Trading Acts

**Presented to Parliament by the Secretary of State for  
Trade and Industry by Command of Her Majesty  
September 1993**

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<sup>1</sup>These members formed the group which was responsible for this report under the chairmanship of Mr D G Goyder.

## **Joint note by the Department of Trade and Industry and Director General of Gas Supply**

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the reports under the Fair Trading Act 1973 as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests.

In accordance with section 25(6) of the Gas Act 1986, the Secretary of State has directed the Director General of Gas Supply to exclude from the copies of the reports on references under section 24 of that Act to be sent to the Gas Consumers Council and published under section 25(5)(b) of that Act, certain matters the publication of which appears to the Secretary of State to be against the public interest or the commercial interests of certain persons.

Each of the omissions has been made under the powers referred to above both from the reports under the Fair Trading Act 1973 and from the reports under the Gas Act 1986. These omissions are indicated by a note in the text.

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# 1 Background to the inquiry

## Introduction

1.1. This chapter traces the background to the current references. It starts with a brief history of the gas industry in Great Britain prior to the privatization of British Gas plc (BG) in 1986 (paragraphs 1.2 to 1.5). It then describes the key aspects of the relevant legislation (paragraphs 1.6 to 1.45), BG's Authorisation as a public gas supplier (paragraphs 1.46 to 1.48), the first MMC inquiry (paragraphs 1.49 and 1.50), the tariff price formula review (paragraph 1.51), the 1991 Office of Fair Trading (OFT) review (paragraphs 1.52 and 1.53), BG's undertaking to the OFT (paragraphs 1.54 to 1.56), and subsequent developments (paragraphs 1.57 to 1.63). Appendix 1.1 contains some observations of the scope for structural change under the current regulatory structure. Appendix 1.2 lists the BG undertakings to the OFT.

## Historical background

1.2. By the mid-1930s there were some 11 million gas customers in Great Britain. They were supplied with town gas, manufactured mainly from coal, by, initially, private companies and municipal undertakings. In 1949 the gas supply companies and undertakings were nationalized and amalgamated into 12 Area Boards. Each Board was a separate statutory body with considerable authority in the determination of all aspects of the manufacture and supply of gas. A central body, the Gas Council, acted as a channel of communication with the Government. It also assisted the Area Boards, for example by borrowing money and carrying out research on their behalf. In the 1950s sharp increases in coal and labour costs, together with the promise of cheap nuclear electricity, led to a stagnation in gas sales, which in turn stimulated the search for more economic means of producing gas. New processes were developed for the production of high-pressure gas using petroleum distillates. This led to cost reductions and gas sales increased markedly in the early 1960s. The Gas Council also pioneered the transport of liquefied natural gas (LNG) which was imported mainly from Algeria.

1.3. Natural gas was discovered in the UK sector of the North Sea in 1965. The Gas Council was involved in North Sea exploration as a partner in a consortium with oil companies. It was estimated that the fields which were discovered in the mid-1960s could produce nearly three times the consumption of town gas at that time. It was decided that since future gas supplies would be distributed from terminals on the East Coast, a national high-pressure gas transmission system should be constructed, based on the existing pipeline system developed for the transmission of the earlier Algerian gas imports. Because existing town gas-burning equipment was not designed to operate on natural gas, it was necessary to convert all gas appliances throughout the country to enable them to burn natural gas. The main conversion operation started in 1967 and was completed in a little over ten years.

1.4. These developments in the structure of the supply and transmission of gas called for a radical change in the organization of the gas supply business. Under the Gas Act 1972, the Gas Council was renamed the British Gas Corporation (BGC) and took over the operations of the 12 separate Area Boards. Although the national supply of gas was now operated by a single undertaking, the BGC retained a regional structure, with 12 regions superseding the Area Boards. The introduction of natural gas led to a rapid increase in the amount of gas sold. Oil price rises in 1973 and 1979 made gas much more attractive to the industrial and commercial markets and gas demand rose still further. Meanwhile, new sources of gas were discovered in the northern North Sea and Irish Sea and BGC added new terminals at St Fergus and Barrow to its existing terminals at

Bacton, Theddlethorpe and Easington on the East Coast. All these terminals were linked into the national transmission system (NTS), which today transmits gas to most parts of Great Britain.

1.5. In May 1985 the Government announced its intention to privatize the BGC and to sell its shares in the business to the public. The Gas Act 1986 (the Gas Act) provided for the business of the BGC to be transferred to BG and established the current regulatory regime. Shares in BG were offered for sale in November 1986.

## **Relevant legislation**

### **Gas Act 1986**

#### ***Director General of Gas Supply and the Gas Consumers' Council***

1.6. Section 1 of the Gas Act provides for the appointment, by the Secretary of State, of the Director General of Gas Supply (the Director),<sup>1</sup> for a term not exceeding five years. Section 2 provides for the establishment of the Gas Consumers' Council (GCC).

#### ***Principal duties***

1.7. Section 4 of the Gas Act, as amended by section 38 of the Competition and Service (Utilities) Act 1992 (the 1992 Act) and article 2 of The Gas (Modification of Therm Limits) Order 1992 (the 1992 Order), imposes on the Secretary of State and the Director a duty to exercise their functions in a way best calculated to secure:

- (a) that authorized gas suppliers satisfy, 'so far as it is economical to do so, all reasonable demands for gas in Great Britain';
- (b) that such suppliers are 'able to finance the provision of gas supply services'; and
- (c) in relation to the conveyance and storage of gas, 'secure effective competition' between gas suppliers.

1.8. Subject to the requirements set out in paragraph 1.7(a) and (b), the Secretary of State and the Director must exercise their functions in the manner best calculated to:

- (a) protect the interests of gas consumers 'in respect of the prices charged and the other terms of supply, the continuity of supply, and the quality of gas supply services provided';
- (b) 'promote efficiency and economy' on the part of authorized gas suppliers and the 'efficient use' of the gas supplied;
- (c) protect the public from dangers arising from the transmission, distribution or use of gas; and
- (d) enable effective competition in the supply of gas at rates which, in relation to any premises, exceed a threshold of 2,500 therms a year (the new threshold, which was reduced by the 1992 Order from 25,000 therms a year, came into effect in August 1992).

1.9. In protecting the interests of gas consumers in respect of the quality of gas supply services, particular account must be taken of the interests of those who are disabled or of pensionable age.

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<sup>1</sup>For convenience, the Director and his office are frequently referred to in this report as the Office of Gas Supply (OFGAS), and the Director General of Fair Trading (DGFT) and his office as the Office of Fair Trading (OFT).

## *Gas suppliers*

1.10. Section 5 makes it an offence for an unauthorized person to supply gas through pipes to any premises.<sup>1</sup> There are essentially two types of authorization. A public gas supplier may supply gas to any premises within a designated area.<sup>2</sup> The Gas Act imposes a wide range of obligations on a public gas supplier (see subsequent paragraphs). These include a duty to develop and maintain an efficient, co-ordinated and economical system of supply and to comply, so far as it is economical to do so, with any reasonable request to supply gas to any premises (see paragraph 1.13). It is also required to give and continue to give a supply of gas to any premises located within 25 yards of a 'relevant main'<sup>3</sup> or connected by a service pipe to such a main. This obligation does not, however, apply to the supply of more than 25,000 therms a year to any premises (see paragraph 1.13). A public gas supplier also has certain benefits, the principal one being that premises within 25 yards of a relevant main and consuming less than 2,500 therms a year may only be supplied by the designated gas supplier, unless that supplier gives consent under section 8 (see paragraphs 1.30 and 1.39). A public gas supplier also enjoys planning benefits in respect of the construction of cross-country pipelines (see paragraph 1.41). A section 8 authorized supplier may supply gas to any premises specified, or of a description specified, in the authorization. It may not, however, be authorized to supply gas through pipes to any premises situated within 25 yards of a relevant main of a public gas supplier, in quantities of less than 2,500 therms a year, without the consent of that public gas supplier (see paragraph 1.30). A section 8 authorized gas supplier does not have placed upon it the obligations imposed upon a public gas supplier (see Appendix 1.1), nor does it enjoy the planning benefits accorded to a public gas supplier. In terms of section 6 a 'notifying' supplier may supply in excess of 2 million therms a year to any premises.

## *Public gas supplier*

1.11. Section 7, as amended by section 38 of the 1992 Act, allows the Secretary of State to authorize any person to supply gas to any premises in a designated area. Unless revoked, an authorization continues in force for a period specified in or determined by or under the authorization. It may include conditions as appear requisite or expedient having regard to the duties imposed on the Secretary of State by section 4. Such conditions may also require arrangements to be made with respect to the provision of special services for meeting the needs of consumers who are disabled or of pensionable age; initial or periodic payments to be made to the Secretary of State; and the provision of information to the GCC. Subsequent modifications to the authorization of a public gas supplier are the responsibility of OFGAS (see paragraphs 1.24 and 1.48).

1.12. The Secretary of State may subsequently authorize other public gas suppliers. A subsequent authorization may not, however, include in the designated area any area situated within 25 yards of a main of an existing public gas supplier, unless the main in question is not, and is not intended to be, a 'relevant main'; or the existing public gas supplier has consented to the area being included in the authorization.

1.13. Other sections of the Gas Act impose various obligations on a public gas supplier. Section 9(1) imposes a duty 'to develop and maintain an efficient, coordinated and economical system of gas supply' and, subject thereto, 'to comply, so far as it is economical to do so, with any reasonable request' to supply gas to any premises. A public gas supplier must also 'avoid any undue preference in the supply of gas to persons entitled to a supply in pursuance of section 10(1)'. Under section 10(1) a public gas supplier is required to 'give and continue to give' a supply of gas to any premises located within 25 yards of a relevant main or connected by a service pipe to such a main. The entitlement to a supply, and to continuity of supply, under section 10 imposes a more specific obligation on the public gas supplier than the section 9 obligation to comply with reasonable requests. Unlike the section 9 obligation, it is not qualified by a test of what is economical. Section 10(1), as distinct from the general obligation under section 9(1), does not require a public gas supplier to supply more than 25,000 therms to any premises in any 12-month period.

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<sup>1</sup> An exception is made for the supply of gas for use in a building or part of a building by a person who has an interest in the building, eg the landlord. The gas in question must, however, have been supplied to the building by an authorized or notifying supplier.

<sup>2</sup> BG is currently the only public gas supplier in Great Britain; no other application for public gas supplier status has been made.

<sup>3</sup> A 'relevant main', in relation to a public gas supplier, means any distribution main which is being used for the purpose of giving a supply of gas to any premises at a rate not exceeding 25,000 therms a year.

1.14. In the case of premises located within 25 yards of a 'relevant main', section 10(1) requires a public gas supplier to provide and lay any pipe that may be necessary. A person requiring supply must serve notice on a public gas supplier specifying the premises where supply is required and the day, not being unreasonably soon, when supply is required to commence. If a public gas supplier has to provide and lay pipe to meet its supply duty, it may require a portion of the costs to be defrayed by the customer. If new or enlarged mains are necessary in order to meet a requirement for new or additional supply for non-domestic purposes, a public gas supplier may refuse supply unless the customer either contracts for a minimum quantity of gas over a minimum period, or makes payments additional to the cost of the gas supplied. The minimum quantities or additional payments required must have regard to the expense incurred in the additional works carried out by the public gas supplier. A consumer may require a gas supply solely for stand-by purposes. In such circumstances, a public gas supplier may refuse to give or discontinue supply unless the customer contracts to pay a fixed charge which is payable regardless of the volume of gas actually supplied. The charge should give the public gas supplier a reasonable return on the capital expenditure incurred in providing the stand-by supply. It should also cover other expenditure incurred in order to meet the premises' maximum demand. When a new or increased supply is required in excess of 25,000 therms a year, or beyond 25 yards from a 'relevant main', the provisions of section 9 apply.

1.15. A public gas supplier may, under section 11, require a person entitled to a supply of gas to give a reasonable security for payment for the gas or for the provision and laying of pipe. Interest will be paid on any money paid by way of security at a rate approved by OFGAS. Failure to give such a security entitles a public gas supplier to refuse to give supply or to provide and lay the pipe. Section 12 requires a public gas supplier to charge for gas according to the number of therms supplied, calculated on the basis of the declared calorific value of the gas. The Gas (Alternative Method of Charge) Regulations 1990, made under section 13, enable a public gas supplier to charge customers, in a defined area, according to the actual calorific value of the gas supplied rather than on the basis of a predicted calorific value published in advance. The Regulations were made because the increasing variability in the calorific value of the gases delivered into the NTS made it more difficult to predict these values accurately in advance. This meant that, in order to be sure of meeting its declared calorific value, BG had to declare a figure that was often materially lower than the quality of the gas it actually supplied. As a result, BG now uses this alternative method of charge rather than the standard method of charge provided by section 12.

1.16. Section 14, as amended by article 2 of the 1992 Order, requires that the prices to be charged by a public gas supplier for the supply of gas are to be in accordance with tariffs fixed by the public gas supplier.<sup>1</sup> The tariffs may relate to the supply of gas in different areas, cases and circumstances, and must be framed to show the methods by which and the principles on which the charges are to be made, as well as the prices to be charged. The tariffs must also be published in a manner which secures adequate publicity. A tariff may include a standing charge in addition to the charge for the actual gas supplied, and a rent or other charge in respect of any gas meter or other fitting provided by the public gas supplier on the premises of the consumer. In fixing tariffs for supply below a threshold of 25,000 therms in any 12-month period, a public gas supplier must not show undue preference to, nor exercise undue discrimination against, any person or class of persons.

1.17. A public gas supplier may enter into a special agreement with any consumer if, owing to special circumstances, the fixed tariffs are not appropriate, or if the minimum quantity of gas to be supplied under the agreement to any premises exceeds 2,500 therms annually. Those not on such special agreements are defined as tariff customers and comprise nearly all of BG's customers, including all customers below 2,500 therms. BG does not offer special agreements to its customers between 2,500 and 25,000 therms. They remain, therefore, tariff customers. Above 25,000 therms, virtually all of BG's customers are on special terms and are non-tariff. Customers of BG's competitors, including those using between 2,500 and 25,000 therms a year, would be described as non-tariff.

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<sup>1</sup>These tariffs should not be confused with the price schedules for contract customers which BG is required to publish by the terms of its Authorisation (see paragraph 1.50).

1.18. Section 16 requires the Secretary of State to prescribe standards for gas supplied through pipes by public gas suppliers and other suppliers. Testers must be appointed to ensure that the gas supplied conforms to the standards. Section 17 provides for the appointment of meter examiners whose duty it is to stamp or authorize the stamping of all meters used by gas suppliers. General safety legislation applies to all gas suppliers.<sup>1</sup> Section 18 enables the Secretary of State to make regulations providing for rights of entry on safety grounds.

1.19. Under section 19, as amended by section 38 of the 1992 Act, any person may, after giving a public gas supplier not less than 28 days' notice, apply to OFGAS for directions which secure the right of third party transportation (common carriage) through the public gas supplier's pipeline system. OFGAS may adjourn such an application to enable negotiations to take place between the applicant and the public gas supplier. A number of conditions must be satisfied before directions are given. It is necessary that the gas in question is similar to the kind the pipeline is designed to convey; that doing so would not prejudice the conveyance of gas by the public gas supplier necessary to fulfil its responsibilities as a supplier and its contractual obligations; and that it would not prejudice the conveyance of gas by any other person with a right to use of the pipeline system.

1.20. Such directions may specify the terms on which the public gas supplier should enter into an agreement with an applicant for the purposes of securing the right of conveyance and ensuring that it is not prevented or impeded. They may regulate the charges involved and the terms on which the public gas supplier will supply gas to the applicant where the applicant's exercise of the right is temporarily interrupted by inability to obtain gas from other sources. Directions may secure the right to have the applicant's pipeline connected to the public gas supplier's pipeline by the public gas supplier. They may also specify the sums, or the method of determining the sums, which should be paid in consideration for such a right and require the public gas supplier to enter into an agreement on those terms.

1.21. In giving such directions, OFGAS is required to apply the principle that a public gas supplier should be entitled to receive, by way of charges, the appropriate proportion of the costs incurred in administering, maintaining and operating its pipeline system, together with the appropriate proportion of the return received by the supplier on the capital value of the system (the 'appropriate proportion' should properly reflect the use made of the system under the right secured by the directions as compared with the use made of it for other purposes).

1.22. Section 20 prohibits a public gas supplier from constructing a high-pressure pipeline exceeding two miles in length, unless it has given not less than two years' notice to OFGAS, or such shorter period as OFGAS may allow, of its intention to construct such a pipeline.<sup>2</sup> OFGAS must publish the supplier's notice, including the location and capacity, and invite representations. If OFGAS is satisfied that demand exists or is likely to exist, for the conveyance of similar gas over a similar route, it may direct the public gas supplier to construct the pipeline so as to be capable of conveying specified quantities of gas. The directions may specify the sums or method of determining the sums, which should be paid by persons who made representations to OFGAS for the purpose of defraying so much of the cost of constructing the pipeline as is attributable to that requirement. They may also specify arrangements for those sums to be paid to the supplier or, if such arrangements are not made by any such person, for the elimination of the consequences of the representations made to OFGAS by that person.

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<sup>1</sup>This includes certain of the provisions of the Pipelines Act 1962 (the Pipelines Act), the Health and Safety at Work Act 1974, the Gas Quality Regulations 1983, the Gas (Testing) Regulations 1949, the Gas Safety (Installation and Use) Regulations 1984, the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1985 and, when quantities of liquefied petroleum gas (LPG) of 25 tonnes or over are to be stored, the Notification of Installations Handling Hazardous Substances Regulations 1982.

<sup>2</sup>The statutory framework does not appear to address the position where both a public gas supplier and another gas shipper wish to build pipelines over a substantially similar route. At present the Gas Act and the Pipelines Act apply, allowing a public gas supplier to benefit from the accelerated procedures applicable under the Gas Act, although another gas shipper would be able to share in those benefits through access to capacity in the public gas supplier's pipeline under sections 19 and 20 of the Gas Act. It is understood that Ministers are currently considering whether there should be legislative change to ensure that a public gas supplier and other shippers operate within the same statutory framework.

1.23. Section 21 enables any person to apply to OFGAS to ensure that a public gas supplier's pipeline can and should be modified by installing a junction through which another pipeline may be connected; or, in the case of a high-pressure pipeline, that the capacity of the pipeline can and should be increased. OFGAS may give directions to the public gas supplier which specify modifications consequent on the application; the sums or the method of determining the sums, to be paid by the applicant for the purpose of defraying the cost of the modifications; the arrangements for securing that those sums are paid to the supplier if it carries out the modifications; and, if those arrangements are made, the period within which the modifications will be made.

1.24. Section 23 allows OFGAS to modify the conditions of a public gas supplier's authorization, with the consent of the public gas supplier. Before doing so, OFGAS must first notify its intention to make the modifications and set out their effects, state the reasons for the modifications and consider any representations or objections. In respect of a modification affecting the supply of gas to tariff customers, the Secretary of State may direct OFGAS not to make any modification without a prior report from the MMC pursuant to a reference under section 24.

1.25. Section 24, as amended by section 38 of the 1992 Act, allows the Director to refer to the MMC the question of whether any matters relating to the supply of gas by a public gas supplier to tariff customers, or the conveyance or storage of gas by a public gas supplier, operate, or may be expected to operate, against the public interest; and, if so, whether the adverse public interest effects could be remedied or prevented by modifications of the conditions of the authorization. The Director may vary a reference by adding to or excluding some or all of the matters specified. For the purposes of assisting the MMC in carrying out their investigation, the Director may specify in the reference any effects adverse to the public interest which, in his opinion, the matters specified have or may be expected to have. He may also specify any modifications of the conditions of the authorization by which, in his opinion, those effects could be remedied or prevented.

1.26. In determining whether any particular matter operates, or may be expected to operate, against the public interest, the MMC must have regard to the duties imposed on the Secretary of State and the Director by section 4. Section 25 requires the MMC to include in their report definite conclusions on the questions comprised in the reference, together with an account of their reasons for those conclusions. If the MMC conclude that any of the specified matters operate, or may be expected to operate, against the public interest, their report must specify the effects adverse to the public interest which those matters have or may be expected to have. The report must also specify any modifications to the conditions of the authorization which could remedy or prevent the adverse effects.

1.27. The Director must, under section 26, make such modifications to the authorization as appear requisite to him for the purpose of remedying or preventing the adverse effects specified by the MMC. Before doing so, he must have regard to the modifications specified in the MMC report. The Director is required to publish notice of his intention to make modifications, set out their effect and consider any representations or objections.

1.28. Section 27, as amended by section 38 of the 1992 Act, allows the Secretary of State, in exercising powers under the Fair Trading Act 1973 (the Fair Trading Act) and the Competition Act 1980 (the Competition Act), to modify the conditions of a public gas supplier's authorization. Section 28, as amended by section 48 of the 1992 Act, provides for enforcement procedures against a public gas supplier which contravenes any relevant condition of its authorization or requirement imposed by or under the Gas Act. The Director may make a final or a provisional order for the purpose of securing compliance with such a condition or requirement by the public gas supplier. Breach of a section 28 order causing loss or damage is actionable and may be subject to injunctive relief. It may also give grounds for terminating a public gas supplier's authorization. A public gas supplier has a right of appeal to the courts under section 30 on the grounds that the order was *ultra vires*, or that the procedural requirements of section 29 were not complied with.

1.29. Section 31 requires the Director to investigate any enforcement matter (ie a matter which can be enforced pursuant to section 28) which is the subject of a representation by or on behalf of an interested party, or which is referred to OFGAS by the GCC. Section 32 imposes on the GCC a duty to investigate non-enforcement matters. Section 32A, inserted by section 18 of the 1992 Act, requires the GCC to carry out preliminary investigations of disputes on behalf of OFGAS.

### *Authorized gas suppliers*

1.30. Section 8 allows the Secretary of State, or the Director acting under a general authority of the Secretary of State, to authorize any person, or class of persons, to supply gas to premises specified, or of a description specified, in the authorization. Notice of an application must be given to any public gas supplier in whose designated area the premises fall. The supply of gas to any premises situated within 25 yards of a main of a public gas supplier may not be authorized unless the main is not, and is not intended to be, a 'relevant main'; or the rate of supply to the premises would be likely to exceed an annual threshold of 2,500 therms; or the public gas supplier has consented to the giving of supply.

1.31. An authorization, unless revoked, continues in force for a period specified in or determined by or under the authorization. It may include such conditions as appear to be requisite or expedient, having regard to the duties of the Secretary of State and the Director contained in section 4(2)(c) relating to protecting the public from dangers arising from the transmission, distribution or use of gas. It may also include conditions requiring the payment of determined amounts. An authorization must be copied to the Health and Safety Executive (HSE), any public gas supplier concerned and entered into a public register kept by OFGAS, unless the Secretary of State directs that doing so is against the public interest or any commercial interest.

1.32. It is the current practice of OFGAS, in granting section 8 authorizations, to include a number of safety-related conditions.<sup>1</sup> Under these conditions, an authorized supplier must require an occupier to provide access at reasonable times to examine the gas installation and, if necessary to avert danger, at any time to disconnect the supply; provide a continuously-manned emergency service for the purpose of dealing with gas escapes; and observe proper principles of safe practice in storing gas in a liquid state and in transmission and distribution of gas and, in particular, have regard to the guidance of the HSE. An applicant for authorization must provide written confirmation by a competent person that arrangements proposed for the storage, transmission and distribution of the gas to be supplied conform to proper principles of safe practice. The authorization may be revoked if the applicant contravenes the relevant safety provisions. With the passage of the Gas (Exempt Supplies) Act 1993 (the 1993 Act), the Department of Trade and Industry (DTI) is considering appropriate interim arrangements and conditions to apply to section 8 authorizations for LPG suppliers, prior to the transfer of full responsibility for such suppliers to the HSE once the 1993 Act commences.

### *Notifying suppliers*

1.33. Under section 6, a gas supplier may notify the Secretary of State that it proposes to undertake a supply of gas to any premises at an annual rate in excess of 2 million therms. It may then supply gas unless its notification is declared invalid. The notification may be regarded as invalid if the Secretary of State is of the opinion that supply to the premises would be unlikely to exceed the required rate, or is unable to form an opinion as to whether the required rate would or would not be likely to be exceeded.

## **Competition and Service (Utilities) Act 1992**

1.34. The 1992 Act, passed on 16 March 1992, followed the Government's Citizen's Charter White Paper commitment to strengthen the powers of the utility regulators in respect of standards of performance and service to customers. The main substantive sections of the 1992 Act were phased in over the following few months. The 1992 Act also included provisions to facilitate greater competition in gas supply and provided for the Secretary of State to reduce the gas monopoly threshold. The threshold was reduced from 25,000 therms to 2,500 therms from 6 August 1992. The Government has announced that a further review of the threshold level will occur in 1993. The DTI told us that, to protect customers who require less than 25,000 therms, the statutory obligation on BG to supply them will remain until competition has developed.

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<sup>1</sup>See *Notes for Gas Suppliers on Authority under Section 8 of the Gas Act 1986*, OFGAS, 1988.

1.35. On 1 July 1992 the sections of the 1992 Act came into force which provide the utility regulators with statutory powers to set and monitor standards of performance for the utility companies. The sections of the 1992 Act giving the utility regulators power to resolve disputes between customers and the utilities came into force on 1 September 1992. In the case of gas, these relate to provisions of the Gas Act governing the supply of gas, the security to be given to a public gas supplier for payment for gas supplied or for the provision and laying of pipe, and the fixing of tariffs by a public gas supplier.

1.36. Section 11, which inserts sections 33A and B into the Gas Act, allows OFGAS to make regulations prescribing standards of performance to be achieved, in individual cases, in the provision of gas supply services to tariff customers by public gas suppliers. Such regulations may be made only with the consent of the Secretary of State and after consultation with public gas suppliers and persons or bodies likely to be affected. The regulations may prescribe the way in which public gas suppliers inform tariff customers of their rights under the regulations; and prescribe standards of performance and the circumstances in which public gas suppliers are to be exempted from any requirements. They may also make different provision with respect to different public gas suppliers. A public gas supplier has to compensate any tariff customer if it fails to meet a prescribed standard, though this may not prejudice any other remedy for the failure. Any dispute may be referred, by either party, to OFGAS, which shall arrange for the matter to be determined. OFGAS may also determine overall standards of performance for the provision of gas supply services by public gas suppliers; different standards may be determined for different public gas suppliers. Every public gas supplier has a legal duty to conduct its business in such a way as can reasonably be expected to lead to the achievement of these standards. A public gas supplier may be directed by OFGAS to regularly inform its customers of the standards and its level of performance under section 33C (inserted by section 12 of the 1992 Act). OFGAS is required to collect and publish information on the levels of performance achieved.

1.37. Section 14, which inserts section 33E into the Gas Act, requires a public gas supplier to establish a procedure for dealing with complaints made by potential or actual tariff customers. The procedure must be approved by OFGAS and the GCC has also to be consulted. Section 15, which inserts section 15B into the Gas Act, allows OFGAS to determine the standards of performance, in connection with the promotion of the efficient use of gas by consumers, to be achieved by public gas suppliers. Different standards may be determined for different public gas suppliers.

1.38. Other sections give additional functions and responsibilities to OFGAS. These include section 16, which inserts section 14A into the Gas Act and provides for OFGAS to determine any dispute, arising under specific provisions of the Gas Act, between a public gas supplier and a person who is, or wishes to become, a tariff customer. Section 17, which inserts section 15A into the Gas Act, provides for the Secretary of State to make regulations whereby billing disputes between a public gas supplier and a tariff customer may be referred to OFGAS for determination. This section is not yet in force. In particular, section 38 amends section 4 of the Gas Act by the addition of a requirement on the Secretary of State and the Director to exercise their functions in relation to the conveyance and storage of gas, in a manner best calculated to secure effective competition between persons whose business consists of or includes the supply of gas. It also amends section 24 of the Gas Act so as to allow the Director to refer to the MMC, besides any matters which relate to the supply of gas by a public gas supplier to tariff customers, matters which relate to the conveyance or storage of gas by any public gas supplier; and section 27 of the Gas Act by the inclusion of references to orders in respect of the conveyance or storage of gas by a public gas supplier.

## **The Gas (Modification of Therm Limits) Order 1992**

1.39. Section 37 of the 1992 Act inserts section 8A into the Gas Act, which authorizes the Secretary of State, by order, to amend the Gas Act by reducing any limit expressed in various sections of the Gas Act by reference to a number of therms or kilowatt hours. Under section 2 of the 1992 Order, the Secretary of State amended sections 4, 8 and 14(4)(b) of the Gas Act by substituting 2,500 therms for 25,000 therms. This altered the boundary between the tariff and non-tariff markets, thereby reducing the number of gas consumers which could be exclusively supplied by BG and increasing the number which could be supplied by its competitors. It did not affect BG's obligation to supply customers consuming up to 25,000 therms a year pursuant to section 10 of the Gas Act. The Government has announced its intention to examine the experience of the reduction and the scope for further reductions.

## **Other legislation affecting the gas industry**

1.40. Exploration and production for oil and gas are regulated by licences granted by the Secretary of State under the Petroleum (Production) Act 1934. The licences incorporate model clauses, prescribed by regulations, which specify terms and conditions.<sup>1</sup>

1.41. Authorization is required under section 1 of the Pipelines Act in respect of the construction of any cross-country pipeline of more than ten miles in length. A public gas supplier is, however, exempted from this requirement by section 58. Authorization is required in respect of any new offshore pipeline under section 20 of the Petroleum and Submarine Pipelines Act 1975. Under section 10 of the Pipelines Act and section 23 of the Petroleum and Submarine Pipelines Act, the Secretary of State can require the owner of a pipeline to make any spare capacity available to a third party in the case of a pipeline the construction of which was authorized under either of those Acts.

1.42. The 1993 Act, when brought into force, will provide a general power for the Secretary of State to exempt suppliers from the prohibition on unauthorized supply under the Gas Act in respect of supplies of natural gas. The 1993 Act will also exempt from regulation, on terms approved by the Secretary of State, supplies of propane or butane gas to premises such as caravan parks. The effective exemption of LPG suppliers from the need for authorization will cover the majority of suppliers currently authorized under section 8. Those supplying methane through BG's pipes or directly (eg from landfill sites), together with suppliers of certain other gases, still require authorization. OFGAS has advised us that it no longer seeks to prosecute LPG suppliers for supplying gas without authorization.

## **EC legislation**

1.43. The EC has taken, or proposed, a number of steps aimed at liberalizing the gas market. The first phase was completed on 1 January 1993 with the implementation of the Gas Transit Directive which provides rights of access for grid companies to ship gas over the territory of other member states to third countries and the Price Transparency Directive which provides for the supply and publication twice a year of prices for gas charged to industrial customers in specific regional centres in different consumption categories.

1.44. In January 1992 the EC issued a draft Directive, 'Common Rules for the Internal Market in Natural Gas', to form the second phase of its gas liberalization plans. These proposals are currently under discussion. They provide for transparency and non-discrimination in licensing of gas storage and LNG facilities and in the construction of gas pipelines. They also provide for transparency of operations, requiring the separation of management and accounting for production, transmission and distribution within vertically-integrated companies. Moreover, they extend the provisions of the Gas Transit Directive by providing for the limited introduction of third party access, requiring transmission and distribution companies to offer access to their networks to large users and distribution companies.

1.45. In 1975 the EC made the 'Gas Burn' Directive to safeguard supplies of gas, which were perceived at that time to be in short supply. The Directive set stringent criteria for the granting of authorizations for the use of gas in power stations. However, given the changed circumstances in gas technology and the greater availability of supply, the Council repealed this Directive in March 1991.

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<sup>1</sup>The regulations currently in force are the Petroleum (Production) (Seaward Areas) Regulations 1988 and the Petroleum (Production) (Landward Areas) Regulations 1991.

## BG's Authorisation

1.46. The BGC was authorized as a public gas supplier on 28 July 1986.<sup>1</sup> The Authorisation, which was subsequently transferred to BG, covers any premises in Great Britain and was granted for a period of at least 25 years. It may terminate any time thereafter, provided that the Secretary of State has given ten years' notice of termination to BG. It may be revoked at 30 days' notice if BG:

- (a) agrees that it should be revoked;
- (b) fails to pay fees due under the Authorisation;
- (c) fails to comply with an order under section 28 of the Gas Act;
- (d) fails to comply with an order, relating to the gas supply business,<sup>2</sup> under the Fair Trading Act or the Competition Act; or
- (e) ceases to carry on business as a public gas supplier, is unable to pay its debts, enters into receivership or is wound up.

1.47. Much of the initial Authorisation was concerned with the regulation of BG's charges to tariff customers, including the RPI-2 tariff charge condition, and standing and connection charges. BG was required to publish a schedule of maximum prices for contract customers, though initially it was free to discount below the published maxima. The Authorisation also required BG to:

- (a) keep separate accounts for the Gas Supply business, have full audited accounting statements (including a six-month profit and loss statement) and obtain the approval of OFGAS to changes in the basis of apportionment between the Gas Supply business and any other business of BG;
- (b) furnish information to OFGAS and the GCC;
- (c) prepare a statement setting out guidance for those who wished it to convey their gas, giving examples of prices and of matters to be negotiated, the statement to be updated, after consultation with OFGAS, in the event of any material change;
- (d) prepare a statement, with similar terms to the preceding statement, for the supply of back-up gas for those having gas conveyed whose gas supply may be temporarily interrupted;
- (e) provide an emergency service;
- (f) prepare codes of practice on the nature of service available to tariff gas customers and the payment of bills;
- (g) arrange for the provision of services for persons who are of pensionable age or disabled, including free safety checks of customers' appliances, provision of special controls, adaptors and repositioning of meters, provision of identification of authorized officers and provision of advice;

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<sup>1</sup> *Authorisation granted and directions given by the Secretary of State for Energy to the British Gas Corporation under the Gas Act 1986*, Department of Energy, London, HMSO, 1986. With the Authorisation was published, by the Secretary of State, a direction which was mainly concerned with the restriction on disclosure or use of protected information derived from geological or geophysical characteristics of strata and technical information relating to exploring for or producing petroleum.

<sup>2</sup> The Authorisation defined the gas supply business, which included: the procurement, treatment, storage, transmission and distribution of gas for sale and safe delivery through pipes to customers in Great Britain; provision of remedial and other services to customers in Great Britain in furtherance of the safe and proper use of gas or gas fittings; research and development; and the conveyance of gas for third party suppliers. The following were specifically excluded: installation of gas appliances or supplies (from the meter on the customer's premises), or contract work for regular or periodic servicing or maintenance; trading in gas appliances; exploration for, production or manufacture of gas; and consultancy, unless in connection with gas supply in Great Britain.

- (h) prepare a statement setting out general information for guidance of tariff customers in the efficient use of gas;
- (i) supply gas to public lamps for which there was an existing supply obligation; and
- (j) pay to the Secretary of State a fair proportion of the costs estimated by OFGAS as likely to be incurred in the ensuing year by OFGAS, the MMC and the GCC under the Gas Act.

1.48. The Authorisation has, by agreement, been modified by OFGAS on three occasions:

- (a) *March 1989*: BG was required to publish price schedules for contract customers; its ability to impose terms which restricted the purposes for which gas was used by contract customers was limited; it was required to make available more detailed information on common carriage arrangements; and it was required to notify OFGAS of the arrangements for restricting the access of BG employees involved in purchasing and selling gas to information obtained by BG in the course of common carriage negotiations.
- (b) *April 1989*: BG was required to establish methods for handling domestic tariff customers in default.
- (c) *December 1991*: service standards were imposed in respect of the provision of gas supply services to actual and potential tariff customers; BG was allowed to change its financial year ending from March to December; the tariff charge price control was modified to RPI-5; and modified gas cost pass-through and energy efficiency terms were introduced. With the exception of the financial year change, which was operative from 1 January 1992, the December 1991 changes took effect from 1 April 1992.

## The first MMC inquiry

1.49. In 1987 the DGFT referred to the MMC the supply of gas to non-tariff customers.<sup>1</sup> The MMC found that many such users had no immediate or realistic alternative to gas, nor an alternative gas supplier. They also found that there was extensive discrimination in the pricing and supply of gas to contract customers, attributable to the existence of the monopoly, and that prices were directly and inversely related to the ease with which customers could use alternative fuels. The MMC concluded these practices to be against the public interest, since they imposed higher costs on customers less able to use alternative fuels. By relating prices to those of the alternative fuels available to each customer, BG was in a position selectively to undercut potential competing gas suppliers. This acted as a deterrent to new entry and inhibited competition. Other practices regarded by the MMC as being against the public interest included BG's:

- (a) lack of transparency in prices;
- (b) refusal to supply interruptible gas to some consumers;
- (c) pricing of gas for combined heat and power (CHP) schemes;
- (d) contract terms which restricted the use of gas or other forms of energy by contract customers;
- (e) failure to provide adequate information on the costs of common carriage;

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<sup>1</sup> *Gas: a report on the matter of the existence or possible existence of a monopoly situation in relation to the supply in Great Britain of gas through pipes to persons other than tariff customers*, Cm 500, October 1988.

- (f) ability to use information obtained when negotiating common carriage terms to identify potential customers of competing suppliers and the potential source of gas; and
- (g) position as a dominant, indeed at that stage sole, purchaser of gas.

1.50. To remedy the adverse effects, the MMC recommended that BG should publish a schedule of prices for firm and interruptible gas at which it was prepared to enter into special agreements with contract customers. The schedule should be supplemented by a requirement on BG not to discriminate in pricing or supply. The MMC said that it would not be adequate merely to impose a requirement not to show undue preference, or to exercise any undue discrimination, since such a requirement would be liable to interpretation as requiring all prices to be identical, regardless of volume, load factor and other conditions of supply. BG should not refuse to supply interruptible gas on the basis of the use made of the gas, or the alternative fuel available. It should publish further information on common carriage terms, and should contract initially for no more than 90 per cent of any new gas field (the 90/10 rule). The MMC also concluded that, if competition in the supply of gas failed to develop over the next five years, further consideration would be appropriate as to whether changes in the structure of the gas industry were necessary to ensure competition. The MMC's recommendations were implemented, broadly as proposed, by modification of BG's Authorisation and by undertakings agreed with the OFT. The 90/10 rule was introduced for a two-year period on the basis that it applied to all gas offered to BG in the period concerned rather than on a field-by-field basis. BG, of its own volition, initially applied the rule on a field-by-field basis. In announcing the measures, DTI Ministers referred to a further review by the DGFT at the end of the two-year period.

## **Tariff price formula review**

1.51. In June 1990 OFGAS indicated its intention to review the tariff price formula in BG's Authorisation. BG told us that, following lengthy discussions and in the circumstances then prevailing, it had accepted a revised formula as a result of which the non-gas cost element of its prices was based on RPI-5. BG also told us that its acceptance of the formula followed assurances that OFGAS would consider representations about an adjustment of the formula in the event of any change in the operation of the NTS or in BG's monopoly rights. OFGAS told us that it had received no such representations from BG.

## **The 1991 OFT review**

1.52. In October 1991 the OFT completed a review of the effectiveness of the remedies applied following the MMC report. The review found that BG had complied with the undertakings given. BG had more than met the 90/10 target, though most of the new gas purchased by buyers other than BG was bought for power generation, a development largely unforeseen at the time of the MMC report, rather than for general industrial and commercial use. BG had, by swap arrangements, gone beyond the 90/10 undertaking and agreed to make available gas under its own existing contracts to enable competitors to gain early access to gas supplies. The OFT review concluded that the remedies introduced following the MMC report had been ineffective in encouraging self-sustaining competition to BG. Particular obstacles identified to the growth of competition were the lack of available gas for competing suppliers to the industrial and commercial sector, BG's monopoly supply to tariff customers, and its control of the transmission, distribution and storage system. The OFT referred to BG's ability to cross-subsidize, act in a discriminatory manner and set price levels in the interruptible market that its competitors could not match.

1.53. The DGFT acknowledged that BG felt it had not been given an adequate opportunity to comment upon all facets of the review and that it had raised issues going beyond questions of competition in the non-tariff market. He concluded that it was appropriate to refer the supply of contract gas through pipes to the MMC for further investigation in order to generate remedies to the seriously uncompetitive situation found to exist. In particular, the DGFT identified the following key areas that needed to be addressed:

- (a) the need for BG to release a significant proportion of its contracts gas in the short to medium term in order to allow the development of competition in advance of non-BG suppliers having access to the

fields not then contracted; there was a consensus that competitors to BG would not have access to new sources of gas much before 1995/96;

- (b) the divestment of the transportation and storage business of BG and the requirement for that business to deal even-handedly with BG and non-BG shippers and regulation of prices charged by this business by OFGAS;
- (c) the eventual abolition of BG's tariff monopoly;
- (d) steps to provide competitors with the same planning regime as BG in respect of onshore pipelines; and
- (e) development of policies on gas trade covering imports and exports, and promotion of European market liberalization.

The DGFT indicated that he was prepared to accept suitable undertakings from BG in lieu of such a reference.

## **BG's undertakings to the OFT**

1.54. Following the announcement of the outcome of the OFT review, and on the same day as the announcement by the Government of its intention to reduce the monopoly threshold, BG began discussions with the OFT about undertakings which would avert the need for an MMC reference. OFGAS told us that it attended the discussions in an observer capacity only. It was BG's view that OFGAS participated in the discussions but withdrew from the latter stages of the negotiations. In December 1991 BG agreed undertakings in principle with the OFT. These were formally given in March 1992 (Appendix 1.2). In summary, BG undertook to:

- (a) create the conditions by which other suppliers should be able to supply at least 60 per cent of gas to contract customers by 1995, including the necessary release of gas by BG;
- (b) use its best endeavours, subject to its statutory and contractual obligations, to secure the development of genuine, self-sustaining competition in the contract gas market as quickly as possible;
- (c) organize its gas business in order to establish a separate gas transportation and storage unit (BG T&S), to be in full operation by 1 January 1994;
- (d) publish separate accounts from the year ending 31 December 1993, in a form agreed by the OFT;
- (e) produce a discussion document outlining alternative pricing principles for gas transportation and, on the basis of comments received, publish a transparent pricing system on 1 September 1992, for implementation on 1 October 1992 for shippers other than BG and on 1 January 1993 for BG Trading;
- (f) ensure that charges would apply equally and even-handedly to BG Trading and other shippers;
- (g) produce by 1 January 1993 a discussion document outlining the storage services that the unit intended to offer and to put such services with BG Trading and other companies in place by 1 October 1993;
- (h) put in place arrangements to provide gas conveyance, system reinforcement, and extension and site connection from 1 January 1993, on the basis of non-discrimination between BG and other shippers;
- (i) endeavour to reach agreement with the OFT by 31 August 1992 on the basis on which the separate unit will be regulated;

- (j) treat information received from other parts of BG and other shippers on the same basis; and
- (k) provide quotations for shipping of gas in five to ten working days, on a non-discriminatory basis between BG Trading and other shippers.

1.55. The undertakings did not have statutory force. However, if breached, the DGFT would have the option of a reference to the MMC. If the MMC found appropriate detriments, this could lead to remedies with a statutory basis.

1.56. In the light of the additional powers available to the Director by the 1992 Act and of the present MMC references, the DGFT indicated that he would not regard BG as being bound by the undertakings relating to BG T&S (the market share and gas release undertakings remaining in operation). Although no longer required to do so, BG stated that it decided to proceed with plans to implement the separation of its transportation and storage activities from its trading activities, separating within trading the supply of gas as between the tariff market and the contract market, and to implement transparent accounting and transfer pricing arrangements. The timetable for implementing the separation of storage and transport from BG's other businesses (referred to in paragraph 1.54) was lengthened in order to avoid possibly unnecessary expenditure pending the outcome of the inquiry.

## Subsequent developments

1.57. Although OFGAS was not party to or bound by the undertakings, it agreed with the OFT that it should assume responsibility for advancing with BG the undertakings relating to transportation and storage. This agreement reflected the new powers given to OFGAS to regulate transportation and storage under the 1992 Act. BG subsequently submitted to OFGAS a draft public consultation document on transportation policy. OFGAS made a limited number of comments on the document and told BG that it was not bound by the proposals in the document and that it reserved the right to produce a different set of proposals if it felt that was appropriate. OFGAS also told BG that the document contained inadequate information on how the proposed pricing methodology would work in practice in respect of BG's proposals for arrangements for a Network Code. BG published the consultation document, with few material changes, by the due date. OFGAS told us that it had separately asked BG to come forward with early proposals giving fair access to storage. BG had refused to do so. BG said that, in terms of the undertakings, it was required to produce a document containing such proposals by 1 January 1993. The document was, in fact, submitted to OFGAS on 1 October 1992. BG said that it had also offered an interim storage service on a transitional basis.

1.58. The consultation process took place in the first half of 1992. Some shippers expressed doubts about the methodology entailed in BG's proposals, others were more concerned with the length of the consultation period. The illustrative prices in the public consultation document were based on a 4.5 per cent rate of return (ROR). In July 1992 BG put to OFGAS detailed arguments in favour of higher RORs. OFGAS's response in July 1992 indicated that it would compare BG's submission with its own view of the matter but that it did not intend entering into negotiations, since this was an issue best addressed by the MMC. OFGAS subsequently indicated that it did not believe the higher rates were acceptable for such a low-risk business. In June 1992 BG made proposals on the question of separation of its transportation and storage and supply businesses. OFGAS considered that the proposals contained insufficient detail of the changes that would be necessary to create meaningful separate accounting or 'Chinese walls' between the businesses.

1.59. OFGAS told us that it had intended to adhere to the timetable for the completion of the basic work by 1 October 1992 but decided, after three months' discussion with BG, that this was unlikely to be possible. OFGAS believed that the failure of BG to respond to fundamental questions about the proposed basis for the charging and operation of a separate transportation and storage business indicated that it had either not thought through the issues or that it was unwilling to reveal its thinking. If the former were the case, OFGAS believed that the position of BG was not easily defensible, since it had known from October 1991 that it would be necessary to prepare properly for the creation of a new transportation unit and regime. OFGAS believed that BG's action in refusing to provide prompt responses to essential questions, to release data which OFGAS believed should have been readily available, and the failure of its proposals to reflect the need to develop competition on the basis of non-discrimination between its own supply business and other

shippers made it impossible to keep to the timetable. This view was shared by a number of shippers which argued strongly that a later date for implementation should be chosen, with a proper process of consultation undertaken under the direction of OFGAS. BG said that it had responded promptly to OFGAS's request for information and, in particular, that it had complied fully with both the spirit of, and the time-scales set out in, the undertakings. In June 1992 OFGAS proposed formally to BG that the timetable be extended. BG agreed but argued that the need for an extension was in no way due to its failure to abide by its undertakings to the OFT. BG also argued that it could not change the time-scale without the agreement of the OFT, bearing in mind the undertakings which it had signed. Progress had continued to be made on various aspects of the future transportation and storage regime.

## **Reasons for the references**

1.60. BG's views of the developments which led up to the references are set out in paragraphs 16.1 to 16.3. OFGAS told us that it had to accept that delay to the undertakings timetable was inevitable. OFGAS also said that it had become concerned that the attitude of BG would make it impossible to reach agreement on a whole range of major issues in time to meet a 1 October 1992 deadline. OFGAS came increasingly to the view that a reference to the MMC was the best way forward. OFGAS believed that many of the regulatory problems it would face in setting up the new regime were due to the transportation and storage business remaining not only as part of BG, but not even being established as a separate subsidiary company. OFGAS was also concerned that the new regime should be set up in such a way that there would be no possibility of costs and profits being shifted between the different businesses to frustrate competition and transparency and distort regulatory pricing mechanisms. It was by no means clear either that, if the transportation business was only a unit within the BG UK gas supply business, the necessary 'Chinese walls' between the transportation and trading arms could be erected. In OFGAS's view, a more radical structural solution to the problem, with the transportation and storage business becoming a separate company, needed to be considered. This was not a matter best addressed by OFGAS given its impact on the totality of BG's UK business and the fact that OFGAS had only limited powers to implement any such solution. OFGAS believed that a reference to the MMC was necessary on this score alone.

1.61. In addition, it appeared to OFGAS most unlikely that, even with an extended timetable, BG's attitude was conducive to setting up a genuinely workable and non-discriminatory regime in the longer term. In the view of OFGAS, the approach of BG's management had consistently been to put the interests of the gas supply business first, to regard transportation as a residual function and to create as many financial, operational and contractual barriers as possible to the use of the pipeline and storage system by competitors. BG was committed only to the strict letter of the undertakings. Discharging these alone could not, in the opinion of OFGAS, result in fair and open access to transportation and storage. On a number of major issues OFGAS believed that BG had delayed bringing forward definitive proposals. And, according to OFGAS, there was every indication that it would not be able to reach an accommodation with BG to allow the necessary changes to BG's Authorisation to be made by agreement. In OFGAS's view, the question of the ROR, while important, was only one of these issues. Others were providing access to storage, pricing methodology, the nature of the arm's length relationship proposed, and a number of questions relating to the Network Code. OFGAS felt that it faced a distinct possibility of having to make a reference later on in the process when attempts to set up new arrangements by agreement had been exhausted. This would have delayed the onset of competition yet further. In the circumstances, OFGAS felt that an early reference to the MMC could lead to an earlier resolution of these issues than would otherwise be the case. Quite apart from this, the views of the MMC on such matters as the ROR would be valuable in themselves.

1.62. In the light of this, OFGAS concluded that a reference should be made of the BG transportation and storage business. Before making the reference, OFGAS discussed its intention with BG. BG opposed the making of a reference on the grounds that it was not necessary; the issues could be resolved without such action; a reference would extend the period of uncertainty; and it would take up unnecessarily a lot of BG's senior management time, which would be better spent on resolving issues. OFGAS remained of the opinion that a reference was appropriate and the reference was duly made on 31 July 1992.

1.63. The DTI told us that BG and OFGAS were unable to agree the basis on which BG would operate its transportation and storage business at arm's length from gas trading and would charge both its own and competitors' use of the system on a transparent and non-discriminatory basis. OFGAS decided accordingly to refer this matter to the MMC. At the same time, BG asked the Secretary of State to make a wide-ranging reference of its business to the MMC, because, in its view, the cumulative regulatory changes since privatization were creating uncertainty in the market and impeding its ability to carry on its business effectively. It also argued that circumstances had altered materially since it gave its agreement to the revised tariff formula for the second quinquennium. BG said that it had agreed to the setting of the revised RPI-5 tariff formula on the basis of the circumstances prevailing at the time. BG subsequently took the view that the reduction of the tariff threshold and the effects of the OFT undertakings rendered RPI-5 unreasonable and that a review of the formula was now appropriate. In the circumstances, the Secretary of State concluded that the proper course would be to make monopoly references under the Fair Trading Act. This would allow the MMC to take a comprehensive view of the gas market and the development of competition since the 1988 report. Within this wider context, the MMC could consider the provision of gas transport and storage services and the tariff formula and make recommendations on these and other matters they consider appropriate. Once the Secretary of State had announced his referral of both the tariff market and transportation and storage, OFGAS thought it appropriate, for technical reasons, to make a further reference, under the Gas Act, of the tariff market.