



Gas shippers and traders, transporters,
potential new entrants, consumer
groups and other interested parties

*Promoting choice and
value for all customers*

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Dear colleagues,

Final decision on Ofgem's consultation on licensing policy for Gas Traders

We¹ consulted on changes to Ofgem's licensing policy for Gas Traders in January 2012 (our open letter consultation)² and again, on the basis of a 'minded to' position in July 2012.³ Having considered the responses to both of our consultations, we are hereby clarifying that Gas Traders should not be required to obtain a gas shipper licence in order to carry out activities under the Uniform Network Code (UNC).⁴ This will affect those persons who are not involved in the physical conveyance of gas on the Great Britain (GB) network system, ie who only trade gas as a commodity at the National Balancing Point (NBP) (Gas Traders).

Today we are also directing the implementation of the related modification proposal UNC 338V 'Remove the UNC requirement for a 'gas trader' User to hold a Gas Shipper Licence', raised by National Grid Transmission.⁵

This letter summarises the responses to our 'minded to' consultation published in July 2012 and sets out our views on the issues raised.

In summary, our view remains:

1. As Gas Traders' activities do not fall within the prohibition of unlicensed activities contained in the Gas Act 1986 (the Gas Act), we wish to clarify that they should not be required to obtain a gas shipper licence, but should be able to continue to carry out their activities.
2. Requiring a Gas Trader to have a gas shipper licence represents an inappropriate barrier to entry, especially for small parties. Removing this barrier is consistent with our duty in respect of better regulation and the Government's red tape challenge.
3. Clearly defining gas trading as a separate activity from gas shipping would make the status of industry parties more transparent.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This consultation and the non confidential responses to it can be found here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=196&refer=Licensing/Work>

³ This letter and the non confidential responses received can be found here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=233&refer=Licensing/Work>

⁴ For the avoidance of doubt, all those parties intending to become involved in shipping activities, as defined in the Gas Act 1986, will continue to require a gas shipper licence.

⁵ Our decision letter on UNC 338V can be found here:

<http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Pages/Modspage.aspx>

Background

During 2010, we commenced a review of our licence application process. As part of this review, we noted a marked increase in gas shipper licence applications during 2009. We asked Xoserve⁶ to provide us with details of parties that were using their systems for shipping and found that many licensees were not physically conveying gas. We attributed the increase in gas shipper licence applications to the requirement to hold a gas shipper licence in order to accede to the UNC and access the Gemini system.⁷

In June 2010, we launched a consultation on proposed changes to the Licence Application Regulations.⁸ As part of this consultation we welcomed views on whether parties should be required to hold a gas shipper licence in order to be able to carry out gas trades and sign up to the UNC. The majority of respondents agreed that it was not appropriate to require parties to obtain a gas shipper licence prior to being able to carry out gas trades.

In January 2012, we published our open letter consultation on changes to Ofgem's licensing policy for Gas Traders. We sought views on whether Gas Traders who are not involved in the activities prescribed by the Gas Act should be required to have a gas shipper licence.

In July 2012, we published our 'minded to' consultation on Ofgem's licensing policy for Gas Traders. We also set out that we were minded to approve related modification proposal UNC 338V. UNC 338V proposes to remove the UNC requirement for Gas Traders to have a Gas Shipper Licence.

Issues raised by respondents and our views

We received four responses to our July 2012 consultation: three in support and one against.

Those respondents in support agreed with us that the participation of non-physical traders in the gas market should not be dependent on holding a licence. Respondents agreed that appropriate market entry requirements, security and other necessary commercial terms can be put in place through provisions in the industry codes and contracts. One respondent did not agree with our 'minded to' position. Our views on the concerns raised are set out below.

Inability to effectively enforce penalties or sanctions

The respondent, who did not support our 'minded to', did not support our view that appropriate obligations should be placed in and enforced through the UNC, as they did not believe that the UNC's enforcement provisions are sufficiently robust. They considered that it is important to clarify the status of the UNC enforcement powers before the proposed change to licensing is made. They also did not agree with Ofgem that there will be no governance gap, as they considered that many of the powers under the Competition Act would not be relevant for the type of activities and failures that a Gas Trader could be involved in. Finally they highlighted the need to ensure that there is a clear obligation for Traders to accede to the UNC before they can trade.

As already noted in our 'minded to' consultation, most conditions in the gas shipper licence relate to physical aspects of the network and are therefore not relevant to Gas Traders.

⁶ Xoserve manages the commercial interfaces between the major gas transporters operating in Great Britain and Gas Shippers.

⁷ The Gemini system is managed and operated by xoserve and enables gas shippers to carry out gas nominations, energy balancing and exit capacity booking.

⁸ 'Proposed changes to the current Application Regulations and Revocation Schedules of future licences', reference number 74/10. This consultation can be found at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=App%20Regs%202010%20Consultation.pdf&refer=Licensing/Work>

Again, we have received no response indicating specifically what type of obligation currently contained in the licence may need to be maintained, in addition to those identified by us and discussed in our 'minded to' consultation.⁹

As regards enforcement under the UNC, although we agree with the respondent that the enforcement rules in the UNC could benefit from a review with a view to potentially strengthening these, we do not think it is necessary to wait for this review to have taken place before bringing in this licensing change. We would therefore encourage industry to explore this issue further and raise appropriate modification proposals if any are identified. We do not think that it is proportionate to maintain a licensing obligation simply to augment the UNC provisions.

In relation to our own enforcement powers, we agree with the respondent that, depending on the circumstances of any potential abuse by a Gas Trader, Ofgem may not be able to use its enforcement powers under the Competition Act 1998. However, the Authority¹⁰ will be given further powers for monitoring and enforcement through the implementation of the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT),¹¹ which specifically addresses insider trading and market manipulation in the energy sector.

We restate our view that no gap in regulation would be created, as those activities subject to regulation under the Gas Act and other statutes will continue to be regulated. In addition, any Gas Traders who are no longer directly regulated through a Gas Shipper Licence will remain subject to the terms of the UNC, which itself is subject to regulatory oversight. We will of course continue to monitor the regulation of Gas Traders and could, if appropriate, consider what action may be required should any regulatory gaps be identified.

Finally, in relation to the obligation for Gas Traders to sign up to the UNC, we note that the Gas Shipper Licence does not oblige a gas shipper to sign up to any of the codes. Therefore we do not consider that the removal of the obligation to have a Gas Shipper Licence for Gas Traders would make any difference in relation to this obligation. Also, as highlighted by National Grid Transmission in their response, if Gas Traders intend to trade gas at the NBP with other UNC parties and have these trades recognised and accounted for in the system clearing process, they would still need to accede to the UNC to be able to use the relevant UNC trade notification systems.

Impact on security of supply

Referring to the Significant Code Review on Gas Security of Supply (Gas SCR) that Ofgem has undertaken, one respondent noted their concern that Gas Traders might be able to avoid increased cash out penalties in an emergency, by failing to post credit margins and then entering into administration. In their view, the Trader could then re-enter the market under a replacement Trader user identity without penalty and Ofgem would have no say in the matter.

We note that Gas Traders are exposed to cash-out charges (and credit requirements) under the UNC and would continue to be exposed to such charges even without a shipper licence. We also note that the credit rules contained in Section X of the UNC allow National Grid Transmission to require Users to make additional payments where a credit limit is exceeded, and to terminate a User who does not make this payment after one business

⁹ As discussed in our 'minded to' consultation letter, the licence obligations in relation to co-operation in an emergency will be inserted in the UNC following implementation of UNC338V; on the other hand, as discussed in our 'minded to' letter, we do not think it is appropriate at this stage to insert an obligation, to provide information to the Authority, in the UNC.

¹⁰ The Authority is designated as the regulatory authority for Great Britain under section 3A of the Utilities Act 2000.

¹¹ Regulation (EU) No 1227/2011 of the European Parliament and the Council on wholesale energy market integrity and transparency available online at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:326:0001:0016:en:PDF>

day. We note the point, made by this respondent, that if a Trader goes into administration the costs are socialised between the remaining UNC parties, but we also note that this is true whether the failing party holds a shipper licence or not.

As highlighted by the issue discussed above, we are concerned that there may be a prevailing perception that the granting of a licence to an applicant can of itself give future counterparties some assurance as to their bona fide nature. Our licence application process should not replace the need for normal due diligence and 'know your customer' checks. We reiterate that parties should not rely on a licence in place of industry pre-contractual checks as a form of due diligence. In issuing a licence, we do not give any guarantee, warranty or endorsement of any applicant, their financial status, or business methods.

Reasons for our decision

Under the Gas Act it is an offence to carry out certain activities without a licence or an exemption from the requirement to hold a licence. Section 7A(2) of the Gas Act states that *"the Authority may grant a licence authorising any person to arrange with any gas transporter for gas to be introduced into, conveyed by means of or taken out of a pipe-line system operated by that transporter, either generally or for purposes connected with the supply of gas to any premises specified in the licence"*. Therefore, the activity for which a shipper licence is required is arranging the physical conveyance of gas from one point to another (gas shipping).

As the Gas Act refers only to gas shipping and not trading activities, we do not think it is appropriate for Ofgem to continue to issue licences to Gas Traders that are not involved in the physical conveyance of gas. This is in line with our functions in respect of granting licences and more broadly with our duty in respect of 'better regulation'. This duty requires us to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed (as well as other principles we consider represent best regulatory practice). For the avoidance of doubt, it is for each party to determine whether their activity is in fact a "prohibited activity", as prescribed by the Gas Act, for which a licence is required.

In addition, we consider that although the fee for a shipper licence is only £350, requiring a non-physical trader to have a shipper licence represents an unnecessary and unjustified barrier to entry. It is an administrative burden, especially for small parties and parties who are based abroad. We do not consider the fact that there are also other steps industry parties need to take to become Gas Traders to be relevant to the principle of this issue. We note that, in a parallel context, this barrier does not exist in the electricity market where there is no requirement to hold a licence to trade.

We consider that there is merit in clarifying our licensing policy and where applicable making changes to industry contracts in order to differentiate between those parties who intend to trade gas as a commodity and those intending to physically ship gas: a shipper and a trader have different types of obligations and need to put in place different securities with the transporter. Clearly defining gas trading as a separate activity from gas shipping will provide greater transparency on the status of industry parties.

We also confirm our initial view, put forward in our January 2012 consultation, that individual parties are best placed to determine whether they require a licence. Therefore, we would primarily consider revoking licences where the licence holder applies to us to have their licence revoked. However, we will where appropriate consider exercising our powers to revoke licences in other circumstances, such as if a licence holder ceases to (or does not) carry out any business as a gas shipper.

Implementation date

As mentioned in the Final Modification Report (FMR) on UNC338V, no material changes to systems or processes will be required by the UNC change related to the licensing issues discussed in this letter. Therefore, both UNC338V and our licensing change could be implemented immediately following our final decision. However, while we think that UNC338V can be implemented soon after the Authority decision, the industry might want some more lead time for our licensing change to come into effect. In our July 2012 'minded to' letter, we proposed two alternative dates: 1 October 2012 or 1 January 2013. Of the four respondents, two have expressed their preference that the licensing change should come into effect on the 1 January 2013, one did not express any preference, while the fourth considered that Ofgem should delay the proposed implementation until a more thorough review of the UNC has been undertaken.

As already discussed above, we do not think that it is proportionate to maintain a licensing obligation simply to augment the UNC provisions. Therefore, to provide an appropriate lead time before the change is effective, we propose that this licensing change takes effect from 1 January 2013.

Our 'Guidance for gas and electricity licence applications' will be updated with the proposed wording which we have consulted upon as part of our 'minded to' consultation.¹² For the avoidance of doubt, we are not changing the Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations,¹³ as this change is merely a clarification of when a person requires a gas shipper licence and does not, therefore, affect those Regulations.

Yours faithfully,

Declan Tomany
Associate Partner for Industry Codes and Licensing

¹² Please refer to Annex 1 of this letter for the exact wording.

¹³ These can be found at http://www.legislation.gov.uk/ukxi/2010/2155/pdfs/ukxi_20102155_en.pdf

ANNEX 1 – Wording to be inserted in our “Guidance for gas and electricity licence applications”

Ofgem publishes on its website the “Guidance for gas and electricity licence applications”¹⁴ (the Guidance).

This document sets out our guidance on licensable activities and how to apply for licences, or for extensions, restrictions, modifications of areas and transfers of existing licences. It also explains the process that follows a proposal by us not to grant a licence.

We consult with industry when we change our licensing guidance. As part of our July 2012 ‘minded to’ consultation on Ofgem’s licensing policy for Gas Traders, we have consulted on proposed wording to insert in paragraph 1.12 of the Guidance, which contains the definition of ‘gas shipper’.

There was general agreement on the proposed wording and therefore the new definition for the updated Guidance will be:

“Allows the licensee to arrange with a GT for gas to be introduced into, conveyed through, or taken out of a pipeline system operated by that GT. In all instances, the purpose of the gas movement should be general or for purposes connected with the supply of gas to premises. Persons not involved in the physical conveyance of gas on the GB network system, but who trade gas as a commodity at the National Balancing Point (NBP), are not included in the definition of Gas Shipper and are therefore not required to obtain a Gas Shipper Licence”.

This change will be effective from 1 January 2013.¹⁵

¹⁴ The Guidance can be found at <http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasand0electricityapplications.pdf>

¹⁵ The Joint Office may implement UNC 338 sooner, in which case the requirement in the UNC for Gas Traders to hold a Gas Shipper Licence will be removed.