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Dear

BGT price regulation review - Modification to Special Condition 3 of BGT's gas suppliers' licence

On 26 February 2001 Ofgem published its final proposals for the price regulation of British Gas Trading (BGT) from April 2001, including the proposed licence modification to implement the proposals.¹

We received 8 responses to our proposals. We have carefully considered these responses and decided to make the modification to Special Condition 3 of BGT's gas suppliers' licence as set out in our proposals. BGT has confirmed its acceptance of the modification, which will come into effect on 1 April 2001.

Ofgem believes that the relative price regulation which caps the differential between BGT's Direct Debit and LatePay/ PrePayment tariff, and between its PromptPay and LatePay/ PrePayment tariff, will ensure that customers on the LatePay/ PrePayment tariff, and particularly those in debt, benefit from the stronger competitive pressures faced by BGT for Direct Debit and PromptPay customers. Ofgem is continuing to work to allow customers in debt to benefit from the competitive market. Ofgem is encouraged that the industry is participating in this process, and Ofgem will be looking for the industry to develop a way forward in the coming months to allow many customers in debt to participate in the competitive market.

Attachment 1 summarises the responses received to the consultation on Ofgem's final proposals and the proposed licence modification. Attachment 2 is the notice formally to introduce the licence modification from 1 April 2001.

If you have any questions about the issues discussed in this letter or the attached licence modification, please do not hesitate to contact Colin Garland on 020-7901-7071.

Yours sincerely

John Neilson Managing Director, Customers and Supply

¹ "Review of British Gas Trading's price regulation, Final proposals", Ofgem, February 2001.

Attachment 1 – Summary of responses to Ofgem's final proposals

We received 8 responses to our final proposals document, from BGT, Powergen, Aquila, npower, Yorkshire Electricity, Scottish and Southern Energy, Scottish Power and TXU Europe. We have summarised the responses below, and set out Ofgem's response to the comments under the following categories:

- the form of price regulation;
- the terms of the licence modification;
- BGT's market position; and
- customers in debt.

The form of price regulation

Respondents' views

Six respondents broadly supported Ofgem's proposals to introduce relative price regulation for BGT's tariffs. These respondents generally welcomed the removal of price caps, as they were concerned that these distorted the development of competition. Three of these respondents indicated that they would have preferred Ofgem to have been able to remove price regulation completely, but understood Ofgem's concerns about customers in debt. One respondent welcomed the continuation of price regulation for BGT as this would align BGT's regulation with the timetable for the review of the PES's supply regulation.

One respondent believed that the form of relative price regulation proposed by Ofgem could be simplified to cover only the gap between BGT's Direct Debit and PrePayment tariffs, with no price regulation of BGT's PromptPay and LatePay tariffs.

One respondent expressed disappointment that Ofgem had chosen to continue with price regulation, bearing in mind the distortions to the development of competition as a result of the existing price caps. It was concerned that the current differentials were not cost reflective, particularly in respect of prepayment customers, and believed that decisions about the appropriate level of differentials should be determined by the market rather than the regulator. It was also concerned that otherwise economic price reductions for customers on the 'marker' tariffs would be delayed because of the need for equivalent reductions for customers on the 'target' tariff, thereby distorting the development of competition.

Ofgem's views

Ofgem is disappointed that it was unable to remove all price regulation over and above competition law. However, Ofgem believes it is important that customers in debt, who are on BGT's LatePay/ PrePayment tariff, are adequately protected while they cannot take advantage of the competitive market. Ofgem expects, subject to sufficient progress in the development of competition, and co-operation from the industry on debt blocking, to remove relative price regulation from 1 April 2002. Ofgem will consider the need for future price regulation of BGT

and the PESs in the light of the conclusions of the competitive market review that will be undertaken this year

Ofgem does not believe that it would be appropriate to have relative price regulation that covered only the differential between BGT's Direct Debit and PrePayment tariffs. There are a similar number of customers in debt on BGT's LatePay and PrePayment tariffs, so Ofgem believes it is appropriate that relative price regulation applies for both customer groups. Ofgem also considers it important that BGT retains a combined LatePay/ PrePayment tariff to ensure that BGT has an appropriate incentive to manage debt efficiently. Ofgem believes that if PromptPay was not a marker tariff along with Direct Debit, BGT may not have a sufficiently large profit stream from its marker tariff to provide an incentive to minimise the level of the target tariff (LatePay/ PrePayment).

Ofgem understands the concern that regulation may distort the development of competition. However, as explained above, Ofgem believes that BGT's customers in debt on its LatePay/ PrePayment tariff need continuing protection because they are not able to fully participate in the competitive market. Relative price regulation should ensure that these customers benefit from the competitive pressures for Direct Debit and PromptPay customers, as BGT will be required not to increase the current differential when it changes tariff levels. Ofgem has assessed in detail the appropriate level of differentials between BGT's tariffs and believes that the current levels are broadly cost reflective. This should ensure that any distortion to the development of competition is minimised.

The terms of the licence modification

Respondents' views

Two respondents were concerned that the proposed licence modification introduced a preapproval process for changes to BGT's domestic gas terms and conditions, including prices. The respondents believed that direct regulation should be reduced to allow customers to benefit more quickly from innovation and to ensure that Ofgem's resources are appropriately focused. The respondents believed that the introduction of the pre-approval process contradicted Ofgem's stated intention to reduce ex ante regulation, by removing the non-discrimination licence conditions. One respondent was also concerned that if Ofgem approval had to be given to changes, then BGT's requirement to notify customers of tariff changes may not apply under the proposed Standard Condition 44 of the proposed new gas suppliers' licences.

BGT stated that subject to any changes Ofgem proposed to the licence modification as a result of the consultation, it was able to accept the change to its licence.

One respondent was concerned that the disapplication process within the proposed licence modification was significantly shorter than the equivalent process in the electricity supply licences. It suggested that the two processes should be aligned given Ofgem's stated intention to remove price regulation for gas and electricity from April 2002 and to align gas and electricity regulation where possible. It suggested that the amendments could be made in the forthcoming standard licence conditions to be introduced by the DTI.

Ofgem's views

Ofgem does not believe that the proposed licence modification requires BGT to obtain prior approval for price changes, within the constraints of the relative price regulation, as pre-approval is limited to changes in terms and conditions other than price. Ofgem believes it is important that the relative price regulation works effectively, and therefore, the licence modification requires BGT to notify Ofgem of changes to terms and conditions of existing tariffs and the introduction of new tariffs, so that Ofgem can ensure such changes do not dilute the incentives in the relative price regulation. To ensure that BGT's ability to respond to competition is not unduly restricted there is a provision for BGT to seek to make urgent changes to its terms and conditions, or to introduce new tariffs. Ofgem does not believe that the proposed Standard Condition 44 would operate in the way suggested by the respondent, and the requirement to notify customers of changes in terms and conditions would have to be explicitly waived by Ofgem.

Ofgem welcomes BGT's acceptance of the licence modification.

The disapplication processes in the PES electricity supply licences were accepted by the PESs when the price controls were introduced last year. Ofgem will be reviewing the price regulation of the PESs this year, and will bring forward initial proposals for the future price regulation in November 2001. Also Ofgem is very reluctant to suggest to DTI further changes to licence conditions through the process to introduce new standard licence conditions, particularly where such changes have not been subject to public consultation.

BGT's market position

Respondents' views

Two respondents expressed concern at BGT's market position in gas and electricity. One respondent said that while it supported the removal of the price caps on BGT, it believed new regulatory obligations should be introduced to ensure the transparency of BGT's operations. It suggested that more details of cross-selling/ white labelling initiatives should be available and a process for regulatory pre-approval of advertising should be introduced. It suggested that the extent of BGT's customer 'winbacks' in gas made this particularly pertinent. One respondent supported Ofgem's decision to continue to monitor BGT's market position.

Ofgem's views

Ofgem does not believe that it would be appropriate to introduce new regulatory obligations on BGT at this time, particularly as competition is continuing to develop. Ofgem continues to monitor BGT's behaviour and will seek to take action under its sector specific or competition law powers if there is evidence that BGT has breached relevant statutory provisions.

Customers in debt

Respondents' views

One respondent believed that it was appropriate that the concerns about customers in debt were taken forward in an energy sector wide context. Two other respondents explained how they were participating in an industry group to develop proposals to address the debt blocking issues.

BGT stated that it was committed to playing a leading role in co-operation with the industry to secure progress on the debt blocking issue to enable the removal of relative price regulation as soon as possible.

Ofgem's views

Ofgem agrees that, if possible, it is best that common approaches to allow customers in debt to participate in the competitive market are applied in gas and electricity. Ofgem welcomes the industry's commitment to addressing this issue. It will be important that the industry works in a timely manner to develop a trial that allows a substantial number of customers in debt to participate in the competitive market, and involves as many suppliers as possible and that thereafter the industry accepts more permanent changes which allow many customers in debt to take advantage of the competitive market.

Attachment 2 – Licence modification

Modification

Gas Act 1986 Section 23(1)(a)

Modification of Special Condition 3 of the licence treated as granted under section 7A(1) of the Gas Act 1986 to British Gas Trading Limited (*BGT*)

Whereas

- A. Pursuant to section 23(3) of the Gas Act 1986 (*the Act*), the Gas and Electricity Markets Authority (*the Authority*) gave notice on 26 February 2001 that it proposed to modify Special Condition 3 of the licence treated as granted under section 7A(1) of the Act to BGT (*BGT's gas supplier licence*).
- B. The Authority has considered any representations or objections relating to the proposed modifications duly made and not withdrawn.
- C. The Authority gave notice of the proposed modifications to the Secretary of State and has not received a direction from him not to make the modifications.
- D. The consent of BGT has been obtained.

Modification

Now in accordance with the powers contained in section 23(1)(a) of the Act and having obtained the consent of BGT, the Authority hereby modifies Special Condition 3 of BGT's gas supplier licence in the manner specified in the attached Schedule with effect on and from 1 April 2001.

The official seal of the Gas and Electricity Markets Authority here affixed is authenticated by:

authorised for that purpose by the Gas and Electricity Markets Authority

29 March 2001

SCHEDULE

MODIFICATION

For Special Condition 3 of the Special Conditions of BGT's gas supplier licence there shall be substituted the following Special Condition –

"Condition 3: Restriction of certain prices for domestic customers

Interpretation

1 In this condition, unless the context otherwise requires-

"Additional Charge" means a charge for the provision of goods or services to a particular domestic customer, or a class of domestic customers, making payment for gas supplied under either the Marker Tariff (Category A), Marker Tariff (Category B) or the Target Tariff in addition to the charge for gas supplied;

"Advance Payment Tariff" means the category of Gas Payment Provisions described as Advance Payment;

"Gas Payment Provisions", in relation to the terms or terms and conditions referred to in paragraph 2 below, means the provisions relating to payment of charges for gas supplied (other than the amounts to be charged) therein described;

"last resort supply customers" means customers supplied with gas pursuant to a direction given to the licensee by the Authority in accordance with Standard Condition 5 of the Standard Conditions;

"Marker Tariff (Category A)" means the category of Gas Payment Provisions described as monthly direct debit payment or ValuePlus;

"Marker Tariff (Category B)" means the category of Gas Payment Provisions described as Prompt payment by cash or cheque, quarterly direct debit payment or standing order payment;

"permitted tariff" means any Gas Payment Provisions which comply with the provisions of paragraph 2;

"Standby Tariff" means the category of Gas Payment Provisions described as the Schedule of Standby Charges for gas supplies not exceeding 73,200 kWh per annum (determined by the licensee under paragraph 8 of Schedule 2B to the Act);

"Target Tariff" means the category of Gas Payment Provisions in force immediately before 1 April 2001 described as late payment by cash or cheque (later than 10 days), payment with magnetic card, payment by Benefit Agency, monthly repayment or using a prepayment meter; and

"urgent request" means a request notice given to the Authority under paragraph 5 in relation to which the licensee demonstrates that its commercial interest would be seriously prejudiced if the proposed request contained within the request notice was not introduced quickly.

Permitted tariffs

- 2. Subject to paragraphs 4 and 5, the licensee shall ensure that -
 - (a) the terms on which it is prepared to enter into a contract for the supply of gas to domestic customers determined under Standard Condition 3(1)(a) of the Standard Conditions;
 - (b) the terms and conditions on which it supplies gas to domestic customers, other than last resort supply customers, determined in accordance with the scheme made under paragraph 8(8) of Schedule 2B to the Act; and
 - (c) the terms and conditions on which it supplies gas to domestic customers,

determined by, or in accordance with, the scheme made under paragraph 19(4) of Schedule 5 to the 1995 Act,

provide for payment of charges for gas supplied (other than the amounts to be charged) in accordance with –

- (i) the Marker Tariff (Category A),
- (ii) the Marker Tariff (Category B),
- (iii) the Target Tariff;
- (iv) the Advance Payment Tariff, or
- (v) the Standby Tariff.
- 3. Subject to paragraphs 4 and 5, the licensee shall ensure that such of the terms or terms and conditions referred to in paragraph 2 which applied immediately before 1st April 2001 apply after that day.

Introduction of new permitted tariffs, variation or abolition of the permitted tariffs

- The licensee may vary the Gas Payment Provisions of Prompt payment (as set out in the Marker Tariff (Category B)), to provide for the percentage discount on the Target Tariff to be reduced to 28.9%.
- The licensee may introduce a new permitted tariff, vary a permitted tariff (including a change to Table 1, or as the case may be, Table 2 in paragraph 7) or abolish a permitted tariff -
 - (a) to give effect to any change in the law affecting relations between the licensee and its domestic customers;
 - (b) for the sole purpose of withdrawing a new permitted tariff or disapplying a

variation or abolition to which paragraph 6 below applies; or

- (c) by sending a request notice to the Authority accompanied by -
 - (aa) a statement of the reasons (including, where the new permitted tariff, variation or abolition relates to the imposition, variation or abolition of an Additional Charge, a forecast of costs that would not be incurred by the licensee if the new permitted tariff, variation or abolition were made after deducting any additional costs that would be so incurred); and
 - (bb) in the case of an urgent request, sufficient information as will enable the Authority to consider the urgency of the matter,

and the request shall have effect if the Authority -

- (i) has consented to the request;
- (ii) in the case of an urgent request, has not objected to the request within 14 days of the receipt of the request notice by the Authority; or
- (iii) in the case of any other request, has not objected to the request within 2 months of the receipt of the request notice by the Authority.
- 6. Where a new permitted tariff, variation or abolition under paragraph 5 entitles the licensee to impose, vary or abolish an Additional Charge, the Authority may, after consulting the licensee and taking into account any representations made by it, not later than 3 months after the giving of the consent by the Authority to the licensee in respect of that new permitted tariff, variation or abolition under sub-paragraph (c)(i) of paragraph 5, direct that, so long as the new permitted tariff, variation or abolition has effect, paragraph 2 and the entry in Table 1 or, as the case may be, Table 2 in

paragraph 7 relating to any maximum charges differential for gas supplied shall be treated as varied in such a manner as the Authority may specify in the direction.

Maximum charges differentials

- 7. The licensee shall ensure that from 1 April 2001 -
 - (a) the maximum difference between the charges for gas supplied to any domestic customer on the Target Tariff and the charges for gas supplied to any domestic customer on any Marker Tariff (Category A) are as shown in Table 1.

TABLE 1 (p/kWh) FROM 1 APRIL 2001

	Marker Tariff (Category A)
for the first 1143 kWh per quarter in respect of a customer's consumption	0.556
for any consumption greater than 1143 kWh per quarter in respect of a customer	0.046

(b) the maximum difference between the charges for gas supplied to any domestic customer on the Target Tariff and the charges for gas supplied to any domestic customer on any Marker Tariff (Category B) are as shown in Table 2.

TABLE 2

(p/kWh)

FROM 1 APRIL 2001

	Marker Tariff (Category B)
for the first 1143 kWh per quarter in respect of a customer's consumption	0.719
for any consumption greater than 1143 kWh per quarter in respect of a customer	0.000

Disapplication of this condition

- 8. The licensee may, at any time after 1 January 2002 (and in any case no more often than once in any 4 month period), request by notice served on the Authority complying with paragraph 9 (in this condition, the "disapplication request") that the Authority provide for this condition to cease to have effect in this licence.
- 9. Any disapplication request pursuant to paragraph 8 shall -
 - (a) specify the date (in this condition, the "disapplication date") from which the licensee requests the Authority to agree this condition should cease to have effect (subject to paragraph 12, the date specified shall be no earlier than 1 April 2002 or 2 months after the date of service of the disapplication request); and
 - (b) provide a statement of the reasons for disapplying the condition and present evidence to support the disapplication.

- 10. A disapplication request shall cease to have effect if, within 2 months of the date of service of the notice, the Authority serves a notice on the licensee stating that the Authority is of the opinion that the disapplication request should not take effect together with the reasons for the rejection.
- 11. Within one month of the date on which a disapplication request is served, the Authority may serve a counter-notice (in this condition, the "information counter-notice") on the licensee specifying such further information as the Authority may reasonably require for the purposes of considering any aspect of the disapplication request.
- 12. The information counter-notice shall operate to increase the 2 month period referred to in paragraphs 9 and 10 by the number of days between the service of the information counter-notice and such time as the licensee provides all such information as requested to the Authority and either the Authority has confirmed in writing that such information is complete or a period of one month from the date on which the last such information was provided by the licensee to the Authority will have elapsed.

13. If the Authority -

- (a) agrees to the disapplication request; or
- (b) does not send a notice to the licensee pursuant to paragraph 10 within 2 months (or such extended period as provided for by paragraph 12),

this condition shall cease to have effect from the disapplication date or, in the case of (a), such later date as the Authority may direct.

14. The Authority may, at any time, direct the licensee that this condition shall cease to have effect in this licence from a date specified in that direction. "