

August 2000

**A Review of the Development of
Competition in the Industrial and
Commercial Gas Supply Market**

Executive summary

This document explains the conclusions of Ofgem's 1999 review of the development of competition in the industrial and commercial gas supply market. Ofgem's review has concluded that competition in the industrial and commercial gas supply market is continuing to develop very well. During this review, Ofgem has received very few complaints about barriers to entry in the market, and it appears that there are no significant barriers to suppliers making, and customers obtaining, potentially competitive offers. There are more than 30 shippers and suppliers, more than sufficient for a competitive market to function effectively.

Overall, BGT has a market share of about 12% by volume shipped and 41% by sites shipped to, in the industrial and commercial market, excluding gas shipped for power generation, natural gas vehicles and feedstocks (BGT's market share is 20% of the whole market by volume shipped). BGT's market share is lower for sites consuming higher volumes, suggesting that customers with larger bills have switched supplier in greater numbers.

Prices for single site supply contracts have tended to be more stable in nominal price terms than multi-site contracts over the period of the survey (October 1997 – October 1999), which for both firm and interruptible supply contracts have increased in nominal terms over the period of the survey and in some cases become at least as expensive as single site contracts for similar volume levels. The prices offered illustrate the opportunities in most market sub-sectors for customers to obtain relatively competitive prices by shopping around amongst competing suppliers.

BGT retains a market share of greater than 60% in the interruptible power generation sector, mainly due to its long term supply contracts. Ofgas considered the concerns about the provisions of these contracts, particularly in relation to restrictions on the resale of gas under these contracts, in 1998. Should any new information become available or any issues arise, Ofgem could consider the provisions of these contracts under competition law.

Removing Special Condition 5A from BGT's gas suppliers' licence

As a result of the continued development of competition in the industrial and commercial gas supply market and the lack of complaints about BGT's market position

and behaviour, Ofgem is proposing to remove Special Condition 5A from BGT's gas suppliers' licence. This condition restricts the terms that BGT can require in its contracts with its industrial and commercial gas supply customers. Ofgem intends to remove this condition from BGT's gas suppliers' licence from the end of October 2000, subject to responses to this consultation.

Ofgem's future monitoring of the industrial and commercial gas supply market

Ofgem has an obligation under Section 39 of the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000) to review the development of competition in the industrial and commercial gas supply market annually. As well as Ofgem's reviews of the development of competition in the industrial and commercial gas supply market, there are a number of other organisations that review the development of the market. Competition is now sufficiently developed in this market that Ofgem does not believe that it is necessary to carry out detailed reviews such as this in the future. Instead, Ofgem will monitor competition in the industrial and commercial gas supply market by monitoring the trends of any complaints received from customers and reviewing the market reviews referred to above. In future, the conclusions of Ofgem's monitoring will be set out in Ofgem's annual report.

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1. Introduction

Purpose of this document

- 1.1 This document explains the conclusions of Ofgem's 1999 review of the industrial and commercial gas supply market. It considers the development of competition to date and analyses the prospects for its further development in the market as a whole and sub-sectors of the market. It also considers whether there are any issues that need to be addressed to promote effective competition. The conclusions of this review take account of responses to Ofgem's survey of all gas shippers, suppliers and customer representatives to obtain quantitative and qualitative information about the development of competition.¹
- 1.2 As part of the conclusions of this review, it is proposed to remove Special Condition 5A from BGT's gas suppliers' licence from the end of October 2000. Special Condition 5A restricts the terms BGT can require in its contracts with customers consuming above 73,268 kWh a year. In particular, Special Condition 5A prevents BGT including terms which:
- ◆ restrict the purpose for which the gas supplied may be used;
 - ◆ require the provision of facilities for using other forms of energy for the purposes of which the gas supplied may be used;
 - ◆ require the provision of facilities for using other forms of energy for the purposes of which the gas is supplied; and
 - ◆ confer powers of entry on premises to ascertain the purposes for which the gas supplied is used or to inspect facilities for using other forms of energy for those purposes.
- 1.3 This review fulfils Ofgem's requirement under Section 39 of the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000) to review the development of competition in the industrial and commercial gas supply market. This review follows on from Ofgas' 1997 industrial and commercial gas supply

¹ "1999 Industrial and Commercial Gas Market Survey", Ofgem, January 2000.

competitive market review,² and covers the period from October 1997 to the present.

Background

- 1.4 British Gas' statutory monopoly to supply gas throughout Great Britain to industrial and commercial customers (defined as those customers consuming at or above 73,268 kWh of gas a year) was removed during the 1980's and early 1990's, culminating in the reduction in the competitive market threshold to customers consuming at or above 73,268 kWh (in August 1992). The removal of British Gas' statutory monopoly was not sufficient on its own to allow competition to develop successfully. Further regulatory action was taken to remove the economic barriers to entry, including:
- ◆ requirements for British Gas to price according to published schedules in the industrial and commercial gas supply market to prevent discriminatory pricing;
 - ◆ the release of wholesale gas to competitors;
 - ◆ the complete separation of British Gas' transportation and storage facilities from its trading businesses, to facilitate non-discriminatory access to British Gas' transportation network; and
 - ◆ a market share target for British Gas in this market.
- 1.5 Ofgas' 1997 industrial and commercial gas supply competitive market review concluded that competition was developing well, with:
- ◆ the level of complaints about barriers to entry and the general operation of the market being less than in previous years, with little evidence that BGT's behaviour was causing problems;
 - ◆ over 40 active competitors to BGT in the market; and
 - ◆ British Gas Trading's (BGT's) share of the whole market having declined compared to the previous year.

² "1997 Competitive Market Review, Part 1: above 2,500 therms a year", Ofgem, May 1998.

Related issues

The level of wholesale gas prices

- 1.6 Ofgem has recently looked into the causes of the recent significant rises in wholesale gas prices, which have been high and volatile since April of this year.³ A number of factors appeared to be important in contributing to these high prices, including:
- ◆ high demand for gas due to colder than expected weather in April and May;
 - ◆ exports of gas to continental Europe through the Bacton interconnector;
 - ◆ gas supply failures; and
 - ◆ capacity constraints on Transco's National Transmission System (NTS).
- 1.7 Ofgem was satisfied, on the basis of its analysis, that recent prices were largely driven by underlying market conditions. Ofgem did not find evidence of market manipulation, nor any evidence to suggest that the new gas trading arrangements (and in particular, the auctions of NTS entry capacity and Transco's balancing incentives) had been a significant contributory factor to the high wholesale prices in recent months.

Ofgem's 1999 review of the development of competition in the industrial and commercial electricity supply market

- 1.8 In April 2000, Ofgem published a survey of all electricity distribution companies, suppliers and customer representatives, to obtain quantitative and qualitative information about the development of competition in the industrial and commercial electricity supply market. Ofgem is currently collating and analysing the responses to this survey and will be publishing its conclusions about competition in the industrial and commercial electricity supply market shortly.

³ "The New Gas Trading Arrangements, A review of the new arrangements and further development of the regime, A review and decision document", Ofgem, July 2000.

Supply 'non-discrimination' licence conditions

- 1.9 Last month, Ofgem published a consultation proposing to remove the supply 'non-discrimination' licence conditions from the gas and electricity supply licences.⁴ The non-discrimination conditions prevent 'dominant' suppliers in the domestic and industrial and commercial markets, from exercising undue discrimination, showing undue preference or engaging in predatory or unduly onerous pricing. The prohibition on dominant suppliers showing undue preference or exercising undue discrimination becomes less restrictive as competition develops.

Outline of this document

- 1.10 Chapter 2 explains the regulatory framework against which competition is developing. Chapter 3 explains Ofgem's approach to assessing the development of competition and the factors that have been taken into account. The remaining chapters of the document look at each of these factors in turn.
- 1.11 Chapter 4 considers how the number of competitors in the market has changed since October 1997. Chapter 5 analyses the market shares of gas shippers and suppliers by volume supplied and customer numbers, and considers the trends since October 1997. Chapter 6 analyses the prices offered by suppliers at different consumption levels, considers how prices have changed since October 1997 and the possible reasons for these changes. Chapter 7 considers the movement of customers between suppliers and how these movements appear to have been affected by changes in the prices offered by suppliers since October 1997. Chapter 8 considers the qualitative responses to Ofgem's survey and, what, if any, action is required to address remaining barriers to entry into the market. Chapter 9 summarises the conclusions of Chapters 4 to 8, and explains how Ofgem intends to monitor the development of competition in the industrial and commercial gas supply market in the future. Appendix 1 explains the main legislative and regulatory developments to facilitate competition in the industrial and commercial gas supply market since 1988. Appendix 2 lists the respondents

⁴ "Gas and electricity supply licences, Proposals for standard non-discrimination licence conditions", Ofgem, July 2000.

to the qualitative survey. Appendix 3 is a Section 23 notice to remove Special Condition 5A from BGT's gas suppliers' licence.

Views invited

- 1.12 It would be helpful to receive responses to the issues raised in this document, and in particular, the proposal to remove Special Condition 5A of BGT's gas suppliers' licence, by 18 September 2000. Responses should be addressed to:

Nick Fincham
Director, Competition
Office of Gas and Electricity Markets
Stockley House
130 Wilton Road
London SW1V 1LQ
Fax: 020-7828-3154

- 1.13 It is open to respondents to mark all or part of their responses as confidential. However, we would prefer, as far as possible, that responses were provided in a form that can be placed in Ofgem's library.
- 1.14 If you have any queries concerning this document, then Andrew Pester (tel: 0207 932 6317 or email: andrew.pesther@ofgem.gov.uk) will be pleased to help.

2. Background

- 2.1 This chapter explains the regulatory framework against which this review is taking place.

Regulatory Framework

- 2.2 We have set out below the legislative duties and powers that are particularly relevant to this review. These duties and powers are contained within:

- ◆ the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000);
- ◆ the gas suppliers' and shippers' licences; and
- ◆ the Competition Act 1998.

The Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000)

- 2.3 On 27 July 2000, the Utilities Act 2000 received royal assent. The Act amended the Gas Act 1986 (as amended by the Gas Act 1995) to create the 'Gas and Electricity Markets Authority'. The Authority replaces the role of the Director General of Gas Supply. The Authority's duties include a primary duty to act in the manner best calculated to 'protect the interests of consumers, where possible by promoting effective competition'.
- 2.4 Under Section 39 of the Act, Ofgem has a duty to review the development of competition in gas shipping and supply markets annually.
- 2.5 The Utilities Act 2000 extends Ofgem's power under the Gas Act 1986 (as amended 1995) to levy penalties on final order for present or future breaches of a licence condition. The Act gives the Authority the power to levy monetary penalties on licensees for past or present breaches of a licence condition, a relevant requirement or for failing to meet a guaranteed standard of service. The Authority cannot levy a penalty under the sector specific legislation if a penalty has already been levied under the Competition Act 1998 for the same offence. The Authority will be required to calculate a penalty under the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000) that is, "...reasonable

in the circumstances of the case", and does not exceed 10% of the licensee's turnover. A Statutory Instrument explaining how turnover is to be calculated is to be laid before Parliament. Ofgem will be consulting in due course on the approach that it will take to calculate penalties when using these powers. The Act does not place any time limit on Ofgem's investigations of suspected licence breaches. However, Ofgem will be required, within 12 months of a suspected licence breach, to issue a notice that it intends to investigate the suspected licence breach.

Gas shippers' and suppliers' licences

- 2.6 The Gas Act 1986 (as amended 1995) provides for the licensing of gas shippers and suppliers.⁵ These licences contain standard conditions that apply to all shippers and suppliers. BGT's licences contain a number of special conditions, one of which directly affects the operation of its industrial and commercial gas supply business.
- 2.7 The standard conditions that are of most relevance to this review are:
- ◆ Standard Condition 7 of the suppliers' licence;
 - ◆ Standard Condition 13 of the shippers' licence; and
 - ◆ Standard Condition 13 of the suppliers' licence.
- 2.8 The first two conditions allow suppliers, through their shipper, to block the transfer of a customer in the industrial and commercial gas supply market to another supplier, if the customer has been in debt to the supplier for more than 28 days and the supplier has requested the outstanding debt in writing. Ofgem is currently considering changes to these conditions.⁶
- 2.9 Standard Condition 13 of the gas suppliers' licence prevents 'dominant' gas suppliers from exercising undue discrimination, showing undue preference, or engaging in predatory or unduly onerous pricing. The prohibition on dominant

⁵ Shippers contract with Transco and other Public Gas Transporters to ship gas through the pipeline network to end users on behalf of suppliers. Suppliers contract with shippers to supply gas to customers and are responsible for managing the relationship with customers.

⁶ "Customers in debt and their access to the competitive market, A Consultation Document", Ofgem, December 1999.

suppliers showing undue preference and exercising undue discrimination becomes less restrictive as competition develops. As explained in chapter 1, Ofgem is currently consulting on its proposal to remove this condition from the gas suppliers' licence and use only the Competition Act 1998 to address anti-competitive behaviour in the gas supply market.

- 2.10 Special Condition 5A of BGT's gas suppliers' licence restricts the terms that BGT can require in its contracts with industrial and commercial customers. This condition was introduced following concerns that BGT was discriminating in the prices and terms it offered some industrial and commercial gas customers.
- 2.11 As a result of the Utilities Act 2000, new standard gas shipper and supplier licences will be implemented.

The Competition Act 1998

- 2.12 On 1 March 2000, the substantive parts of the Competition Act 1998 came into force. This replaced most of the Competition Act 1980, the Restrictive Trade Practices Acts 1976 and 1977, and the Resale Prices Act 1976. The Competition Act 1998 contains two prohibitions. The Chapter I prohibition prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices that have as their object or effect the restriction, distortion or prevention of competition in the United Kingdom. The Chapter II prohibition prohibits the abuse of a dominant position by an undertaking within the United Kingdom. Any undertaking found to have breached either of the prohibitions of the Competition Act 1998 may face a fine of up to 10% of its turnover for each year of the breach up to a maximum of three years.
- 2.13 Ofgem has concurrent powers with the Office of Fair Trading (OFT) to apply the Competition Act 1998 to the gas and electricity sectors in Great Britain. The OFT, along with Ofgem and the other sectoral regulators, has issued advice and information in accordance with Section 52 of the Competition Act 1998, explaining how the Act will be implemented. These guidelines are available on OFT's website at www.offt.gov.uk.

2.14 Ofgem and OFT have recently formally consulted on the advice and information they intend to issue on how the Act will be applied to the gas and electricity sectors.⁷ This consultation ended in July 2000 and a final guideline will be issued in the last quarter of this calendar year.

⁷ "Competition Act 1998, Application to the Energy Sector, Formal Consultation Draft", Ofgem and OFT, May 2000.

3. Approach

Assessing the Development of Competition

- 3.1 Ofgem believes that, consistent with the new duty under the Utilities Act 2000, consumers interests, in terms of price and the quality and variety of service on offer, will be most effectively protected in the industrial and commercial gas supply market by effective competition between shippers and suppliers in that market.
- 3.2 There are a number of important conditions for effective competition, including that:
- ◆ the abuse of market power is prevented;
 - ◆ customers in the market are aware of a range of competitive offers from both shippers and suppliers; and
 - ◆ the operation of competition is actually promoting innovation in the market and improved economic efficiency.
- 3.3 The abuse of market power may be one of the factors that prevents effective competition developing. Hence, it is important that such abuse is prevented. If there is effective competition, over time, competition can be expected to lead to innovation – since successful innovation will be properly rewarded – and to improved economic efficiency.
- 3.4 The development of competition is a dynamic process, characterised by constantly changing structures, behaviour and performance. The development of competition cannot be clearly measured against a simple set of indicators, e.g. market shares. The functioning of the market depends upon the combined effects of the actions of the incumbent shipper and supplier, competitors and customers, as well as the structural conditions in which they all operate.
- 3.5 Bearing in mind the dynamic nature of competition, Ofgem has considered a range of indicators of the development of competition in this review, which reflect the importance of considering customer, shipper and supplier behaviour, and also the market conditions in which they operate. The approach Ofgem has

adopted for this review is similar to the approach adopted for previous competitive market reviews, including the 1999 review of the domestic gas supply market.⁸ The factors Ofgem has considered are set out below, along with the chapter in which the factor is discussed:

- ◆ the extent of entry and exit in to the market by shippers and suppliers (Chapter 4);
- ◆ shippers' and suppliers' performance, including, their market shares (Chapter 5);
- ◆ suppliers' price offers (Chapter 6);
- ◆ customer switching behaviour, and in particular, how customer choices reflect changes in suppliers' relative offers (Chapter 7); and
- ◆ barriers to entry in the market (Chapter 8).

Ofgem's 1999 industrial and commercial gas market survey

3.6 Taking account of the approach set out above to review competition, Ofgem sent a survey to all industrial and commercial gas shippers and suppliers, and customer representatives, in January 2000, requesting quantitative and qualitative information about the development of competition. The following quantitative information was requested:

- ◆ the ownership structure of each shipper and supplier;
- ◆ the number of sites shipped to, or supplied, on 1 October 1998 and 1999, and 31 December 1999, split by volume bands, by whether the contract is for a single site or multi sites and whether the supply is firm or interruptible;

⁸ "A Review of the Development of Competition in the Domestic Gas Market", Ofgem, December 1999.

- ◆ volumes of gas shipped and supplied to end users between 1 October 1997 and 30 September 1998, 1 October 1998 and 30 September 1999 and 1 October 1999 to 31 December 1999, split by volume bands, by whether the contract is for a single site or multi sites and whether the supply is firm or interruptible;
- ◆ indicative average prices for supply contracts signed for 1 October 1997, 1 April 1998, 1 October 1998, 1 April 1999 and 1 October 1999, split by volume bands, by whether the contract is for a single site or multi sites and whether the supply is firm or interruptible; and
- ◆ the number of sites supplied on 31 December 1999, that were in debt such that the supplier could prevent their transfer to another supplier under Standard Condition 7(4) of the gas suppliers' licence, split by volume bands, by whether the contract is for a single site or multi sites and whether the supply is firm or interruptible.

3.7 As well as the information obtained from shippers and suppliers, Ofgem has also obtained information from Transco about the volumes shipped and supplied, and the number of sites registered with each shipper.

3.8 In addition to the quantitative information requested, Ofgem raised four qualitative issues on which it sought views, as to the importance of the issue for the development of competition and any action that could be taken to address the issue. The four issues raised by Ofgem where:

- ◆ concerns that customers cannot cross the consumption threshold between the domestic and industrial and commercial markets due to insufficient information about actual consumption levels;
- ◆ BGT customers being moved from British Gas Home Energy (BGHE) to Business Gas when they cross the consumption threshold, without being informed that they had crossed the threshold;
- ◆ the defaulting of customers to BGT when a new gas supply is being installed, but the process is not completed; and
- ◆ the removal of BGT's Special Condition 5A.

- 3.9 In addition, Ofgem asked respondents to raise any other issues that were adversely affecting the development of competition in the industrial and commercial gas supply market.
- 3.10 Virtually all shippers and suppliers responded to the quantitative survey. The information provided in response to the survey was generally comprehensive and appears to be of a good quality when cross referenced to other sources of information. A number of suppliers had particular difficulties providing information on the number of sites with debt in the format requested by Ofgem. We have explained in the relevant chapter any limitations on the quality of the results due to the quality of the information provided. Ofgem is grateful for the time and effort of the shippers and suppliers that responded to the survey, and also to Transco for the information it provided.

4. Entry and exit of shippers and suppliers

4.1 A fundamental feature of a competitive market is the choice available to customers in the market. One way this may be measured is by reference to the number of industrial and commercial gas shippers and suppliers operating in the market. This chapter explains the changes in the number of industrial and commercial gas shippers and suppliers during the gas years 1997/98, 1998/99 and the first quarter of the gas year 1999/2000. It also considers which of those shippers and suppliers have been active in the market since October 1997.

Licensed gas shippers and suppliers

4.2 Table 1 below shows the changes in the number of gas shippers and suppliers licensed to operate in the industrial and commercial market since October 1997.

Table 1 – The number of gas shippers and suppliers licensed to operate in the industrial and commercial market at dates since October 1997

	Licensed gas shippers	Licensed gas suppliers
1 October 1997	75	75
1 October 1998	93	83
1 October 1999	106	90
31 December 1999	107	91

4.3 Over the period of the survey there have been a number of new shippers and suppliers entering the market. In part this is due to new companies entering the market, but it is also because current shippers and suppliers have applied for additional licences.

4.4 Over the period of the survey there have been a number of mergers and acquisitions, which have altered the number of competitors in the market. These include, the mergers of gas producers Exxon and Mobil, and BP and Amoco, which then subsequently merged with Atlantic Richfield. Also, some of the mergers of electricity companies over the period of the survey has reduced the number of competitors, including the mergers of East Midlands Electricity

and Powergen, Scottish Hydro-Electric and Southern Electric, and National Power and Midlands Electricity.

Active competitors

4.5 There is no requirement for licence holders actively to ship or supply gas to end users. Also, a number of companies hold more than one shipping and/ or supply licence. Based on the results of Ofgem's survey, the table below shows Ofgem's estimate of the number of active competitors in the industrial and commercial gas supply market. As some of the returns to the survey did not distinguish between previously separate companies that have now merged, it was not possible in all cases to identify the number of active competitors in the early period covered by the survey. This is likely to underestimate figures for the number of active competitors in 1997/98 and 1998/99.

Table 2 – Ofgem's estimate of the number of active competitors in the industrial and commercial gas supply market

Gas years	Shippers	Suppliers
1997/ 98	22	30
1998/ 99	22	30
1999/ 2000	24	34

4.6 Table 2 shows that over the period of the survey, the number of actively competing shippers and suppliers in the market has grown. The increase in the number of active competitors is due to new companies entering both the shipping and supply markets, against the background of some consolidation amongst existing shippers and suppliers.

Conclusions

4.7 There have been some changes in the number of licensed gas shippers and suppliers since October 1997 because of mergers and acquisitions, and a number of new entrants to the market. However, since October 1997 there has consistently been over 20 active shippers and about 30 or more active suppliers

in the market. Ofgem believes that there are more than enough active competitors in the market for the development of effective competition.

5. Market Shares

5.1 Market shares provide an indication of shippers' and suppliers' performances at particular points in time. It is important to consider how market shares change over time and consider market shares in relation to market developments. This chapter summarises:

- ◆ the market shares of shippers and suppliers by the volumes shipped and supplied;
- ◆ the market shares of shippers and suppliers by the number of sites shipped to, and supplied;
- ◆ the market position of BGT in the interruptible power generation sector; and
- ◆ the number of customers in debt to their supplier, such that the supplier could block their transfer to another supplier under Standard Condition 7(4) of the gas suppliers' licence.

5.2 We have attempted to publish as much information as possible about shippers and suppliers market shares, while bearing in mind the need to respect the commercial sensitivity of the information.

The market shares of shippers and suppliers by volumes shipped and supplied

5.3 Table 3 below shows the total volumes of gas shipped and supplied in Great Britain during the period of Ofgem's survey of the industrial and commercial gas supply market, including power generation, natural gas vehicles and feedstocks.

Table 3 – Total volumes shipped and supplied from October 1997 to December 1999⁹

Gas year	Total volume shipped and supplied (kWh)	% growth in demand from 1997/98
1997/98	357,392,644,162	-
1998/99	411,924,345,723	15
First quarter of 1999/00	153,639,307,086	-

5.4 The table shows a significant growth in demand for gas, with demand for the 1998/99 gas year 15% higher than for the previous year. Growth in the use of gas for power generation appears to be one of the main drivers of increased demand. Gas shipped through the Bacton interconnector should not be included in the figures as shippers and suppliers were asked to only include information about gas shipped and supplied to end users in Great Britain, when responding to the survey.

5.5 Table 4 shows BGT's market share by volume shipped over the period of the survey in the industrial and commercial gas supply market.¹⁰

Table 4 – BGT's market share by volume shipped

Gas year	BGT's market share (%)
1997/98	26
1998/99	19
First quarter of 1999/2000 ¹¹	12

⁹ The figures for total volumes may over estimate the total volumes shipped because of some double counting of volumes shipped when analysing responses to the survey, where it has not been possible for Ofgem to clearly distinguish returns that related to shipping only, supply only and both shipping and supply.

¹⁰ These market share figures exclude volumes shipped for power generation, natural gas vehicles and feedstocks.

¹¹ Market share figures for the first quarter of a gas year may be affected by the seasonal profile of demand.

5.6 From October 1997, BGT's market share by volume shipped in the industrial and commercial gas supply market (excluding power generation, natural gas vehicles and feedstocks) has declined from about 26% to about 12%. This compares to 24% in 1996/97.

5.7 Table 5 provides a breakdown of the market shares of all companies in the market over the period of the survey.

Table 5 – Market shares by volume shipped

Market share (%)	Gas year		
	1997/1998	1998/1999	First quarter of 1999/2000
> 10	4	4	4
8 – 10	1	2	-
3 – 8	3	3	3
2 – 3	1	1	2
1 – 2	2	4	2
< 1	11	8	13

5.8 There were 3 shippers, along with BGT who had a market share of more than 10% over the period of the survey. Two shippers had a market share greater than BGT in the final quarter of the 1999/ 2000 gas year.

5.9 Table 6 below shows BGT's market share by market sub-sector.

Table 6 - BGT's market share by volume shipped in the first quarter of the 1999/2000 gas year¹²

Market sector	Market share (%)
Large firm (above 732,679 kWh per year)	7
Small firm (above 73,268 kWh per year)	22
Interruptible	12
Power Generation	35
Natural Gas Vehicles	-
Feedstocks	-
Total	20

5.10 BGT's overall market share, when power generation, natural gas vehicles and feedstocks are included was 20% by volume shipped in the first quarter of the 1999/ 2000 gas year. As the table above shows its market share varies by market sub-sector and is lowest in the large firm sector of the market, suggesting that customers with larger bills are generally exercising their right to switch more than those with smaller bills in the small firm sector. BGT's continuing relatively high market share in the power generation sector in part reflects its long term interruptible contracts for this sector of the market, which are discussed below.

5.11 There are about 11 suppliers who are not also shippers, and one shipper that is not also a supplier. These suppliers accounted for a relatively small proportion of gas supplied.

The market shares of shippers and suppliers by sites

5.12 The table below shows the total number of sites over the period of the survey.

¹² The figures for natural gas vehicles and feedstocks are not shown because there are relatively few sites in these sectors, so any information published would be likely to reveal commercially sensitive information.

Table 7 – Total sites from October 1997 to December 1999¹³

Date	Total number of sites
1 October 1998	324,000
1 October 1999	345,000
31 December 1999	349,000

5.13 As with volumes shipped, the number of sites in the industrial and commercial gas supply market has grown since October 1998. However, the growth in the number of sites has not been as much as the growth in volume, because the growth in volume has mainly come from gas supplied to larger sites, such as power stations.

5.14 Table 8 below shows BGT's market share by sites shipped to, over the period of the survey.¹⁴

Table 8 – BGT's market share by sites to which gas was shipped

Gas year	BGT's market share (%)
1997/98	48
1998/99	42
First quarter of 1999/2000	41

5.15 As shown in the table above, BGT's market share by site shipped to has declined from about 48% to about 41% over the period of the survey. BGT has retained a greater market share by site than by volume, showing that more customers consuming higher volumes have switched to an alternative supplier.

5.16 Table 9 provides a breakdown of the market shares by sites shipped to for all companies in the market over the period of the survey.

¹³ The figures for total sites are slightly higher than Transco's current estimate of the total number of sites, which is about 335,000. Ofgem believes that some of the difference may be due to some double counting of sites when analysing responses to the survey, where it has not been possible for Ofgem to clearly distinguish returns that related to shipping only, supply only and both shipping and supply.

¹⁴ These market share figures exclude volumes shipped for power generation, natural gas vehicles and feedstocks.

Table 9 – Market shares by site

Market share (%)	Gas year		
	1997/1998	1998/1999	First quarter of 1999/2000
> 10	1	1	1
8 – 10	3	3	0
3 – 8	5	8	10
2 – 3	3	2	4
1 – 2	1	2	0
< 1	9	6	9

5.17 No other shipper had a market share of more than 10% on any of the dates for which information was provided. Compared with the by volume market shares, it appears that BGT is retaining a number of low volume sites, while competitors are having most success obtaining high volume sites. Indeed, some of the market share trends suggest that some suppliers have focused on obtaining high volume sites at the expense of lower volume sites.

5.18 Table 10 below shows BGT's market share by sites shipped to, for various market sub-sectors.

Table 10 - BGT's market share by site shipped in the first quarter of the 1999/2000 gas year¹⁵

Market sector	Market share (%)
Large firm (above 732,679 kWh per year)	10
Small firm (above 73,268 kWh per year)	43
Interruptible	11
Power Generation	23
Natural Gas Vehicles	-
Feedstocks	-

¹⁵ The figures for natural gas vehicles and feedstocks are not shown because there are relatively few sites in these sectors, so any information published would be likely to reveal commercially sensitive information.

- 5.19 As with its market share by volumes shipped, BGT's market share by sites shipped to, varies by market sub-sector. As with its market share by volume shipped, BGT's market share by site is lowest in the large firm sector of the market. For the smaller sectors of the market BGT has retained a greater market share by site shipped to, than volume shipped.
- 5.20 There are about 11 suppliers, who are not also shippers, and one shipper who is not also a supplier. These suppliers accounted for a relatively small proportion of sites supplied.

The market position of BGT in the interruptible power generation market

- 5.21 BGT's market share of the interruptible power generation sector has remained relatively stable over the period of the survey, at greater than 60%. One of the reasons for this is the long term nature of interruptible contracts in this sector. As gas is increasingly used for power generation these contracts have and are expected to account for a smaller proportion of the overall market for gas for power generation. As the contracts end there will be opportunities for other suppliers to compete to supply these power stations.
- 5.22 Interruptible contracts provide the supplier with significant interruption rights. The contracts also restrict the rights of the other parties to the contracts to resell gas supplied under the contracts. In 1998, Ofgas considered whether these restrictions raised any issues for customers and competition that should and could be addressed by Ofgas. Ofgas concluded that these were commercial contractual issues and that there was no evidence at that time that the contracts were having a significant adverse effect on competition. Should any new information become available or any issues arise, Ofgem could consider the provisions of these contracts under competition law.

Customers in debt

- 5.23 As explained in Chapter 3, respondents found it difficult to provide information on the number of customers in debt, such that their transfer to another supplier could be blocked under Standard Condition 7(4) of the gas suppliers' licence. Most suppliers provided some information, although this was often an estimate.

- 5.24 Based on the information provided, about 49,000 sites were in debt on 31 December 1999, of which about 22,000 sites were for single site firm supply contracts and 27,000 sites were multi-site firm supply contracts. From the information provided, Ofgem estimates that about 200 sites for interruptible supply contracts are in debt. It appears that sites at all different consumption levels had debt, except power generation, natural gas vehicle and feedstock sites. Overall, about 14% of sites in the industrial and commercial gas supply market are in debt such that their current supplier could object to their transfer to an alternative supplier.

Conclusions

- 5.25 Overall, BGT has a market share of about 12% by volume shipped and 41% by sites shipped to, in the industrial and commercial market, excluding gas shipped for power generation, natural gas vehicles and feedstocks. This compares with a market share of 26% by volume shipped for the gas year 1997/98 and by 48% by sites shipped to, in October 1998. This decline in market share has taken place at the same time as demand for gas in the industrial and commercial gas market has grown. BGT's market share is lower for sites consuming higher volumes, suggesting that customers with larger bills have switched supplier in greater numbers.
- 5.26 BGT retains a market share of greater than 60% in the interruptible power generation sector, mainly due to its long term supply contracts. Ofgas considered the concerns about the provisions of these contracts, particularly in relation to restrictions on the resale of gas under these contracts, in 1998. Should any new information become available or any issues arise, Ofgem could consider the provisions of these contracts under competition law.
- 5.27 About 14% of industrial and commercial gas supply customers are in debt, such that their transfer to another supplier could be blocked by their current supplier.
- 5.28 Market shares provide an indication of suppliers' positions in the market at any one point in time, but need to be considered alongside other relevant factors, including market circumstances and operation, when assessing the development of competition. Changes in market shares over time may give an indication of a particular supplier's success or failure in acquiring and retaining customers.

6. Suppliers' price offers

- 6.1 Suppliers were asked to provide an indication of the prices contained in contracts signed in each sub-sector of the industrial and commercial gas supply market in October 1997, April 1998, October 1998, April 1999 and October 1999. This pricing information was given by suppliers in the strictest confidence, and therefore, Ofgem has not attributed specific pricing levels to particular suppliers. In particular, because of the relatively small number of different suppliers in the power generation, natural gas vehicles and feedstock sectors, no pricing information is published for these sectors, although the general trend is described. We have set out below:
- ◆ average weighted prices and price ranges offered by suppliers over the period of the survey, shown separately for firm and interruptible supply split by single and multi site contracts; and
 - ◆ an explanation of the price levels and trends in the power generation, natural gas vehicles and feedstock sectors.
- 6.2 In general, the information provided by suppliers on indicative prices was clear and comprehensive. However, there were a number of incomplete returns, which may distort the results, particularly for the calculation of weighted average prices. Also, to calculate weighted average prices very accurately would require detailed information about the profile of consumption across the gas year. Therefore, the information presented below provides indicative estimates of pricing levels and trends in the market.

Firm supply

- 6.3 Table 11 below shows weighted average prices for firm supply.

Table 11 – Weighted average prices for firm supply (nominal values)¹⁶

Consumption band (kWh)	October 1997		October 1998		October 1999	
	Single	Multi	Single	Multi	Single	Multi
73,268 – 146,536	1.18	1.04	1.19	0.93	1.46	1.23
146,537 – 293,071	1.13	1.01	1.11	0.92	1.07	1.13
293,072 – 732,678	0.99	1.00	1.01	0.91	0.96	1.16
732,679 – 2,198,033	0.86	0.89	0.84	0.86	0.81	1.03
2,198,034 – 29,307,100	0.75	0.80	0.72	0.77	0.70	0.89
29,307,101 – 293,071,000	0.62	0.68	0.58	0.75	0.58	0.69
Over 293,071,000	0.58	0.63	0.52	0.64	0.51	0.54

6.4 Since October 1997, and particularly since October 1998, there have been some significant increases in multi-site prices, and particularly for higher consumption customers the prices for multi-site contracts tend to be higher than single site contracts. There has also been a significant price rise in the small firm sector for October 1999, while prices for firm supply in some other market sectors have declined over the period of the survey.

6.5 Tables 12 and 13 below show the range of prices offered by suppliers for single and multi site contracts over the period of the survey.

¹⁶ Over the period of the pricing information (October 1997 to October 1998) the retail price index rose by about 4%.

Table 12 – Firm price ranges for single site contracts (p/kWh)

Consumption (kWh)	October 1997	April 1998	October 1998	April 1999	October 1999
73,268 – 146,536	0.92 – 2.42	0.92 – 2.02	0.97 – 2.52	0.74 – 1.38	0.83 – 2.36
146,537 – 293,071	0.89 - 1.81	0.89 - 1.39	0.96 – 1.68	0.72 - 1.29	0.8 - 1.59
293,072 – 732,678	0.85 - 1.31	0.85 – 1.26	0.87 – 1.22	0.73 – 1.24	0.77 – 1.16
732,679 – 2,198,033	0.82 - 1.37	0.76 - 1	0.8 - 1.02	0.74 - 1.1	0.72 - 0.94
2,198,034 – 29,307,100	0.58 – 0.94	0.56 – 0.99	0.58 – 0.94	0.56 – 0.94	0.63 – 0.82
29,307,101 – 293,071,000	0.5 - 0.8	0.52 - 0.94	0.5 - 0.8	0.5 - 0.73	0.46 - 0.77
> 293,071,000	0.42 - 0.8	0.42 - 0.62	0.46 – 0.8	0.46 – 0.55	0.45 – 0.81

Table 13 – Firm price ranges for multi site contracts (p/kWh)

Consumption (kWh)	October 1997	April 1998	October 1998	April 1999	October 1999
73,268 – 146,536	0.83 – 1.52	0.85 – 1.25	0.89 – 1.2	0.35 – 1.2	0.82 – 1.41
146,537 – 293,071	0.89 - 1.12	0.87 - 1.22	0.9 - 1.01	0.87 – 1.28	0.83 - 1.17
293,072 – 732,678	0.81 – 1.12	0.81 – 1.36	0.85 – 1.07	0.8 – 1.24	0.82 – 1.28
732,679 – 2,198,033	0.73 - 0.98	0.75 - 0.97	0.81 – 0.96	0.74 - 1.11	0.72 - 1.04
2,198,034 – 29,307,100	0.71 – 0.89	0.58 – 1.02	0.74 – 0.93	0.71 – 0.96	0.68 – 0.9
29,307,101 – 293,071,000	0.54 – 0.84	0.55 - 0.8	0.56 – 0.88	0.53 - 0.75	0.56 - 0.8
> 293,071,000	0.37 – 0.96	0.37 – 0.71	0.53 – 0.88	0.37 – 0.8	0.49 – 0.79

6.6 The tables above show that broadly the larger the consumption level in the contract the better the price that is obtained. However, over the period of the survey the difference between the prices in the single and multi site sectors has closed and in some cases multi site contracts are higher in price than single site contracts.

6.7 The price ranges offered by suppliers suggest that customers who shop around for an alternative supplier can obtain relatively competitive prices. However, it should be noted that some of the prices at either end of the range related to relatively small volumes.

Interruptible supply

6.8 The table below shows the weighted average prices for interruptible supply contracts.

Table 14 – Weighted average prices for interruptible supply (nominal values)

Consumption band (kWh)	Gas year 1997		Gas year 1998		Gas year 1999	
	Single	Multi	Single	Multi	Single	Multi
732,679 – 2,198,033	0.64	-	0.78	-	-	-
2,198,034 – 29,307,100	0.60	0.59	0.6	0.60	0.56	0.66
29,307,101 – 293,071,000	0.54	0.56	0.55	0.58	0.48	0.54
Over 293,071,000	0.53	0.58	0.49	0.49	0.47	0.46

6.9 Over the period of the survey, single site interruptible prices have fallen slightly in nominal terms, while similar to firm contracts, multi-site prices have risen often to higher levels than the firm contract prices. However, it should be noted that because there are far fewer interruptible contracts than firm contracts, the weighted average prices can be significantly affected by the prices of a small number of contracts.

6.10 Tables 15 and 16 below show the range of prices offered by suppliers for single and multi site contracts over the period of the survey.

Table 15 – Interruptible price ranges for single site contracts (p/kWh)

Consumption (kWh)	October 1997	April 1998	October 1998	April 1999	October 1999
293,072 – 732,678			0.5		
732,679 – 2,198,033	0.57 – 0.78	0.57 – 0.78	0.78	0.78	0.78
2,198,034 – 29,307,100	0.46 – 0.7	0.48 – 0.66	0.5 – 0.68	0.51 – 0.62	0.51 – 0.91
29,307,101 – 293,071,000	0.49 – 0.7	0.48 - 0.6	0.49 – 0.6	0.5 - 0.64	0.47 - 0.52
> 293,071,000	0.53 – 0.7	0.38 - 0.53	0.48 – 0.52	0.45 - 0.49	0.45 - 0.50

Table 16 – Interruptible price ranges for multi site contracts (p/kWh)

Consumption (kWh)	October 1997	April 1998	October 1998	April 1999	October 1999
73,268 – 146,536	1.06 – 1.08	1.0 – 1.1	1.1 – 1.13	1.13 – 1.16	1.11 – 1.15
2,198,034 – 29,307,100	0.54 – 0.89	0.56 - 1	0.56 – 0.83	0.56 – 0.84	0.54 – 0.71
29,307,101 – 293,071,000	0.52 – 0.78	0.53 - 0.72	0.55 – 0.74	0.46 - 0.75	0.49 - 0.64
> 293,071,000	0.55 – 0.93	0.49 – 0.61	0.47 – 0.72	0.45 – 0.73	0.45 – 0.59

6.11 As with the firm supply prices, the interruptible prices tend to be higher at lower consumption levels. Interruptible prices are generally lower than firm prices for

similar consumption levels, reflecting the lower transportation charges for interruptible sites and the value to shippers of interruption rights to balance their supply and demand positions in the balancing market.

- 6.12 The interruptible prices have been broadly stable over the period of the survey, with some nominal decreases. Customers have been able to obtain relatively competitive prices by shopping around.

Power generation, natural gas vehicles and feedstock prices

- 6.13 The prices under long term interruptible contracts for power generation tend to vary with different indicators than those used to calculate prices for new contracts. The value of these indicators determines whether prices for new contracts are higher or lower than those for long term interruptible contracts at particular points in time.
- 6.14 Ofgem has not included information on prices for feedstocks and natural gas vehicles prices because the small number of sites in these sectors means that any information that is published would be likely to be commercially sensitive.

Conclusions

- 6.15 Prices for single site supply contracts have tended to be more stable in nominal price terms than multi-site contracts, which for both firm and interruptible supply contracts have increased in nominal terms over the period of the survey and in some cases become at least as expensive as single site contracts for similar volume levels. The price ranges shown above illustrate the opportunities in most market sub-sectors for customers to obtain relatively competitive prices by shopping around amongst competing suppliers.

7. Switching Behaviour

- 7.1 Chapter 5 analysed market share trends since October 1997. Market shares provide an indication of shippers and suppliers performance at particular points in time and market share trends provide an indication of changes in shippers and suppliers market positions and customers behaviour over time. However, market share trends do not explain why the changes in supplier performance have occurred.
- 7.2 One indication of a well functioning competitive market is customers switching supplier following changes in the value of suppliers' relative offers. This chapter considers how customers' choices have reacted to changes in suppliers' offers since October 1997. To analyse customers' behaviour, we have considered changes in a number of suppliers' relative prices in sub-sectors of the industrial and commercial gas supply market and the consequent changes to suppliers' market shares.
- 7.3 In the 146,537 to 293,071 kWh a year consumption sub-sector, between October 1997 and October 1999, a suppliers indicative prices moved from being in the middle of the range of suppliers' prices to become one of the most expensive. Over this period, its market share by gas shipped in this sub-sector halved.
- 7.4 In the 732,679 to 2,198,033 kWh a year firm consumption sub-sector for single site contracts, between October 1997 and October 1999, a supplier moved from being in the middle of the range of suppliers' prices to become one of the most expensive. Over this period, its market share by volume shipped in this sub-sector fell by about 20%.
- 7.5 In the 29,307,101 to 293,071,000 kWh a year interruptible sub-sector for single site contracts, between October 1997 and October 1999, a supplier moved from offering some of the most expensive prices to become one of the more competitive suppliers. Over the period its market share by volume shipped in this sub sector increased by over 50%.
- 7.6 In the 2,198,034 to 29,307,100 kWh a year firm sub-sector for multi-site contracts, between October 1997 and October 1999, a supplier has maintained

a consistent competitive price offer relative to other suppliers. Over the period its market share by volume shipped has remained broadly unchanged.

Conclusions

- 7.7 As shown above, there are a number of examples of customers switching suppliers in response to changes in suppliers' relative price offers. There is also evidence that where suppliers' offers retain their relative competitive position, customers do not switch away from or to that supplier in aggregate. This suggests that at least some parts of the industrial and commercial gas supply market are characterised by a significant amount of price elasticity.
- 7.8 There are other examples in the sector where customer behaviour does not appear to have responded to changes in suppliers' relative prices. This may be because other factors, such as service levels, rather than price were influencing customers' decisions as to whether to change supplier. Also, the extent of suppliers marketing and response to customer requests for quotes will influence customers' responses to changes in suppliers' relative price offers.

8. Barriers to Entry

- 8.1 Potential entrants to the gas supply market and suppliers within the market will consider the return they expect to make in the gas supply market as compared with deploying their resources in other markets. The extent of any real or perceived barriers to entry and their associated costs will be a factor that potential entrants and existing suppliers bear in mind when making their decision as to how to deploy their resources to maximise their return.
- 8.2 Ofgem's last review of the industrial and commercial gas supply market in 1997, found that, in general, problems and complaints raised by suppliers and customers no longer related solely to the dominant position of BGT (except in relation to ownership of the Morecambe Bay gas fields), but related to the general operation of the market. The 1999 industrial and commercial gas market survey asked respondents to comment on the extent to which four specific issues that had been raised with Ofgem, constituted effective barriers to entry, and therefore, barriers to suppliers making, and customers receiving, potentially competitive offers, and what, if any, action should be taken to address the issues. The issues raised in the survey were:
- ◆ concerns that customers cannot cross the consumption threshold due to insufficient information about actual consumption levels;
 - ◆ BGT customers being moved from BGHE to Business Gas when they cross the consumption threshold between the domestic, and industrial and commercial market, without being informed that they have crossed the threshold;
 - ◆ the defaulting of customers to BGT when a new gas supply is being installed, but the process is not completed by the new supplier; and
 - ◆ the removal of BGT's Special Condition 5A.
- 8.3 In addition to these specific issues, Ofgem asked respondents to explain any other commercial practices, which may in the future, act as barriers to entry in the industrial and commercial gas supply market. No additional issues were raised by respondents. We have set out below the responses to the four issues

raised by Ofgem and explained Ofgem's proposed action in the light of responses.

Threshold issues

Concerns raised

- 8.4 Ofgem was aware that some customers were experiencing difficulties in transferring from the market below 73,268 kWh a year to the market above 73,268 kWh a year because of insufficient information about the actual amounts of gas consumed at their sites. Concern was expressed by some customers that they are denied the benefits, e.g. lower prices, from entering the market for consumption above 73,268 kWhs a year.
- 8.5 Views were sought as to whether, and if so how many, customers were being denied the benefits of the market for consumption above 73,268 kWh a year because they could not cross the threshold, and whether any action was required to address the issue, in addition to the full annual quantity¹⁷ (AQ) review this year, which Ofgem had proposed should be undertaken.

Respondents' views

- 8.6 From trial analysis, Transco found that about 160,000 meter points a year may potentially cross the 73,268 kWh consumption threshold to become supply points in the industrial and commercial gas supply market. Two respondents estimated that they receive approximately 50 to 60 contracts a year from customers with a domestic AQ who believe they should be categorised as industrial and commercial customers. Conversely, some suppliers noted that there are a number of customers who wish to obtain a domestic AQ but are categorised as industrial and commercial. One supplier suggested introducing a tolerance around the threshold, whereby customers could choose which market they wished to fall within. Two respondents felt that suppliers should be able to appeal AQs.

¹⁷ The annual quantity is the estimated amount of gas that will be consumed at a site during a year.

- 8.7 One supplier felt the method of changing AQs should be made less complicated and involve greater maintenance by shippers of accurate AQs. A number of suppliers advocated a full AQ review in preference to a partial review, as it improves the accuracy of available information.

Ofgem's conclusions

- 8.8 Ofgem has ensured that during 2000 Transco conducts a full AQ review. The review is intended to improve the quality of information available and should ensure that customers are in the sector of the market that represents their consumption level. The review commenced in April and is expected to be completed by the end of the year. Shippers have had an opportunity to influence the AQ review process through modifications to Transco's Network Code.

BGT customers moving between BGHE and Business Gas when they cross the consumption threshold

Concerns raised

- 8.9 Ofgem was aware that a number of BGT's customers crossing the threshold of 73,268 kWh per year consumption are passed directly from BGHE to Business Gas, without being made aware that they have crossed the threshold. In the market above 73,268 kWh a year, customers are not covered by a number of licence provisions, including BGT's price control and suppliers' social obligations under Standard Conditions 15 to 19 of the gas suppliers' licence. Concerns were also raised with Ofgem that sites consuming more than 73,268 kWh per year, which remain with BGHE continue to be billed at BGHE's standard credit tariff. Views were sought as to how many customers are affected by this issue and whether any action is required.

Respondents' views

- 8.10 The majority of respondents commented that the internal process for transferring customers between different business units of a supplier is the responsibility of the individual supplier and that any concerns regarding this process are

misplaced. Another supplier noted that it was a sensible commercial practice for BGT to behave in this manner.

- 8.11 One supplier believed that this issue highlighted the importance of an accurate AQ determination in resolving this industry problem. Two respondents commented that this is an issue for the whole industry in order to ensure consistency and clarity. One supplier felt that it should be compulsory to notify a customer that moves from the domestic to the industrial and commercial market, and to notify Transco of the change of meter point status.

Ofgem's conclusions

- 8.12 The analysis in earlier chapters suggests that competition is developing well for customers just above the industrial and commercial market consumption threshold. Customers can exercise their right to switch supplier if they are not satisfied with their present supplier. Ofgem is content that competition is such that customers are reasonably able to exercise their right to switch supplier.

The installation of a new gas supply

Concerns raised

- 8.13 Ofgem was aware that on a number of occasions sites had defaulted to BGT when another supplier had arranged for the installation of a new supply, but had failed to complete the nomination process. Ofgem sought views on how often such instances of defaulting occurred, what respondents believed was causing the defaulting and whether any action was required to address the issue.

Respondents' views

- 8.14 Two respondents were aware of a small number of sites that appear to have defaulted to BGT. One supplier felt this process should not be allowed to occur. Another supplier expressed concern that nomination failures should not result in the disconnection of a customer's gas supply and that process failures are within the control of the new supplier.
- 8.15 After investigation, Transco confirmed that its systems were set such that where suppliers began the process of installing a new supply, but failed to complete the

process, the site defaulted to BGT. Transco agreed to investigate the issue with a view to ensuring that customers did not default to BGT in such circumstances.

Ofgem's conclusions

- 8.16 Ofgem accepts that rules should not be set up to compensate suppliers for failing to complete the process of installing a new gas supply. However, it is inappropriate for Transco's systems to be set in such a way that could benefit a particular supplier. Transco has informed Ofgem that it is attempting to resolve the problem and Ofgem expects Transco to address the issue as soon as possible.

BGT's Special Condition 5A

Concerns raised

- 8.17 In July 1998, Ofgem permanently removed Special Condition 5 of BGT's gas suppliers' licence. This condition required BGT to price in accordance with published schedules in the industrial and commercial market.
- 8.18 BGT asked Ofgem to remove the related Special Condition 5A. Special Condition 5A restricts the terms BGT can require in its contracts with customers consuming above 73,268 kWh a year. In particular, Special Condition 5A prevents BGT including terms which:
- ◆ restrict the purpose for which the gas supplied may be used;
 - ◆ require the provision of facilities for using other forms of energy for the purposes of which the gas supplied may be used;
 - ◆ require the provision of facilities for using other forms of energy for the purposes of which the gas is supplied; and
 - ◆ confer powers of entry on premises to ascertain the purposes for which the gas supplied is used or to inspect facilities for using other forms of energy for those purposes.
- 8.19 Ofgem signalled its intention to remove Special Condition 5A of BGT's gas suppliers' licence and sought views on the proposal.

Respondents' views

- 8.20 The majority of respondents believed that the removal of Special Condition 5A was appropriate after the removal of Special Condition 5. The respondent who opposed the removal of the condition did not give any reasons for its view.

Ofgem's conclusions

- 8.21 As is set out in the rest of this document, competition in the industrial and commercial market is developing very well. Taking account of this and the lack of any reasons not to remove the condition from respondents to the consultation, Ofgem is formally proposing the removal of the special condition from BGT's gas supply licence from the end of October 2000, subject to any comments received on this proposal by 18 September 2000. A copy of the Section 23 notice under the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000) to enact this proposal is shown in Appendix 3.

Conclusions

- 8.22 The issues raised in this review relate to the general operation of the industrial and commercial gas supply market and appear to be mainly minor in nature. No issues have been raised during this review about the behaviour of BGT in the industrial and commercial gas supply market. It appears to Ofgem that there are no significant barriers to suppliers making potentially competitive offers to customers in the industrial and commercial gas supply market.
- 8.23 Views would be welcomed on Ofgem's conclusions to the issues discussed above and, in particular, the proposal to remove Special Condition 5A of BGT's gas suppliers' licence.

9. Conclusions

- 9.1 Ofgem's survey shows that competition in the industrial and commercial gas supply market as a whole, and most sub-sectors of the market, is developing very well. There are about 30 or more active shippers and suppliers competing in the market. BGT's overall market share has declined over the period of the review to about 12% of gas shipped to the industrial and commercial market, excluding gas for power generation, natural gas vehicles and feedstocks. For the market as a whole BGT's market share is about 20% of gas shipped. There are 4 companies with a market share of more than 10% of gas shipped, with 2 companies with a greater market share than BGT. There is evidence in a number of sub-sectors of the market that customers are changing supplier in response to changes in suppliers relative prices, which is the type of customer behaviour that would be expected in a well developed competitive market. There have been few complaints in this review about barriers to entry in the market and there does not appear to be any significant barriers to suppliers making, and customers receiving, potentially competitive offers.
- 9.2 Prices for single site supply contracts have tended to be more stable in nominal price terms than multi-site contracts, which for both firm and interruptible supply contracts have increased in nominal terms over the period of the survey and in some cases become at least as expensive as single site contracts for similar volume levels. The prices offered illustrate the opportunities in most market sub-sectors for customers to obtain relatively competitive prices by shopping around amongst competing suppliers
- 9.3 BGT retains a market share of greater than 60% in the interruptible power generation sector, mainly due to its long term supply contracts. Ofgas considered the concerns about the provisions of these contracts, particularly in relation to restrictions on the resale of gas under these contracts, in 1998. Should any new information become available or any issues arise, Ofgem could consider the provisions of these contracts under competition law.
- 9.4 Bearing in mind the continued development of competition, Ofgem is formally proposing to remove Special Condition 5A of BGT's gas suppliers' licence, as we do not consider that it is necessary in a well developed competitive market.

Depending on the responses to the formal consultation under Section 23 of the gas suppliers' licence, Ofgem expects to remove the condition from the end of October 2000.

Ofgem's future monitoring of the industrial and commercial gas supply market

- 9.5 Ofgem has an obligation under Section 39 of the Gas Act 1986 (as amended by the Gas Act 1995 and the Utilities Act 2000) to review the development of competition in the industrial and commercial gas supply market annually. As well as Ofgem's reviews of the development of competition in the industrial and commercial gas supply market, there are a number of other organisations that review the development of the market. Competition is now sufficiently developed in this market that Ofgem does not believe that it is necessary to carry out detailed reviews such as this in the future. Instead, Ofgem will monitor competition in the industrial and commercial gas supply market by monitoring the trends of any complaints received from customers and reviewing the market reviews referred to above. In future, the conclusions of Ofgem's monitoring will be set out in Ofgem's annual report.
- 9.6 Views would be welcomed on the conclusions of this review, the proposal to remove Special Condition 5A of BGT's gas suppliers' licence and the proposal not to carry out detailed reviews of the industrial and commercial gas supply market in the future.

Appendix 1 - The development of competition in the industrial and commercial gas supply market

- 1.1 The 1988 Monopolies and Mergers Commission (MMC) Gas Report following an OFT reference under the Fair Trading Act, alleging that British Gas was engaged in price discrimination, 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 the 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 293,072 kWh 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 73,268 kWh a year. The MMC also recommended restrictions on British Gas' purchases of new wholesale gas to ensure that gas was available for competitors to purchase.
- 1.2 Subsequent reviews by the 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 following the OFT review, (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 business, including a requirement to treat all users of British Gas plc's transportation and storage facilities in a non-discriminatory manner, following the MMC report. 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.
- 1.3 Ofgas suspended the requirement to price according to published schedules in the market for firm gas above 293,072 kWh 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 293,072 kWh threshold after the schedules were suspended. Subsequently, Standard Condition 13 of the gas suppliers' licence

was introduced, which prevents dominant suppliers exercising undue discrimination.

- 1.4 A review of the competitive market by Ofgas in March 1995¹⁸ 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.
- 1.5 As a result of Ofgas' 1996 competitive market review,¹⁹ the requirement on British Gas plc to price according to price schedules was permanently removed for supplies of firm gas in the above 293,072 kWh 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 BGT. In the 73,268 to 293,072 kWh market and the interruptible market, the requirement to price according to published schedules was suspended to the end of July 1997 and the suspension was extended until the end of May 1998, pending the outcome of the 1997 competitive market review.
- 1.6 Following this review, Ofgas did not 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 market, as these mainly related to the general operation of the market rather than BGT's behaviour.

¹⁸ "The Competitive Market Review: Decision to Suspend the Requirement to Price According to Published Schedules", Ofgem, June 1995.

¹⁹ "Review of the Competitive Gas Supply Market Above 2,500 Therms a Year – A Decision Document", Ofgas, July 1996.

Appendix 2 - Respondents to the quantitative survey

2.1 The companies that responded to the quantitative survey are listed below:

- ◆ British Gas Trading;
- ◆ Contract Natural Gas Limited;
- ◆ London Electricity;
- ◆ Norweb;
- ◆ Seeboard; and
- ◆ Transco.

Appendix 3 - Section 23 notice of the proposed removal of Special Condition 5A of BGT's gas suppliers' licence

NOTICE

GAS ACT 1986 Section 23

Notice of proposal to modify the special conditions of the Gas Supplier Licence treated as granted under section 7A(1) (a) and (b) of the Gas Act 1986 to British Gas Trading Limited ("the Licensee")

The Director General of Gas Supply ("the Director"), pursuant to sections 4(1) (a) to (c), 4(2) (a), (b) and (c) (iii) and 23(1)(a) of the Gas Act 1986 (the Act), hereby gives notice as follows -

1. The Director proposes to make modifications ("the proposed modifications") to the special conditions of the Gas Supplier Licence treated as granted under section 7A(1)(a) and (b) of the Act to British Gas Trading Limited in the manner set out in the attached Schedule 1.
2. The effects of the proposed modifications are set out in the consultation document entitled 'A Review of the Development of Competition in the Industrial and Commercial Gas Supply Market', dated August 2000.
3. The reasons why the Director proposes to make the proposed modifications are set out in the consultation document entitled 'A Review of the Development of Competition in the Industrial and Commercial Gas Supply Market', dated August 2000.

4. Representations or objections with respect to the proposed modifications may be made by 18 September 2000 to -

The Director General of Gas Supply
The Office of Gas Supply
Stockley House
30 Wilton Road
LONDON SW1V 1LQ.

The Official Seal of the Director General of Gas Supply
hereunto affixed is authenticated by

A handwritten signature in black ink that reads "Eileen Marshall". The signature is written in a cursive style with a large initial 'E' and 'M'.

Authorised in that behalf by the
Director General of Gas Supply

3 August 2000

SCHEDULE 1

Proposed Modifications

1. The following modifications to the standard and special conditions of the Licensee's Gas Supplier licence are proposed to come into effect on 31 October 2000.

SPECIAL CONDITIONS

Special Condition 5A shall be deleted in its entirety.