Contents

1. Introduction

This document sets out Ofgas' conclusions to its review of the competitive gas supply market. It follows on from the paper, "1997 Competitive Market Review: A Consultation Document" which was published in December 1997. This document is the first of two parts and covers the gas supply market above 2,500 therms a year. Part 2, covering the market at or below 2,500 therms a year will follow shortly.

In the consultation document, Ofgas asked all interested parties whether they considered there were any remaining barriers to the development of effective competition in the above 2,500 therms a year market or the at or below 2,500 therms a year market, which were not already adequately covered by existing licence conditions and undertakings. Ofgas also invited comments on whether the requirement on British Gas Trading (BGT) to price against published schedules in the small firm sub-sector (between 2,500 and 25,000 therms) and the interruptible sub-sector should be permanently removed.

Suppliers and shippers were requested to provide quantitative information about their share of the above 2,500 therms a year market and the at or below 2,500 therms a year market. This information was requested under Standard Condition 30 of the Suppliers' Licence and Standard Condition 9 of the Shippers' Licence, which require Licencees to provide such information as the Director General of Gas Supply (DGGS) requires in order to prepare her annual report to the Secretary of State, as required under Section 39 (2A) of the Gas Act 1986. In addition, Ofgas asked Transco to provide information on the volumes of gas shipped and the number of sites to which gas was shipped through its pipeline system.

Chapter 2 describes the background to the present position with an overview of regulation in the gas supply market above 2,500 therms a year since the Monopolies and Mergers Commission (MMC) Gas Report in
1988. Chapters 3 and 4 summarise responses to the quantitative

questionnaire on volumes and prices respectively. In Chapter 5 Ofgas sets out its views alongside those of the respondents on qualitative issues raised in the consultation document. Chapter 6 summarises Ofgas' conclusions.

2. Background

The 1988 MMC Gas Report found that British Gas plc's actions in the contract market involved "systematic and extensive discrimination in the pricing of firm gas and discrimination in willingness to supply interruptible gas". The MMC recommended that British Gas plc be required to price according to published price schedules for contract customers (consumers using above 25,000 therms a year) from 1989. In 1992, following a reduction in the competitive market threshold under the Competition and Service (Utilities) Act 1992, this requirement was extended to customers using above 2,500 therms a year.

Subsequent reviews by the Office of Fair Trading (OFT) in 1991 and the MMC in 1993 concluded not only that schedules should remain, but also that further regulatory constraints were necessary. These included a market share target (which was achieved and has since become redundant); the release of gas to competitors (1995/96 was the last year of the programme); and the complete separation of British Gas plc's transportation and storage business (Transco) from its trading businesses, including a requirement to treat all users of British Gas plc's transportation and storage facilities in a non-discriminatory manner. The final stage of the separation was the demerger of British Gas plc into two separate companies, BG plc and Centrica plc in February 1997.

Ofgas suspended the requirement to price according to published schedules in the market for firm gas above 25,000 therms a year for 6 months from 1 October 1994 because competition had become well established in that segment of the market. However, British Gas plc still retained a significant market share, and consequently it was required to undertake not to discriminate in supply to customers above the 25,000 therm threshold after the schedules were suspended.

A review of the competitive market by Ofgas in March 1995[1] resulted in the suspension of all price schedules for 12 months from 30 June 1995. This suspension was subject to British Gas plc adhering to a number of conditions designed to reduce barriers to entry to the market and to ensure that British Gas plc did not take unfair advantage of its continuing dominant position.

As a result of Ofgas' 1996 Competitive Market Review,[2] the requirement on British Gas plc to price according to price schedules was permanently removed for supplies of firm gas in the above 25,000 therm sector. Following the demerger of British Gas plc into Centrica plc and BG plc in February 1997 the suspended requirement to price according to published schedules passed to British Gas Trading Ltd, a subsidiary of Centrica plc. In the 2,500 to 25,000 therm market and the interruptible market, the requirement to price according published schedules was suspended to the end of July 1997 and the suspension has since been extended until the end of May 1998, pending the outcome of this review.

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[1] 'The Competitive Market Review: Decision to Suspend the Requirement to Price According to Published Schedules', Ofgas, June 1995.

[2] 'Review of the Competitive Gas Supply Market Above 2,500 Therms a Year - A Decision Document', Ofgas, July 1996.

3. Market Shares

3.1 Introduction

This chapter provides information on the market share of BGT and its competitors in the gas supply market above 2,500 therms and in various segments of that market at the end of 1997. It also gives information on more recent developments.

In previous competitive market reviews Ofgas split the gas supply market into three principal sectors. These were:- the domestic market sector (ie. at or below 2,500 therms a year); the industrial and commercial market sector (ie. above 2,500 therms a year, excluding power generation, feedstocks and natural gas vehicles (NGVs)); and power generation, feedstocks and NGVs. The reviews focused on the industrial and commercial sector (excluding power generation feedstocks and NGVs), since this was the sector to which price schedules were applied. This year Ofgas has widened the analysis to cover power generation, feedstocks and NGVs.

Ofgas has used three sources of data in its analysis:- responses from shippers and suppliers to Ofgas' quantitative survey; data supplied by Transco on supply points held by shippers and on volumes shipped; and data on volumes supplied through dedicated pipelines from the Department of Trade and Industry (DTI).

Ofgas' quantitative questionnaire to shippers and suppliers asked for information about all sectors of the competitive market, distinguishing between the domestic market and the industrial and commercial sector, the power generation sector, the feedstocks sector and the emerging market for natural gas vehicles. In the industrial and commercial sector, Ofgas requested information on volumes shipped or supplied (from 1 October 1996 to 30 September 1997), number of sites shipped to or supplied and indicative prices. The sector was divided into seven volume bands for firm sites and three volume bands for interruptible sites. The
sector was further sub-divided into single and multi-site contracts. Suppliers were asked to provide readily available information on prices for each sector and sub-sector in October 1996, April 1997 and October 1997.

In addition, Ofgas asked Transco to provide shipper data. These data were provided on a different basis from those submitted by suppliers. Transco provided an annual quantity (AQ) report detailing annual supply point volumes in total for each shipper on a particular day, split into the various sub-sectors outlined above, excluding splits between single and multi-site contracts. AQ represents the annual consumption over the previous 12 months for a meter point, adjusted to seasonal normal temperature. Figures for gas volumes supplied to power stations through dedicated pipelines were obtained from the DTI, for the period October 1996 to September 1997.

3.2 Results

3.2.1 The Overall Market

Table 1 provides information on the gas supply market in Great Britain broken down by market sector, together with market share data for gas shipped by BGT. Information for the domestic sector is included in the table, but will be discussed in detail in Part 2 of the 1997 Competitive Market Review.

Table 1 - Gas Volumes Shipped in Great Britain (1/12/97)

Market Sector	Total Therms (m)	BGT's Market Share Therms (m)	%
Above 2,500 Therms			
- Industrial and Commercial	11,988.07[1]	2,880.71	24
- Power Generation	8,066.42[2]	2,065.94	26
- Feedstocks/ Natural Gas Vehicles	✻	✻	✻
- Above 2,500 Therms Total	✻	✻	**28**
At or Below 2,500 Therms[3]:-			
- Excluding Phases 1 & 2	10,138.11	10,138.11	100
- Phases 1 & 2	1,390.63[4]	1,032.10	74
- At or Below 2,500 Therms Total	**11,528.74**	**11,170.21**	**97**
Total, all sectors	✻	✻	**52**

✻ These figures were removed at the request of BGT on the basis of commercial confidentiality.

Notes:

1. 'Industrial and Commercial' consists of customers who consume above 2,500 therms a year excluding power generation, feedstocks and natural gas vehicles.
   Source: Transco, estimated annual volumes shipped as of 1 December 1997.
2. The power generation figure is for gas shipped to gas-fired power stations, predominantly Combined Cycle Generating Turbines (CCGTs).
   Sources: Transco, for volumes shipped through the NTS from October 1996 to September 1997 (4,934.42m therms), DTI figures on dedicated pipelines for the same period (3,132 m therms).
3. 2% of gas supplied to the at or below 2,500 therm market is supplied to industrial and commercial premises.
   Source: Total domestic volume from DTI, Energy Trends for October 1996 to September 1997.
4. Figures for Competition Phase 1 (Devon, Cornwall and Somerset) & Phase 2 (Dorset, the former county of Avon, East Sussex, West Sussex and Kent) as at 1 December 1997. Source: Transco AQ data.

As Table 1 shows, BGT's overall share of the market above 2,500 therms a year is 28%. Its share of the industrial and commercial sector, excluding power generation, feedstocks and NGVs is 24% and its share of the entire gas supply market is just over twice this, at 52%.

In the power generation sub-sector, in addition to acting as a shipper/supplier, BGT acts as a shipper on behalf of other suppliers. This activity accounts for approximately 17% of the gas BGT ships in this sub-sector. Thus BGT's share of the supply in this sub sector is about 22%. In other sectors of the market BGT acts in almost all cases as both shipper and supplier. For the market above 2,500 therms as a whole its share on a as a supplier is 26%, compared to 28% as a shipper.

There are over 40 companies competing with BGT in the above 2,500 therm market with some companies active in all sub-sectors and others active only in some sub-sectors. No single company other than BGT has more than a share of around 10% of the market above 2,500 therms overall. Table 2 below provides a further breakdown of the overall market shares of all companies.

Table 2 - Market Shares of Companies in the Market Above 2,500 Therms a Year

Market Share Band	No. of Companies
10%+	1
8 - 10%	2
3 – 8%	4
2 - 3 %	4
1 - 2 %	5
0.5 - 1 %	7
0 - 0.5 %	21

Source: Transco, estimated volumes shipped as of 1 December 1997.

Over a dozen companies are suppliers only. However, none of these companies has a market share of more than 1%, and the market share of these companies taken together is less than 1.5%. These companies tend to operate in the lower consumption end of the industrial and commercial sector.

3.2.2 The Market Above 2,500 Therms

Table 3 shows BGT's market share above 2,500 therms based on volumes shipped, and its share of the sub-sectors within it.

Table 3 - BGT's Market Share Above 2,500 Therms a Year

Market Sector	Total Therms (m)	BGT's Market Share Therms (m)	%
Large Firm (Above 25,000 therms a year)	5,827.38	1,193.45	21

Small Firm (2,500 – 25,000 therms a year)	2,235.54	830.57	37
Interruptible	3,925.16	856.69	22
Industrial and Commercial[1]	**11,988.07**	**2,880.71**	**24**
Power Generation	8,066.42[2]	2,065.94	26[3]
Feedstocks/ Natural Gas Vehicles	*	*	*
Above 2,500 Therms Total	*	*	**28[3]**

* These figures were removed at the request of BGT on the basis of commercial confidentiality.
Source: Transco, estimated volumes shipped as of 1 December 1997.
Notes:

1. Excludes power generation, feedstocks and NGVs.
2. Power generation figure is for volume shipped to gas-fired power stations, predominantly Combined Cycle Generating Turbines (CCGTs).
   Sources: Transco, for actual sales through the NTS in October 1996 to September 1997 (4,934.42m therms), DTI figures on dedicated pipelines for the same period (3,132 m therms).
3. These figures are 22% and 26% on a supply basis.

Table 4 shows changes in BGT's market share compared to figures compiled at June 1996, from Ofgas' 1996 Competitive Market Review survey and April 1995, from Ofgas' 1995 Competitive Market Review survey.

Table 4 - BGT's Market Share Above 2,500 Therms 1995-1997

Market Sub-Sector	April 1995 (%)[1]	June 1996 (%)[1]	December 1997 (%)[2]
Large Firm (Above 25,000 therms a year)	10	19	21
Small Firm (2,500 - 25,000 therms a year)	45	43	37
Interruptible	57	34	22
Industrial and Commercial[3]	**35**	**29**	**24**
Power Generation	32	24[4]	26[5,6]
Feedstocks/ NGVs	*	*	*
Above 2,500 Therms Total	**n/a**	**30**	**28**[6]

* These figures were removed at the request of BGT on the basis of commercial confidentiality.

Notes:

1. The Business Gas data and the Transco data are not strictly comparable. The Business Gas 1995 data were based on market estimates at the time. Market share figures based on competitive market review returns in 1996 differed from Transco figures by 2 - 5%.
   Source: April 1995 figures - Business Gas (1995 competitive market review), and June 1996 figures - Transco data.
2. Source: Transco, estimated annual volumes shipped as of 1 December 1997.
3. Excludes power generation, feedstocks and NGVs.
4. This figure refers to the calendar year 1995 and includes supplies through Transco's National Transmission System and supplies through dedicated pipelines.
5. Power generation figure is for volume shipped to gas-fired power stations, predominantly Combined Cycle Generating Turbines (CCGTs).
   Sources: Transco, for actual sales through the NTS in October 1996 to September 1997 (4,934.42m therms), DTI figures on dedicated pipelines for the same period (3,132 m therms).
6. These figures are 22% and 26% on a supply basis.

BGT's overall market share in the industrial and commercial sector (excluding power generation, feedstocks and NGVs) has declined since June 1996 from 29% to 24%. This figure rises to 28% of the gas shipped by volume with the inclusion of power generation, feedstocks and NGVs, compared to 30% in 1996. BGT has increased its share of the large firm sub-sector from around 19% to 21%. Its market share in the small firm sub-sector has dropped somewhat, 37% against 43% previously. Its share of the interruptible sub-sector has decreased from 34% to 22%. BGT's share of the volume shipped in the power station sub-sector has

risen slightly, and now stands at 26% compared to 24% in 1996.
No company other than BGT has more than about 18% share of the large firm, small firm, interruptible, power generation or feedstocks/NGVs sub-sectors.

Within the defined narrow volume bands in each sub-sector BGT's market shares on a site basis are similar to the shares on a volume basis since the consumption bands used are quite narrow. However, most sites are in the lower consumption bands and BGT supplies a higher proportion of these.

Reflecting this pattern, BGT's overall share of the industrial and commercial sector on a site basis is 44%, substantially higher than the equivalent figure on a volume basis (28%). The proportion of customers served by BGT is therefore substantially higher than its market share by volume would suggest. Its market share by site is shown in Table 5.

Table 5 - BGT's Market Share by Site in the Industrial and Commercial Market

Market Sub–Sector	Total Sites	BGT's Sites	December 1997 (%)
Large Firm (Above 25,000 Therms a year)	44,157	12,284	28
Small Firm (2,500 - 25,000 Therms a year)	348,960	160,672	46
Interruptible	1,657	379	23
Total Industrial and Commercial[1]	**394,774**	**173,335**	**44**

Notes:
1. Excluding power generation, feedstocks and NGVs.
2. Source: Transco, position on 1 December 1997

BGT's share of customers on single site contracts is much higher than for multi-site contracts. Its market share by volume over all sub-sectors is approximately 55% for single sites, whereas it is 11% for multi-sites.

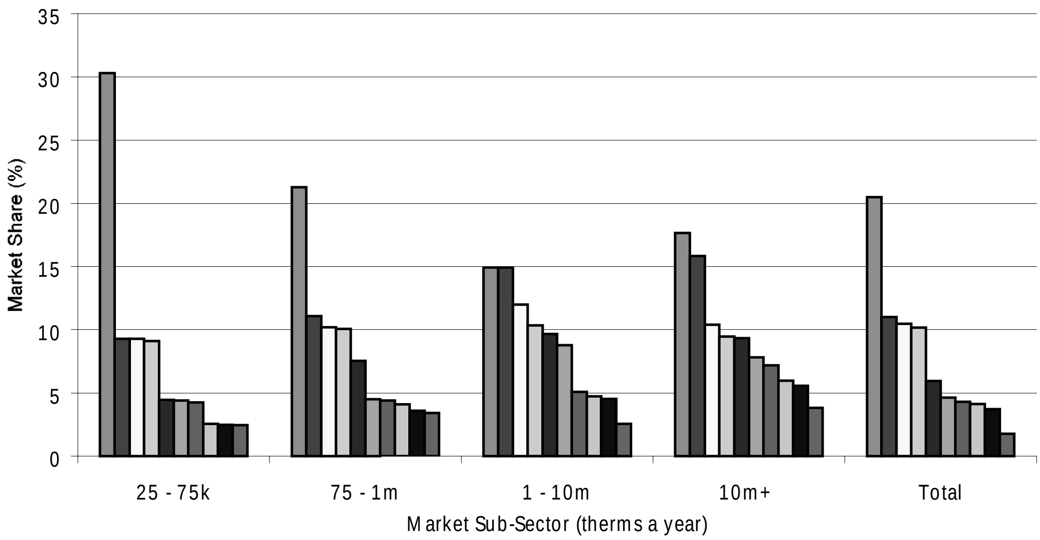
Market share data for the individual sub-sectors are discussed below.

a) The Large Firm Sub-Sector

Figure 1 provides a breakdown of the large firm sub-sector (above 25,000 therms, excluding power generation, feedstocks and NGVs) for the 10 companies with the largest market shares. The total market share of companies not included in the graph is 23%. There are over 35 companies shipping gas to this sub-sector.

BGT has a market share of around 21% by volume shipped. The next largest shippers have a market share of around 11% each. Within some consumption bands BGT is not the largest shipper. In this sub-sector, BGT still has a large presence in single sites (estimated at around 67% in volume terms), but less so in multi-sites (estimated at around 16%).

Figure 1 - Large Firm Sub-Sector



Notes:

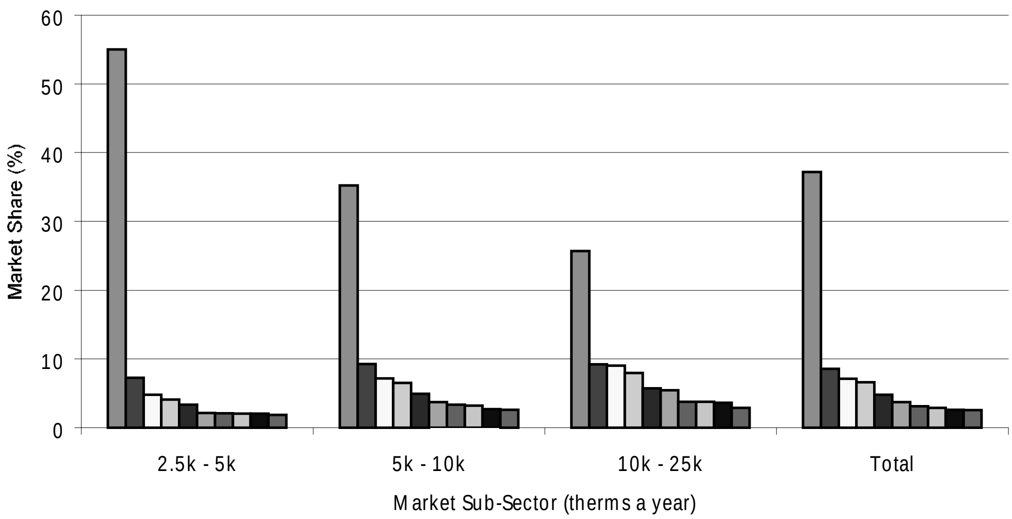
1. The ranking of companies in this graph is different from the ranking in other published data. In order to protect shipper confidentiality, the ordering of the companies differs between the different graphs used in this section.
2. Source: Transco, estimated annual volumes shipped as of 1 December 1997.
3. The total market share of companies not included in the graph is 23%.

b) The Small Firm Sub-Sector

Figure 2 provides a breakdown of the small firm sub-sector (2,500 to 25,000 therms a year) for the 10 companies with the largest market shares. There are over 35 companies shipping gas in this sector. BGT retains a market share of 37% by volume shipped. No competitor to BGT has more than a market share of 10%. The total market share of companies not included in the graph is 21%.

BGT has experienced the least erosion of its market share in the lower volume bands. For both single and multi-sites, it ships gas to 55% of those consuming between 2,500 and 5,000 therms a year. However, the competitive challenge to BGT is larger as the volume of gas shipped grows. BGT ships 35% of gas to sites consuming between 5,000 and 10,000 therms a year and 26% to sites consuming between 10,000 and 25,000 therms a year. BGT retains a substantial presence in single sites (estimated at around 28%), whilst its presence in multi-sites is similar to that in the large firm sub-sector (estimated at around 17%).

Figure 2 - Small Firm Sub-Sector



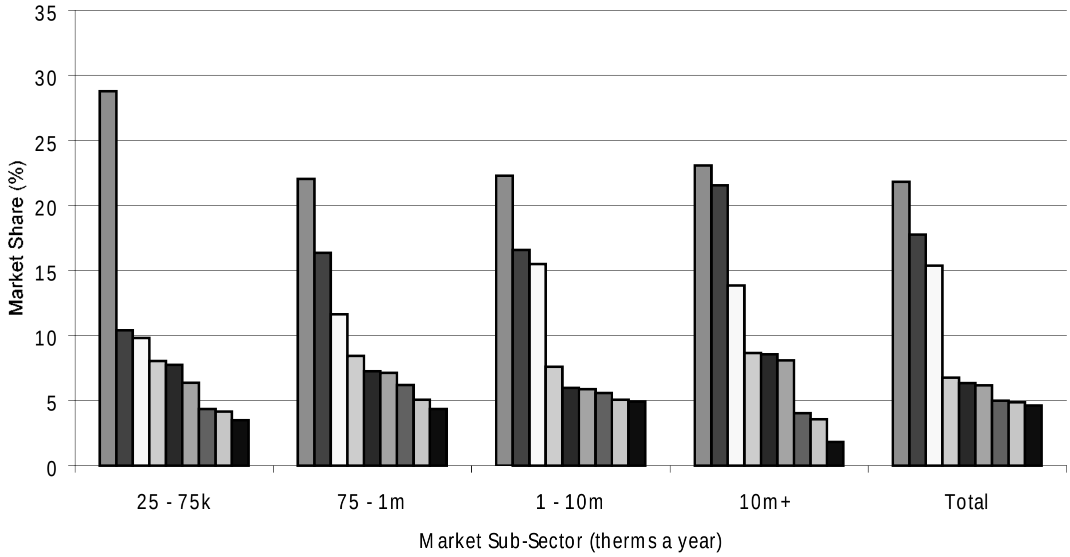
Notes:

1. The ranking of companies in this graph is different from the ranking in other published data. In order to protect shipper confidentiality, the ordering of the companies differs between the different graphs used in this section.
2. Source: Transco, estimated annual volumes shipped as of 1 December 1997.
3. The total market share of companies not included in the graph is 21%.

c) The Interruptible Sub-Sector

Figure 3 provides a further breakdown of the interruptible sub-sector for the 10 companies with the largest market shares. Over 20 companies ship gas in this sub-sector. BGT has a market share of 22% in volume terms. The total market share of companies not included in the graph is 11%. BGT's nearest competitor ships about 18% of the volume in this sub-sector. BGT has a very large share of interruptible single sites (estimated at around 70%) whilst having a very small share of multi-sites (estimated at around 6%).

Figure 3 - Interruptible Sub-Sector



Notes:

1. The ranking of the companies in this graph is different from the ranking in other published data. In order to protect shipper confidentiality, the ordering of the companies differs between the different graphs used in this section.
2. Source: Transco, estimated annual volumes shipped as of 1 December 1997.
3. The total market share of companies not included in the graph is 11%.

d) Power Generation Sub-Sector

BGT currently ships around 26% of all gas used for power generation.[3] However, as discussed earlier, BGT acts as a shipper on behalf of other suppliers. Thus on a supply basis BGT's market share is about 22%. Over a dozen companies ship gas to this sub-sector, with BGT's nearest competitor shipping approximately 16% of the volume to this sub-sector.

e) Feedstocks/Natural Gas Vehicles

BGT remains a dominant shipper of gas to feedstocks and is presently the main gas shipper for NGVs, which is a relatively small sub-sector. There are only three other shippers active in this particular market sector.

[3] Based on Transco's figures for gas shipped during October 1996 to September 1997 to CCGT power stations and DTI figures on gas supplied through dedicated pipelines from October 1996 to September 1997.

4. Pricing

4.1 Introduction

Suppliers of industrial and commercial customers were asked to provide indicative prices in each consumption band for October 1996, April 1997 and October 1997. These prices were given in confidence. In order to preserve this confidentiality, only a limited amount of information on pricing can be published.

4.2 Results

4.2.1 Pricing Trends and Competition

The range of prices charged by different suppliers has narrowed somewhat compared to the data supplied for the 1996 Competitive Market Review. Tables 6 and 7 show that prices generally rose over the year, with the largest rises occurring in the large firm and interruptible sub-sectors, excluding large single site interruptible customers. Suppliers argue that these rises are the result of increasingly cost-reflective pricing following the very low prices experienced in October 1996. The sub-sectors where the largest rises have occurred are ones in which prices at the beginning of the year appeared low in relation to other sub-sectors. The rises in other sectors were generally in line with rises in spot prices.

4.2.2 Market Sectors

a) Firm Sub-Sector

Table 6 - Average Weighted Prices

Sub-Sector	Weighted Average Price p/therm						Change from October 1996-97	
Firm	October 1996		April 1997		October 1997		(%)	
	Single	Multi	Single	Multi	Single	Multi	Single	Multi
2.5k – 5k	32.0	30.1	33.1	32.7	33.1	32.4	3	7
5k - 10k	29.6	28.2	31.1	30.6	30.8	29.7	4	5
10k – 25k	27.1	26.7	28.2	28.4	28.4	28.4	4	6
25k – 75k	23.8	23.6	25.1	25.3	25.6	25.3	7	7
75k - 1m	19.9	17.8	21.2	20.5	21.4	20.6	7	14
1m - 10m	16.2	9.5	18.7	18.7	17.9	10.8	10	13
10m +	10.9	10.4	11.1	8.2	13.5	10.8	19	4
Overall	22.8	20.9	24.1	23.5	24.4	22.6	7	8
Spot Price[1]	12.8		12.4		13.5		5	

Note:
1. Year ahead spot gas prices averaged over the month. Source: British Spot Gas Markets.

In July 1996 Ofgas noted a clear distinction between the prices charged above and below 25,000 therms in the single site market. Charges (excluding transportation) for customers using at least 25,000 therms were closely related to the wholesale price of gas, whilst prices below 25,000 therms were significantly higher.

These relationships have changed, however, with the largest price rises occurring for the customers in the highest consumption bands. Except for some single site contracts consuming more than 10 million therms a year, premiums over wholesale prices (ie. the difference between prices charged and the wholesale price of gas) now show a smooth increase as consumption decreases, a pattern which is consistent with smooth increases in transportation and administration costs per therm as volumes decrease.

For a given total volume of gas supplied, prices provided to Ofgas for multi-site contracts are generally at around the same level as prices for single-site contracts for the same total volume of gas and in some cases are set at lower levels. This is inconsistent with the expectation that administrative costs and transportation costs are lower for a quantity delivered at a single-site than when the same quantity is spread over more than one site. If prices for single-sites and multi-sites were equally competitive it could be expected that multi-site prices could be higher than prices for single-site contracts at the same volume. The lower multi-site prices seen in practice could be a reflection of the fact that multi-site companies are more likely to have staff dedicated to energy purchasing, who are able to give more attention to obtaining the best possible deal from suppliers. These price levels may be one reason why some multi-site customers have had difficulties in getting suppliers to tender for contracts (see section 5.3)

b) Interruptible Sector

Table 7 - Average Weighted Prices

Sub-Sector	Weighted Average Price p/therm						Change from October 1996-97	
Interruptible	October 1996		April 1997		October 1997		(%)	
	Single	Multi	Single	Multi	Single	Multi	Single	Multi
75k – 1m[1]	16.7	-	18.9	17.1	18.3	17.5	9	3
1m – 10m	15.9	13.6	15.1	14.2	16.1	15.3	1	13
10m +	14.3	10.3	14.4	11.2	14.1	14.2	-1	27
Overall	15.6	11.9	16.1	14.1	16.2	15.7	4	23
Spot Price[2]	12.8		12.4		13.5		5	

Notes:

1. In this consumption band the October 1997 multi-site price is compared against the April 1997 price. No data were supplied for October 1996.
   Source: The prices are calculated from all returns to the quantitative questionnaire included in the competitive market review consultation document.
2. Year ahead spot gas prices averaged over the month.
   Source: British Spot Gas Markets.

Prices for single interruptible sites have generally remained slightly above the wholesale price of gas.

Multi-site prices in October 1996 were closely related to the price of wholesale gas across all consumption levels, and lower than the equivalent single site prices. By October 1997 prices had risen above the wholesale price, narrowing the gap between single and multi-site prices, with the largest rises for customers with the largest consumption. However, prices for the higher consumption customers continued to be lower than prices for lower consumption customers.

The number of prices being offered in competition to BGT in the interruptible market is limited in comparison to the firm market. This effect is more evident for customers with larger consumptions.

4.3 BGT's Pricing

In addition to providing evidence of the extent of competition in different parts of the market, the prices provided to Ofgas have been used to examine BGT's pricing behaviour.

Ofgas has examined BGT's prices in relation to the undue discrimination condition (Standard Condition 13) in the Suppliers' Licence, which requires that where competition is established a dominant supplier's prices should not unduly discriminate between customers in the same class, and should at least cover attributable avoidable costs if they are not to be seen as potentially predatory. The dominant supplier should also do no more than is necessary to meet established competition.

On the basis of the indicative data, supplied, Ofgas has no evidence to suggest that BGT's pricing has not been consistent with this licence condition.

4.4 Other Companies' Pricing

Standard Condition 13 of the Suppliers' Licence applies to any dominant supplier. However, as noted in Chapter 3, no company except for BGT has a market share in excess of 10% in the industrial and commercial market sector overall, or more than 18% in any significant sub-sector of it.

5. Barriers to Entry and the Development of Competition

5.1 Introduction

Ofgas' 1997 consultation document requested views on a number of specific issues. Comments by respondents on industrial and commercial issues are summarised below, followed by Ofgas' position in respect of each issue.

The consultation document and subsequent responses demonstrate the continuing changes which have occurred in the industrial and commercial gas supply market over the last few years. In general, such problems and complaints as are now arising in the industrial and commercial sector no longer relate to the dominant position of BGT, except in relation to ownership of the Morecambe gas fields, but have shifted towards the details of the operation of the competitive market.

5.2 The Present Position on the 1996 Undertakings

The 1996 Competitive Market Review identified barriers to entry which could affect the development of effective competition. Certain undertakings were therefore put in place for review in the 1997 Competitive Market Review. The undertakings are summarised below, together with respondents' views on the issues raised and Ofgas' position.

a) Transco's Standards of Service

Transco agreed to discuss proposals to re-structure the incentives within the Network Code standards of service and liabilities package. It also agreed to discuss the inclusion of a new service standard relating to site visits in cases where M-Numbers do not exist. Transco provided the M-Number database to shippers and suppliers in accordance with the Ofgas decision on this issue. A Network Code Review Group, 'Review of Liabilities Package' was set up to look into the restructuring of the standards of service and liabilities package.

Respondents' Views

Many of the comments received by Ofgas on Transco's standards of service were in relation to data problems, such as confused and duplicate M-numbers or inaccurate supply point information. A number of respondents suggested that customers with multi-site tenders are facing particular problems as a result of Transco data inaccuracy. Delays in resolving data problems often mean that not all sites under a multi-site contract begin receiving gas at the same time, resulting in administration problems which could act as a deterrent to suppliers taking on such contracts. Other respondents said that Transco's data problems, in conjunction with suppliers objecting to transfers, increased the difficulty of switching supplier. Some respondents insisted that Transco must form relationships with end users to reduce problems in the future.

Respondents are also very concerned about the amount of time it takes to complete the transfer process. There has recently been a reduction from 42 working days to 31 working days. A number of respondents argue that a faster and easier process for supply point transfers must be introduced urgently. It is argued that although the suppliers' Code of Practice (introduced by the Gas Forum) should help, 31 days to complete a transfer is simply far too long and is a major barrier to competition.

Ofgas' Position

Ofgas has published a consultation document on Transco's standards of service.[4] In that document it is proposed that the liabilities package be rebalanced to put more emphasis on Transco's standards with respect to supply point transfers. Ofgas' conclusions in this area will be published shortly.

On the issue of supply point transfer times, Ofgas agrees with customers' view that 31 days is too long. Transco will shortly be bringing forward a Network Code modification to further reduce this time.

On the issue of data quality, Ofgas shares customers' concerns over inaccurate data on Transco's database. We believe that customers are better placed than shippers to correct their own information. To allow customers and Transco to agree changes to data would necessitate a change in the existing contractual framework within which Transco operates. In particular, it would require a contractual relationship to be developed between some customers and Transco. However, it would be possible for

[4] 'Transco's Standards of Service - A Consultation Document', Ofgas, December 1997.

data to be provided by Transco to customers in advance of such a contractual relationship being developed. Ofgas will be consulting shortly on the issues of allowing customers to see and correct the data held by Transco on their sites.

b) Supply Points

BGT agreed to "release" supply points when so requested by a customer, for the purposes of contracting for top-up gas from another supplier, provided that the customer's contractual obligations have first been met.

Respondents' Views

Ofgas has received no complaints or specific comments in relation to this issue.

Ofgas' Position

Ofgas has no reason to suppose that this undertaking has not been met and therefore formally releases BGT from this undertaking. It will not be raised as a specific issue in further competitive market reviews. However, Ofgas does not expect BGT to change its approach to this issue and we will continue to monitor the situation.

c) British Gas' Trade in Wholesale Gas

In April 1997 Ofgas was asked by the OFT to comment on a proposed change of control of Accord Energy, which constituted a qualifying merger under the Fair Trading Act 1973. Centrica plc and NGC Corporation intended to change the terms of their joint venture in Accord Energy to give operational control of Accord to Centrica. In order to help inform our view, Ofgas published a consultation document.[5] In our reply to the OFT Ofgas did not oppose the change of control. However, in view of the proposed change in the way that Accord and Centrica intended to manage their businesses Ofgas said that it would be necessary to monitor their wholesaling activities more frequently than quarterly. Ofgas therefore asked BGT and Accord to provide data on a monthly basis, as they did before July 1996. BGT and Accord agreed to this change.

Respondents' Views

Ofgas has received no complaints or comments from respondents in respect of BGT and Accord's wholesaling activities.

Ofgas' Position

[5] 'Reorganisation of Shareholdings in Accord Energy Limited', Ofgas, April 1997.

Ofgas has analysed the monthly data provided by both BGT and Accord and concluded that there is no *prima facie* evidence to suggest that either BGT or Accord is behaving in an anti-competitive manner. Accord's dominant position in the gas spot market has been eroded by the growth of activity of other participants in this market; trading of gas on the spot market in itself causes little concern.

However, BGT owns a large amount of gas with exceptional swing[6] characteristics. Morecambe North and South gas fields have remaining reserves of approximately 42.8 billion therms and peak day deliverability of 25.4 million therms representing an approximate swing of 307% (compared to an average of 150-160% for most gas fields). Swing gas is an important contributor to the gas available for balancing purposes, and is important in setting prices for gas in the spot market. Accord's market strategy can be expected to reflect the interests of Centrica as a whole, so it is important to continue to monitor its activities. Ofgas requires that BGT and Accord continue to supply monthly data on their activities until after the economic purchasing review of gas purchased for BGT's domestic
customers during 1997/98 (which is a requirement of BGT's supply price control), when Ofgas will review the matter again.

d) Undue Discrimination

This is now covered by Standard Condition 13 of the Gas Suppliers' Licence. Following the 1996 Competitive Market Review, BGT provided an assurance that it would not follow the practice of back-dating contracts for tariff customers who remain with BGT and who would otherwise have to pay tariff rates. BGT told Ofgas that it was unable to comply with this undertaking until the necessary IT systems were in place. These system changes were completed on 18 November 1996.

Following the 1996 review Ofgas also requested additional information which would enable it to ensure that BGT was meeting its licence requirement on prices. After considering this information Ofgas decided that no further action was needed.

Respondents' Views

Ofgas has received no complaints or comments from respondents in respect of this issue.

Ofgas' Position

[6] Swing is the ability to vary supply of gas to meet variability in demand. It is defined as the peak daily quantity over the average daily quantity.

Ofgas has no reason to suppose that BGT has not met its undertaking on back-dating of contracts and therefore formally releases BGT from this undertaking. However, Ofgas does not expect BGT to change its approach to this issue and we will continue to monitor the situation. The general requirement not to discriminate unduly remains covered by Standard Condition 13.

5.3 Additional Issues Raised in the Consultation Document

a) Prevention of Customer Transfers

Ofgas has received a number of complaints from customers in the industrial and commercial market that their existing suppliers are preventing them from choosing alternative suppliers in circumstances
where their existing supplier is no longer able, or willing, to supply gas. Customers feel that such behaviour is anti-competitive. There are two ways in which incumbent suppliers are said to be preventing the transfer of customers: (i) by blocking the utilisation of unused transportation capacity; and (ii) by objecting to a transfer to a new supplier on the basis (a) of outstanding debt to the incumbent supplier or (b) that the customer is bound by a contract with the incumbent which has not expired. Ofgas issued a consultation letter on this issue in May 1997.[7]

i) Unused Transportation Capacity

The treatment of unused transportation capacity by voluntary or mandatory sharing of supply points by shippers was the subject of a further Ofgas consultation which outlined Ofgas' preliminary views.[8] Ofgas said that we saw no reason why the Network Code should restrict supply points to one shipper and that the Network Code should be modified to provide for shared supply points on both a voluntary and a mandatory basis. Network Code Review Groups were set up to address both issues. A modification to the Network Code to deal with voluntary sharing was proposed and accepted (Modification 139). The Review Group dealing with mandatory sharing also proposed a modification to the Network Code (Modification 147).

Modification 147 enables one shipper, on behalf of a customer, to require that a supply point be shared, in circumstances where the existing shipper does not agree to the sharing of the supply point. Three options were considered by the Review Group.

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[7] Potential Anti-Competitive Behaviour in the Gas Supply Market, Ofgas, May 1997.

[8] 'Potential barriers in the network code to effective competition in the industrial

On 13 November 1997 Ofgas issued a decision document, in which it was concluded that ‘option three’ was the preferred option to facilitate the introduction of mandatory sharing arrangements for off-takes served by Transco’s network, for all contracts signed up to an agreed date.

‘Option three’ would allow an existing shipper to object to a proposed sharing of a supply point except when minimum take provisions have been satisfied, or a commercial interruption had been called by the existing

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and commercial gas supply market’ Ofgas, October 1997.

shipper (as opposed to an interruption called for system reasons by Transco).

We also concluded that this would only apply to existing supply contracts, with 'option two' applying to all new supply contracts signed after an agreed date, ie. those signed after 1 January 1998. 'Option two' prevents an existing shipper from objecting to the arrangement in any circumstances.

The modification to the Network Code to implement this was effective from January 1998.

ii) Outstanding Debt to the Incumbent Supplier

In their responses to Ofgas' May 1997 consultation letter, most suppliers and shippers argued that the ability to prevent transfer due to debt is an important way to prevent customers running up debts. They said that if suppliers do not have the protection of being able to prevent transfer they may have to charge higher prices to reflect their increased risk. Suppliers also said that it would be unfair to remove their ability to enforce their legitimate rights under their contracts in the way they expected to be able to do when the contract was entered into.

The ability to block a transfer on the grounds that there is an existing contract was also discussed by respondents. Suppliers again argued that they should be able to enforce their legitimate rights under a contract as they expected when the contract was signed. Suppliers also made the point that they did not want to return to the dual billing problems that existed before the Network Code was introduced, when situations could arise where two suppliers both thought they were responsible for the site, and both billed the customer.

Some suppliers said that supplying gas is different from other markets because the customer can continue taking gas without the agreement of the supplier. The ability to block a transfer acts as a counter- balance to the fact that customers cannot immediately be cut off.

Customers have argued that in no other market can a transfer to another supplier be blocked by an incumbent supplier and that the licences should be amended to remove the suppliers' ability to object to a transfer. The customers argue this would add competitive pressures and force suppliers to use commercial avenues for recouping debt or legal avenues to settle a contractual dispute.

Respondents' Views

Ofgas received a number of responses on this issue reiterating comments already received and outlined above. Large customers raised their concern that shippers and suppliers are abusing their ability to block customer transfers, particularly on the grounds of debt, by routinely objecting. This problem was raised as a particular concern in connection with multi-site contracts where some sites transferred but others were delayed. These customers argued strongly that licences must be changed to remove the ability to object.

One suggested solution from customers is to modify the Network Code so that suppliers can object to a transfer, but that this objection would not prevent the customer from transferring. It is argued that this would provide a mechanism for suppliers to draw attention to problems but would allow a customer to start taking gas from a supplier whilst it resolves any outstanding issues with the previous supplier.

Shippers and suppliers, on the other hand, stress the need for suppliers to have some control over bad debts. Without this it is argued that contract prices will rise for all customers.

Discussion

It is Ofgas' view that any change or amendment to either the Network Code or shipper/supplier licences must aim to provide customers with as much freedom to pursue their best interests as they have in other markets and that the gas market should not be seen as different. Ofgas is also concerned to ensure that the Network Code does not impede competition.

Ofgas has some sympathy with suppliers' view that existing contracts were entered into on the implicit basis they were accompanied by the ability to object to customer transfers in certain circumstances. However, in some cases the ability to block a transfer has been used in conjunction with contractual rights to interrupt supply, preventing customers from gaining access to gas for an extended period at the end of a contract, except on terms unacceptable to customers. Where the incumbent supplier has been unable or unwilling to agree terms with the customer for the supply of gas, Ofgas' view is that the transfer should not be blocked.

Ofgas recognises that the blocking procedure may lower the cost of pursuing and recovering bad debts, which may be an important factor in contracts with customers with low credit ratings or a history of bad debt. However, removing the ability to object to transfers on the grounds of debt would increase competitive pressure and push prices down. The relative importance of these factors may vary from one customer to another. The pressure to change the present system has come from larger customers.

It has been to brought to Ofgas' attention that a number of suppliers appear to be routinely objecting to customer transfers and may be in breach of their licence conditions. Ofgas will investigate these complaints with a view to taking action to enforce the licence conditions.

The existing licence condition actually sets quite a severe limitation on suppliers' ability to block a transfer. Charges must be due to the licensee or the customer must be bound by the provisions of a contract. The relevant section of Standard Condition 7(4) is reproduced in Appendix 1.

This means that in order to comply with its licence, a supplier must not block a transfer unless it is actually correct in its legal interpretation of its supply contract, that the above criteria apply. It is not enough simply to think that it has a good case. If it transpired, as a result of legal proceedings, that the supplier was not entitled to the charges claimed or that the provisions of an existing contract did not apply then the supplier may well have been in breach of its licence when it blocked the transfer.
Similarly, a shipper is not permitted to block a transfer if it has reasonable cause to believe that the supplier was not entitled to block the transfer.
The relevant Shippers' Licence condition is set out in Appendix 1.

In spite of these licence restrictions, Ofgas remains concerned about the issue of abuse of the ability to block a transfer on debt grounds, where a bill is in dispute. There is a danger that the supplier will enforce its own judgement in this matter unless or until the customer takes the supplier to court. Moreover, so long as the customer believes that the supplier has this ability to block a transfer, the supplier does not necessarily need to apply a block in order to have the upper hand in a dispute with a customer.

Transco has therefore been asked by Ofgas to put forward a Network Code modification removing a shipper's ability to block a transfer in the market above 2,500 therms a year under the Network Code. Transco has indicated that it would not be easy for this to be applied only to the market above 2,500 therms a year and not to domestic customers. Ofgas is therefore also considering other ways forward.

The enforcement of the relevant shipper and supplier licence conditions could be assisted by setting up a monitoring procedure within the Network Code which would provide Ofgas with the information it would require to consider whether some shippers and suppliers are making excessive use of the blocking facility, and to be able to investigate the activities of any such shippers and suppliers.

Broadly, this procedure would require that the supplier would have to give the shipper reasons for its objection. The customer would be contacted by the shipper prior to the objection facility being applied, and given an opportunity to register a formal response. If the shipper has reasonable cause to believe that the requirements of Condition 7(4) of the Suppliers' Licence have not been met, either because the supplier has not given reasons for its objection or because the customer has presented a convincing case, then Condition 13 of the Shippers' Licence requires the shipper to permit the transfer. If the shipper decides that it is permissible to block a transfer on behalf of a supplier, it would record on Transco's database information from the supplier giving reasons why it believes that it is not prohibited from blocking the transfer under Condition 7(4) of its licence. A summary of the case made by the customer would also be recorded in Transco's database.

The final outcome of any dispute, eg. a legal ruling on the interpretation of the contract, would also be registered with Transco. The data collected would be made available to Ofgas, to allow us to monitor whether or not suppliers are abusing their ability to block transfers.

In our view, in order to fulfil its duty to facilitate the securing of effective competition, Transco should, as a minimum, propose a Network Code modification along the lines proposed above.

Finally, in parallel with pursuing changes to the Network Code, Ofgas will pursue the option of licence changes. If Transco does not put forward a licence modification removing the ability to object for customers above 2,500 therms a year, Ofgas expects to put forward for consultation a proposal to further limit suppliers' ability to object to a customer transfer by modifying the licences. This proposal would be framed in terms which we believe answer the objections which shippers and suppliers put forward against the original proposal to completely remove the ability to block a transfer. This approach is in line with the recent Green Paper on utility regulation[9] which said that the "DTI and the gas regulator will keep under review the rules on customers switching suppliers, especially in the large industrial and commercial market, with a view to addressing any remaining barriers to effective competition". The proposed modification would not apply to contracts signed under the expectation that the existing Network Code rules would apply. It would also apply only to certain customers, either those above a specified consumption threshold or possibly only to customers opting out of the present system. Safeguards would be put into place to avoid any increase in dual billing problems.

[9] 'A Fair Deal for Consumers - Modernising the Framework for Utility Regulation', Department of Trade and Industry, March 1998.

Ofgas' Position

Transco has been asked by Ofgas to put forward a Network Code modification removing a shipper's ability to block a transfer in the market above 2,500 therms a year under the Network Code. Transco has indicated some difficulty with this approach. In the absence of such a modification, Ofgas will strictly enforce the terms of the present licence conditions, which set severe limitations on the ability of suppliers and shippers to block a transfer and will ask Transco to propose a Network Code modification which will assist in enforcing these conditions, under its duty to facilitate the securing of effective competition. In parallel with this Ofgas would expect to put forward for consideration a proposal to further limit suppliers' ability to object to a customer transfer by modifying the licences.

b) Contract Overrun Charges

In March 1997, Ofgas wrote to all suppliers asking them to tell us their charging policy for customers when a transfer to another supplier has been delayed for any reason.

Respondents' Views

Ofgas has received only two specific complaints in relation to this issue since the competitive market review consultation document was issued. The issue was not raised in responses to the consultation document.

Ofgas' Position

The suppliers' Code of Practice should help reduce this problem. Among other things, this Code of Practice includes a clause requiring suppliers to write a contract overrun clause into their contracts and draw customers' attention to it. The Code of Practice has been signed by 18 different suppliers. In the future therefore, Ofgas expects that the problem of charging outside the terms of a contract is less likely to arise.

c) Multi-Site Contracts

It was brought to Ofgas' attention that some customers asking for tenders for multi-site contracts have experienced a very low level of interest from suppliers.

Respondents' Views

A large number of respondents recognised, to varying degrees, this issue as a problem. The main reason given was administrative difficulties experienced in the site transfer process due to the data inaccuracies discussed above, under Transco's Standards of Service. For example, one respondent argued that suppliers are generally less willing to tender for multi-site contracts due to the large amount of work normally required to clean the data provided by the customer. This respondent said that low margins on large multi-site contracts do not allow for a great deal of expense for activities such as data cleaning.

Another respondent argued that the primary source of administration problems is Transco. They note that the problems associated with nominations and delays in resolving data problems with Transco often mean that not all sites under a multi-site contract begin receiving gas at the same time. This results in significant administration problems which could act as a deterrent to suppliers taking on such contracts.

Discussion

Data quality, primarily of data held by Transco, appears to be at the centre of this problem, although the relatively low prices for multi-site contracts discussed in Chapter 4 may also be a factor. One solution could be to provide access to Transco's data for the customer, as discussed in the section on Transco's standards of service. If a site's 'key' data could be made available to consumers at prescribed points in time, for example immediately after a transfer and 8 months into a contract year, this would allow customers to check that the transfer has been completed successfully and to correct any inaccuracies in readiness for potential re-tendering.

Such a course of action could help reduce shipper/supplier administrative costs and encourage greater activity in tendering for multi-site contracts.

Ofgas' Position

Ofgas will shortly be issuing a consultation document dealing with customer issues including the problem of data quality and will be giving this matter further consideration in that context.

d) Long Term Gas Purchase Contracts for Electricity Generation

It has been claimed that certain long term contracts dating from the early 1990s between gas suppliers and some electricity generating companies may have contained anti-competitive features and that these may in turn have led to distortions in the gas and electricity markets. According to a complaint currently before the European Commission, some contracts may have prohibited gas purchasers from reselling the gas purchased under the contracts.

Ofgas was asked to consider whether the prohibition on resale of gas is in fact anti-competitive; and if so what remedy or amendment would be appropriate. We have considered the effect of resale prohibition on the gas market.

Respondents' Views

Opinions were divided on whether or not resale restrictions should be lifted. A small number of respondents argued that lifting these resale restrictions would improve liquidity in the flexibility and spot markets, support price stability and increase competition in sources of gas supply, bringing increased confidence in the spot gas and flexibility markets.

Another argument put forward was that most long term contracts were struck at a time when there was no liquid market for spot gas, and supplies could only be obtained from British Gas on non-negotiable terms, leading to artificially high prices. It was also argued that current Long Term Interruptible (LTI) contracts are inconsistent with revised arrangements

whereby Transco is responsible for transporting gas and BGT is responsible for shipping/supplying.

On the other hand a number of respondents argued that there is no evidence that either the intent or effect of these long term contracts has led to any distortions in the gas and electricity markets. Moreover, they would be concerned by any regulatory intervention which gave the appearance of interference in the operation of the market.

One respondent said that the present relative marginal costs of coal-fired and gas-fired electricity generation, and the fact that electricity and gas prices tend to rise and fall together because of their dependence on weather, suggest that the number of days on which it is more profitable to sell gas than to generate are likely to be relatively few. The number of such days would be even lower for gas sold under an interruptible contract. This is supported by the fact that most CCGTs now run for more hours than the take-or-pay requirements in their gas contracts would suggest, indicating that in general converting gas into electricity is more profitable than selling gas on the spot market. If there were significant benefits to be gained from resale it is possible, indeed likely, that the parties to the contracts would already have re-negotiated the contracts to allow both parties to gain some of the benefits.

A number of respondents argued that the contracts need to be understood in their full historical context in order to assess a fair and equitable way forward. It was argued that

any solution which simply lifts the resale restriction in certain contracts is inequitable for those companies that negotiated contractual terms to deliver resale flexibility and were willing to
pay for it. BGT argues that its supplies were priced according to non-discriminatory price schedules which were competitive at the time.
One respondent said that even if the resale restriction was lifted, the contractual terms of some contracts may not allow gas to re-enter the system. This is because current contracts are likely to define the point of
sale as a delivery point within a customers' site. Two possible options for resolving this problem were suggested:

1. Redefine the point of delivery in the contract as the National Balancing Point (NBP). From the NBP, the buyer would be able to resell gas to numerous counterparties.

2. Create dual entry/exit points (such as currently exists with storage). Every major exit/supply point on the Transco system could double as an entry point. Thus, a customer could purchase gas at the delivery point and resell it to another shipper registered at the point who, in turn, could sell gas at the NBP or in the flexibility market.

Discussion

In general, it can be said that removing restrictions on resale could promote liquidity and stability in the spot gas and flexibility markets. In addition, on the small number of days when the gas price is very high the ability to resell gas could have a significant effect on gas price. However, arguably, the overall effect on competition in the gas market is likely to be small, at least at present.

In general terms, direct intervention by a regulator in the contractual terms of existing contracts should be avoided unless there is good reason for such intervention. On the basis of the responses it appears that intervention would not be justified.

In terms of the suggested operational solutions for allowing resale gas to re-enter the system, if a resale constraint was lifted with the agreement of the shipper/supplier then no changes to the Network Code would be needed. The contract could be unbundled back to the NBP. The buyer could either become a shipper and trade at the NBP or arrange for the shipper to administer the trade on its behalf.

In most of the contracts under consideration here the resale constraint is not explicit but comes from the definition of the delivery point as within the customer's site. Ofgas has considered whether the Network Code could be changed to allow gas to be resold in such cases without contract renegotiation. However, it does not appear to be possible to set up a dual entry/exit point system that would allow resales to occur without contractual changes (ie. without the agreement of the supplier).

It therefore appears that if contracts can be re-negotiated then changes to the Network Code are unnecessary and if contractual changes cannot be negotiated then changes to the Network Code do not help.

Ofgas' Position

Ofgas has considered whether to undertake a detailed review of the impact of take-or-pay gas contracts on the market. On the basis of the responses to the consultation we believe that for the time being the effect of resale constraints on the spot gas and flexibility markets is likely to be limited. At present, therefore, Ofgas does not consider that a more detailed review is required or that intervention in existing contractual arrangements is justified by the effects on the gas market.

No structural changes to the Network Code are proposed at this stage. However, Ofgas will consider any further suggestions from respondents that would facilitate resales where they are not explicitly prohibited by the contract.

Ofgas will also consider any further suggestions relating more generally to resale constraints. Similarly, if the situation changes in future, for example, due to changes in the relative prices of electricity and gas, then the position could be reconsidered. We would also emphasise that contracts, including contracts with BGT, may be re-negotiated by the parties concerned.

5.4 Other Issues Raised by Respondents

a) Pipeline Capacity

Respondents' Views

A small number of respondents said that they wish to ensure that Transco is investing sufficiently in the system and that allowances are appropriately spent. They argue that capacity constraints are restricting competition and will restrict growth in the market.

Ofgas' Position

Ofgas recognises that customers have for some time been concerned at how much it costs to obtain system reinforcement from Transco, as well as how long it can take for such reinforcement to occur. We do not believe that lack of system capacity is in fact a barrier to competition in the gas supply market. However, we have recently issued a determination that is directly relevant in addressing customers' concerns.

This was a determination of a connection charge for a power station.[10] Transco had proposed that the connection charge quoted for this new connection should include costs related to system reinforcement. Transco argued that it was possible in this case to identify some system reinforcement related to the particular requirements of the customer, and therefore that it was appropriate to charge this directly to the customer, rather than recovering such costs through transportation charges. This policy is known as a 'deep' connection policy.

The customer argued that it should only pay the actual costs of connection. It suggested that any system reinforcement costs should be recovered via

[10] 'Determination of the Direction in Respect of the Modification of the Transco Pipe-Line System for the Purposes of Conveying Gas to Barry Power Station' - Ofgas, February 1998.

Transco's transportation charges. This is known as a ' shallow' connection policy.

The difference in these two methodologies resulted in a significant difference in the direct costs faced by the customer. Transco's method lead to a higher direct charge than the customer's method.

Ofgas' determination supported the views of the customer. As a result, a lower direct charge was made by Transco to the customer. However, the Ofgas determination also concluded that it would be appropriate for the customer to give some guarantee that it would continue to require gas transportation services for some time.

Transco has now changed its connection policy so that all its quotes for connection to its system reflect the policy contained in the Ofgas determination. As such, the direct costs of connection are likely to fall for customers, so addressing the concern raised by customers in the consultation document.

b) Interruptible Prices

Respondents' Views

Some respondents are concerned that customers on interruptible contracts are not appropriately rewarded. It is argued that the difference between firm and interruptible contracts does not pay for the inconvenience of being interrupted or reflect the value of interruptible contracts to the system.

Ofgas' Position

Ofgas considers that the price of shipper nominated interruptible contracts is a matter for the contracting parties. We concur with customers' views that transporter nominated interruptibility (TNI) needs to be reviewed. Ofgas will be carrying out a review of transportation-related interruptions in the summer.

5.5 BGT's Price Schedules

In the consultation document Ofgas stated that it would be interested to hear the views of gas suppliers on whether or not the requirement on BGT to price against published schedules in the 2,500 to 25,000 therm market and the interruptible market should be permanently removed or further suspended.

Respondents' Views

The majority of respondents believe that the requirement on BGT to price against published schedules should be removed.

BGT argues that it has fully met the undertakings imposed following the Competitive Market Review in 1996 and that real barriers to competition no longer exist in the Industrial and Commercial market. Hence any requirement to price against published schedules should be permanently removed. A number of other respondents agree that the above 2,500 therm market is sufficiently competitive.

However, a number of respondents would prefer that the requirement is not permanently removed. They argue that BGT has a considerable advantage in the 2,500 to 25,000 therm sector and remains a dominant player.

Discussion

During the period under which the requirement has been suspended (since March 1995) BGT's market share has continued to fall in both the small firm (2,500 to 25,000 therm) and interruptible market sub-sectors.

In general, such problems and complaints as are now arising in the industrial and commercial sector no longer relate to the dominant position of BGT (except as noted earlier in relation to ownership of the Morecambe gas fields). Ofgas does not now envisage a situation arising in which the application of price schedules would be an appropriate mechanism for dealing with problems arising in the industrial and commercial sector.

Ofgas' View

In Ofgas' view the present suspended requirement on BGT to price according to published schedules should be permanently removed. To that end Ofgas will carry out a statutory 28 day consultation on the precise terms of this licence modification in June. In the meantime, Ofgas has extended the period of suspension to the end of July 1998.

6. Summary and Conclusions

6.1 Overview of the Market Above 2,500 Therms

BGT's share of the whole above 2,500 therm market (including power stations, feedstocks and NGVs) has dropped from 30% to 28%, on the basis of volume shipped, since 1996. Its share of the industrial and commercial sector (excluding power stations, feedstocks and NGVs) has dropped from 29% to 24%. This drop is made up of a small increase in the large firm sub-sector (above 25,000 therms a year) and larger decreases in the two sub-sectors from which the requirement to publish price schedules has not yet been permanently removed, namely the small firm and interruptible sub-sectors. BGT has a much higher share of single-site contracts than multi-site contracts in all sub-sectors.

There are over 40 companies competing with BGT in the above 2,500 therm market. Of these, no company has more than about a 10% market share overall, or 18% in any sub-sector (small firm, large firm, interruptible, power generation).

Prices generally rose over the year with the largest rises occurring in the large firm and interruptible multi-site sub-sectors. The rises in other sectors were generally in line with rises in spot prices.

6.2 Barriers to Entry and the Development of Competition

In relation to barriers to entry and other factors affecting the operation of competition, the level of complaints is less than in previous reviews and there is little evidence of BGT's activities causing problems. However, Ofgas has decided that action needs to be taken in the following areas:

a) Supply Point Transfer Times

Ofgas agrees with customers' views that the present transfer time is too long. Transco will shortly be bringing forward a Network Code modification to further reduce this time.

b) Data Quality

Ofgas will be consulting shortly on the issue of allowing customers to see and correct the data held by Transco on their sites.

c) Release of Supply Points

Ofgas has no reason to suppose that BGT has not kept its undertaking to 'release' supply points when requested, for the purpose of contracting for 'top-up' gas, provided contractual obligations have been met. This will not be raised as a specific issue in future reviews, although Ofgas does not expect BGT to change its approach.

d) Wholesaling Data

Ofgas requires that BGT and Accord continue to supply monthly data on their activities until after the review of economic purchasing of 1997/98 gas under BGT's price control covering the domestic (below 2,500 therm) market, when Ofgas will review the matter again.

e) Back-Dating of Contracts

Ofgas has no reason to suppose that BGT has not met its undertaking, given in order to avoid undue discrimination, not to back-date contracts for tariff customers who remain with BGT and who would otherwise have to pay tariff rates. This will not be raised as a specific issue in future reviews, although Ofgas does not expect BGT to change its approach to this issue and we will continue to monitor the situation.

f) Prevention of Customer Transfers

Transco has been asked by Ofgas to put forward a Network Code modification removing a shipper's ability under the Network Code to block a transfer of a customer from one supplier to another of the customer's choice. Transco has indicated some difficulty with this approach. In the absence of such a modification, Ofgas will strictly enforce the terms of the present licence conditions, which set severe limitations on the ability of suppliers and shippers to block a transfer and will ask Transco to propose a Network Code modification which will assist in enforcing these conditions, under its duty to facilitate the securing of effective competition. In parallel with this Ofgas would expect to put forward for consultation a proposal to further limit suppliers' ability to object to a customer transfer by modifying the licences.

g) Long-Term Gas Purchase Contracts for Electricity Generation

Ofgas has considered whether to undertake a detailed review of the impact of take-or-pay gas contracts on the market. On the basis of the responses to the consultation we believe that for the time being the effect of resale constraints on the spot gas and flexibility markets is likely to be limited. At present, therefore, Ofgas does not consider that a more detailed review is required or that intervention in existing contractual arrangements is justified by the effects on the gas market.

No structural changes to the Network Code are proposed at this stage. However, Ofgas will consider any further suggestions from respondents that would facilitate resales where they are not explicitly prohibited by the contract.

Ofgas will also consider any further suggestions relating more generally to resale constraints. Similarly, if the situation changes in future, for example, due to changes in the relative prices of electricity and gas, then the position could be reconsidered. We would also emphasise that contracts, including contracts with BGT, may be re-negotiated by the parties concerned.

h) Interruptible Prices

We concur with customers' views that transporter nominated interruptibility needs to be reviewed. Ofgas will be carrying out a review of transportation-related interruptions in the summer.

6.3 Price Schedules

Such problems and complaints as are now arising in the industrial and commercial sector no longer relate to the dominant position of BGT, except in relation to ownership of the Morecambe gas fields. Ofgas does not now envisage a situation arising in which the application of price schedules would be an appropriate mechanism for dealing with problems
arising in the industrial and commercial sector. In Ofgas' view the present suspended requirement on BGT to price according to published schedules should be permanently removed. To that end Ofgas will carry out a statutory 28 day consultation on the precise terms of this licence modification in June. In the meantime, Ofgas has extended the period of suspension to the end of July 1998.

Appendix 1 Standard Conditions

A1.1 Standard Condition 7(4) of Suppliers Licences

"The licensee shall not procure or permit the relevant shipper, in pursuance of any contract with that shipper, or otherwise request it, to prevent a proposed supplier transfer in relation to any premises at which the licensee supplies gas to a customer except for so long as -

(a) the customer fails to pay charges for the supply of gas to those premises or any premises previously owned or occupied by him in respect of which such charges are payable which -

(i) are due to the licensee and have been demanded in writing, and

(ii) have remained unpaid for 28 days after the making of the demand, or

(b) the customer is bound by the provisions of a contract with the licensee for the supply of gas at those premises which will neither expire nor, to the knowledge of the licensee, be terminated on or before the date of the proposed transfer."

A1.2 Standard Condition 13 of Shippers' Licences.

"The licensee shall permit a proposed supplier transfer in relation to any premises in respect of which it is the relevant shipper if, and only if -

"a) it has not been requested, in the particular case, to prevent the proposed supplier transfer -

(i) by the relevant supplier (or a person who would, if licensed as a gas supplier, be the relevant supplier but is not required to be so licensed), or

(ii) except where another supplier has become the relevant supplier, by a gas supplier which has cut off the supply of gas to the premises in pursuance of paragraph 7 of Schedule 2B to the Act, or

b) it has been so requested but knows, or has reasonable cause to believe -

(i) that the request was made in breach of Condition 7(4) of the Standard Conditions of the Gas Suppliers' Licences as incorporated in the supplier's licence, or

(ii) if the person making the request was not a gas supplier, that the request would have been made in breach of Condition 7(4) of the Standard Conditions of Gas Suppliers' Licences had the person in question been a gas supplier bound thereby."