

Modification of standard conditions of gas and electricity licences by the Gas and Electricity Markets Authority

“Collective licence modifications”

*A second consultation by
The Department of Trade and Industry
April 2001*

1 Purpose of consultation

1.1 In March 2000, the Department of Trade and Industry invited comments on proposals for the collective modification of standard conditions in the licences of gas and electricity licensees. Views were invited by 31 May 2000, and 22 responses were received by the Department. These responses were highly constructive, and were very much welcomed as a positive contribution to the development of the proposals.

1.2 Having regard to these comments, it would be helpful to have further views on the revised proposals which are outlined below. Comments are invited from all electricity and gas licensees, trade associations, consumer bodies, and other interested parties by 14 May 2001.

1.3 In addition to making helpful suggestions as to how the market shares and number of relevant licensees could be determined, many contributors – particularly current licensees - focused on the proposed market shares, arguing that there should not be a significant departure from the 90/10 split currently employed in the collective licence modification procedure for gas licensees.

1.4 Responses to the previous consultation also offered constructive ideas on how the market shares might be determined, and on other aspects of the process for voting on modifications.

1.5 Careful consideration has been given to the responses, and revised proposals are set out in section 4 below.

2 Background

2.1 The Utilities Act 2000 (“the Act”) gives effect to Government proposals for the reform of the regulatory regimes for gas and electricity. This includes a provision to reform the way in which licences may be modified by the Gas and Electricity Markets Authority (the Office of Gas and Electricity Markets – “Ofgem”). The Act

establishes the framework for making licence modifications, while aspects of detailed implementation need to be dealt with through secondary legislation.

2.2 Section 35 of the Act establishes collective licence modification procedures (ie the ability to modify standard conditions in all licences of a particular type without the need for the consent of all licence holders or a reference to the Competition Commission (“CC”)) in relation to the standard conditions of electricity licences. Although a collective modification procedure for gas licences has been in place for some time, section 82 amends that procedure in line with the new arrangements proposed for electricity.

2.3 The same sections of the Act provide the Secretary of State with powers to prescribe in secondary legislation numerical values, expressed as percentages, for the proportion of licensees which will be required to block a proposal by Ofgem for the collective modification of a standard licence condition without a reference to the CC..

The current arrangements

2.4 From time to time it becomes desirable or necessary to modify licence conditions. Reasons for this may include the need to regulate specific aspects of licence holders’ behaviour more closely in the interests of consumers, or the need to change conditions to reflect changes that have taken place in the market. At present, to achieve change, the regulator may either seek the consent of the licence holders or he may make a licence modification reference to the CC about matters which operate, or may be expected to operate, against the public interest and seek the CC’s view on whether any effects adverse to the public interest could be remedied or prevented by modifications of licence conditions.

2.5 At present, in the case of gas, where licences contain both individual and standard conditions, standard conditions of licences may be modified collectively, provided that a sufficient number of licensees consent. The test laid down in the Gas Act is that in order for the regulator to proceed with a proposed modification without having recourse to the CC, it must secure the consent of not less than 90 per cent of the holders of the type of licence in question by number and by market share. The basis on which market share is to be measured for the purposes of the second limb of this test is also set down in the Act. These tests are the same for all types of licence and, since they are set down in an Act of Parliament (with no provision for their amendment by way of secondary legislation), they may only be changed by further primary legislation.

2.6 Because the tests measure the level of support for a proposed modification, licence holders who do not respond to proposals for modifications are deemed to have opposed them.

2.7 The Government believes that this militates too much against necessary change. It believes that a different balance needs to be struck which gives the regulator a little more scope for bringing about necessary changes to licences in line with his general duties, while at the same time providing a sufficient level of protection to allow licence holders to safeguard their legitimate interests. In making this judgement and in

determining how and how far to shift the balance, the Government has been conscious of the need to keep regulatory risk to a minimum and to give companies reassurance that the power will be subject to reasonable restraints.

2.8 In gas, when granting licences, the regulator may currently include conditions which are not standard conditions – for example those which reflect the special circumstances of an individual licence holder. These conditions may be modified with the consent of the licence holder or by reference to the CC. These arrangements are considered to be satisfactory, therefore they will be retained in both gas and electricity.

2.9 Since there are no standard licence conditions in electricity licences at present, there is no system of collective licence modification. But on 26 March 2001, the Department published a final draft of standard licence conditions covering all gas and electricity licences. These draft conditions can be viewed on the DTI web site at http://www2.dti.gov.uk/energy/licence_con.htm. Drafting suggestions on these conditions were invited by 26 April 2001. The collective licence modification process which is the subject of this consultation will apply to all standard conditions in both gas and electricity licences.

3 The revised proposals for collective licence modification

3.1 In future, the test for determining whether a proposed licence modification should proceed will relate to the level of opposition which has been registered to it in the course of Ofgem's consultation on the proposed modifications. This switch from measuring support to measuring opposition has the following effects. First, it will require licence holders who are not content with the proposal to register their objection with Ofgem in the manner specified in a notice given by Ofgem. Second, licence holders who do not register their opposition will be deemed not to have objected to the proposal. Third, the numerical tests for determining the level of opposition to a proposal will take the form of blocking-minority thresholds.

3.2 As provided in the Act, each modification proposal will be subject to a two-limbed test, in which the level of opposition will be compared with a pre-determined blocking minority threshold. One of these thresholds will measure the level of opposition to the proposal on a simple numerical basis; the other on a market-share basis. If either threshold is met or exceeded, Ofgem will not be able to proceed with the proposed modification. In the event that neither blocking-minority thresholds is exceeded, Ofgem may proceed with the modification.

3.3 In the event that the proposals are blocked, Ofgem will have a number of options open to it. It may abandon its proposals. It may alter them in the hope of gaining sufficient support in a further consultation. Finally, it may decide to make a licence modification reference to the CC.

3.4 The numerical tests described above relate to opposition registered by eligible licence holders (see below). However, the consultation will not be restricted to such persons. Indeed, it will be open to anyone to make representations to Ofgem. Ofgem will be under a duty to consider all representation made to it from wherever they come.

It will proceed to the numerical tests only if there is nothing in any of the responses which causes it to wish to alter or abandon its proposals.

3.5 Numerical values for the blocking-minority thresholds will be established for each licence type in one or more orders made by the Secretary of State. The basis on which market share is to be weighted for the purposes of the second limb of the test for each licence type will also be established by order by the Secretary of State. These orders will be subject to affirmative resolution by both Houses of Parliament.

3.6 The numerical values for the blocking-minority thresholds and the basis for weighting the market share may be varied by order in the same way.

3.7 Based on the standard conditions of licences, the Government is intending to develop a licence structure which would allow a greater degree of flexibility in the application of obligations imposed by the licence than is at present the case.

3.8 Unless an individual licence has been modified at granting or subsequently, it will contain all of the standard conditions for that type of licence. However, it is intended that not all the conditions need necessarily be operative in the licence at all times. The draft standard licence conditions on which the Department is currently consulting include conditions which would enable Ofgem to switch on or off or suspend the application of certain conditions in each licence type. The Department has indicated, in its commentary which accompanies the draft standard licence conditions, that it wishes to consider further the detail of these “switching” conditions.

3.9 The relevance of a switching condition of some type to the collective licence modification procedure is that when measuring the level of opposition to a modification proposal Ofgem will only count objections, by licence type, from those licence holders in whose licences the conditions to be modified are operative at the time of the consultation.

3.10 The effect of this is to restrict the threshold test to those licence holders who are likely to have a strong and direct interest in what is being proposed. As indicated above, this restriction in no way bars other licence holders from making their views known to Ofgem as part of the consultation on the modification proposals.

4 Blocking minority thresholds

4.1 In the previous consultation, it was proposed that there should be a variety of values accorded to each test, dependent on the type of licence at issue. These values were calculated by reference to a range of criteria, including the position of established players and new entrants in the market; the number of licensees in each case; the existence or otherwise of dominance; and the development or prospects for development of competition in the particular market.

4.2 As we recognised at the time, this approach involves making a subjective assessment of the relative weights of the diverse criteria to arrive at the numerical values. Having regard to the benefit of that first consultation, the revised proposals focus on a simpler approach based on clear principles.

4.3 The key principles are detailed below:

- (i) **the blocking minority threshold should be 20% in each case, except for electricity transmission licensees where no thresholds will be set;**
- (ii) **where a company or group of companies holds more than one licence in respect of which a relevant modification is proposed, only one vote will count for the simple numerical test; but**
- (iv) **the entire market share of such a company or group of companies (in an individual relevant market) will count in the market share test;**

4.4 The measurement of market share for each type of licensee should be determined as follows:

- (a) **Electricity Supply: number of metering points registered**
- (b) **Electricity Distribution: number of metering points**
- (c) **Electricity Generation: installed capacity (“Genset Registered Capacity”)**
- (d) **Gas Supply: number of supply points registered**
- (e) **Gas Shippers: average daily delivery to customers (over previous three months, or over the relevant shorter period for a new shipper)**
- (f) **Gas Transporters: average daily delivery to customers (over previous three months, or over the relevant shorter period for a new transporter).**

4.5 It is proposed that the date on which the relevant tests for market shares should be judged is the date on which the proposals for modifications are issued, and that Ofgem should bear the responsibility for establishing the figures.

4.6 These measures are designed to ensure that the process should be more readily understood. Many respondents to the first consultation registered their view that the 90/10 split which we have in gas should remain. We believe that the pace of change and – in particular – consolidation in the market has fast outgrown the 10% blocking minority figure which would be suggested by reversing the current gas model. There are arguments for having a blocking minority higher, at say 25% or 30%, but setting the threshold at 20% provides a balance between the need for regulatory certainty, and an element of flexibility to permit some sensible future development of licence conditions.

4.7 As a balance to a relatively low blocking minority threshold, it is important to address the concerns raised by a number of respondents over the ability of a single company or group of companies to exert undue influence over the outcome of a collective licence modification procedure by virtue of possessing a number of relevant licences. The proposal outlined at 4.3 (ii) above is intended to provide the requisite element of fairness to the process for the numerical vote. The alternative approach would be to set very high blocking minority thresholds in some licence types, and that would require regular review as markets develop. We are reluctant to adopt this latter approach, as it would lead to some uncertainty for licensees.

4.8 We need to be sure that the measures adopted for determining market share are both fair and practical. Ofgem will be considering the practical implementation of these measures, but any views or suggestions from other interested parties will be very much appreciated.

5 Next steps

5.1 Views on all or any of these revised proposals would be warmly welcomed.

5.2 Responses should be sent by 14 May 2001 to

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