

Gas and electricity licences - Changes to the Application Regulations and Revocation Schedules of future licences

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Target Audience: Gas and electricity licensees, potential new entrants, consumer groups and any other interested parties.

Overview:

We recently reviewed our licence application process in response to concerns that European energy markets could be targeted for large scale VAT fraud, and more generally to ensure that our processes remain fit for purpose and proportionate.

This document sets out our decision to introduce a risk-based, three tier licence application process which will expedite simpler applications while allowing us to carry out a more detailed review of some applications where this is appropriate. This will be given effect through changes to the Gas and Electricity Application Regulations. We are also changing the Revocation Schedules of future gas and electricity licences with immediate effect. These changes aim to align and reduce the time period after which a licence may be revoked for non-use to 1 year for all supply licences and gas shipper licences and 3 years for all other licences.

We also consider changes should be made to the industry codes and contracts to define gas trading as a separate activity from gas shipping to provide greater transparency to the status of industry parties and improve efficiency. We expect industry to progress these changes.

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Context

Under the Gas Act 1986 and the Electricity Act 1989 (together "the Acts") the Authority may grant licences to persons authorising them to undertake certain otherwise prohibited activities. The Authority makes regulations which set out the procedure through which those wishing to participate in the gas and electricity markets can obtain a licence¹. In response to concerns that European energy markets could be targeted for large scale VAT fraud, we recently undertook a review of our licence application processes and, more generally, the extent of licences that have been granted but are unused.

Following this review, on 17 June 2010² we consulted on:

- a number of changes to the current Gas and Electricity Application Regulations 2009³ (the "Application Regulations") and the current Guidance Document⁴ (the "Guidance Document") on licence applications to ensure that our processes remain fit for purpose and proportionate; and
- proposed changes to the Revocation Schedules of all future gas and electricity licences to proactively manage unused licences.

We also noted that unused licences appeared particularly prevalent amongst gas shipper licence holders and that in our view, this may be due to requirements in the Uniform Network Code and the various exchanges for trading only parties to still hold a gas shipper licence and sought views on whether this was appropriate and also the impact and consequences of changes to these arrangements.

Following this consultation we have decided to make a number of changes to the Application Regulations. The new Gas and Electricity Application Regulations 2010 (the "New Application Regulations")⁵ will come into force on 22 September 2010. The New Application Regulations are published as a supplementary appendix to this document. We have also published today an updated version of our Guidance Document (the "Updated Guidance Document").⁶

¹ S.7B of the Gas Act 1986 and S.6A of the Electricity Act 1989.

² Gas and electricity licences - Proposed changes to the Application Regulations and Revocation Schedules of future licences, 17 June 2010.

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=177&refer=Licensing/Work>

³ The Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations 2009 SI 3190

http://www.legislation.gov.uk/ukxi/2009/3190/pdfs/ukxi_20093190_en.pdf; and
The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2009 SI 3191

http://www.legislation.gov.uk/ukxi/2009/3191/pdfs/ukxi_20093191_en.pdf

⁴ Gas and electricity licence applications - Guidance, 17 December 2009

<http://www.ofgem.gov.uk/Licensing/Work/Documents1/Guidance%20Doc%202009.pdf>

⁵ See supplementary appendix 1 - New Application Regulations

⁶ See supplementary appendix 2 - Guidance for gas and electricity licence applications

Associated Documents

- Gas and electricity licences - Proposed changes to the Application Regulations and Revocation Schedules of future licences.
<http://www.ofgem.gov.uk/Licensing/Work/Documents1/App%20Regs%202010%20Consultation.pdf>
- Gas and electricity licence applications - Guidance, 3 September 2010
- See supplementary Appendix 2
- The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2010 SI 2154
http://www.legislation.gov.uk/uksi/2010/2154/pdfs/uksi_20102154_en.pdf
- The Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations 2010 SI 2155
http://www.legislation.gov.uk/uksi/2010/2155/pdfs/uksi_20102155_en.pdf

Table of Contents

Summary	1
1. Introduction	3
Review of licensing processes	3
Purpose and structure of this document	4
2. Decision on proposed changes to the Application Regulations and Guidance Document	5
Key changes to the Application Regulations and Guidance Document.....	5
Risk based tiered application process	5
Change in format and language throughout	6
Respondents' comments and our view	6
Ofgem decision	9
3. Decision on proposed changes to the Revocation Schedule of all future licences	11
Proposed changes to the Revocation Schedules	11
Respondents' views	11
Ofgem view.....	12
Ofgem decision	13
4. Gas shipper licences and changes to industry requirements - way forward	14
Key issues with respect to gas shipper licences.....	14
Respondents' views.....	15
Ofgem view and way forward	15
Appendices	17
Appendix 1 - Consultation Questions	18
List of Respondees	19
Summary of Responses	19
Appendix 2 – Detail on changes made to the Application Regulations	24
General improvements	24
Risk based, tiered application process	24
Additional amendments	26
Appendix 3 - Revocation Schedules of all future licences	28
Appendix 4 - The Authority's Powers and Duties	30
Appendix 5 - Feedback Questionnaire	32

Summary

We have decided to make a number of changes to our gas and electricity licensing processes following our recent review and consultation. We undertook a review in response to public statements raising concern over potential risk of VAT fraud in European energy markets and more generally to ensure that our processes remain fit for purpose and proportionate.

First, we are changing the Application Regulations to introduce a new risk-based, three tier licence application process. This will replace the current one size fits all approach. A revised set of guidance for applicants accompanies this change - the Updated Guidance Document. The New Application Regulations and Updated Guidance Document will come into force on 22 September 2010.

These changes are designed to:

- mitigate risk of potentially fraudulent licence applications by adopting a tiered application process based on risk profiling;
- make the process of applying for a licence much clearer and easier for applicants;
- facilitate us in more effectively carrying out checks to verify the information provided in support of a licence application; and
- place minimal additional administrative burden on applicants balanced against the need to ensure that, as far as possible, only applicants that intend to use the licence for the purpose of carrying out licensable activities are granted a licence.

Second, we are changing the Revocation Schedule of all future gas and electricity licences with immediate effect to better address the issue of unused and dormant licences. The Revocation Schedule⁷ details the circumstances under which a licence can be revoked. We do not consider it is appropriate for licensees to hold a licence that is not being used for its intended purpose. These changes will enable us to more proactively manage unused licences. In particular, all future gas and electricity supply licences⁸ and gas shipper licences may be revoked if unused for 1 year. All other gas and electricity licences will be rationalised to allow for revocation after 3 years if they are unused.

Finally, we consider that there is merit in making changes to industry contracts to differentiate between those parties who intend to trade gas as a commodity and those intending to physically ship gas. Currently the Uniform Network Code (UNC) and a number of trading exchanges require parties, who only intend to trade gas, to hold a gas shipper licence. We consider further action to remove this requirement from the UNC and clearly define gas trading as a separate activity from gas shipping would provide greater transparency to the status of industry parties.

We also do not want parties erroneously relying on a licence in place of industry pre-contractual checks as a form of due diligence. In issuing a licence, we do not give

⁷ Schedule 2 of gas and electricity licences

⁸ The Revocation Schedules for supply licences have also been amended to remove the time period after which a licence may be revoked following cessation of licensable activities.

any guarantee, warranty or endorsement of any application (or related person), their financial status, or business methods. In this regard, there are no checks we could carry out at the application stage that could offer ongoing comfort to other industry participants. In a similar way, network operators should ensure that the contracts they enter into are fit for purpose for the activity and their credit arrangements are in line with the best practice guidelines.

While we recognise that implementing a change to the UNC to differentiate between parties intending to trade gas and those intending to physically ship will require considerable work, we consider the change to be proportionate and we welcome National Grid's commitment to raise a UNC Review on this issue later this year.

1. Introduction

Review of licensing processes

1.1. From time to time we review the licence application regulations and guidance to ensure that they are still fit for purpose and proportionate. We recently undertook a comprehensive review of our existing licensing processes to ensure that the Application Regulations and other parts of the licensing framework are effective against the threat of potentially fraudulent applications and also in light of feedback over their ease of use.

1.2. As part of this review we instructed an independent review of our current licence application process. A key recommendation of the independent review was to adopt a tiered application process based on risk profiling. We consider that this will facilitate the expedient processing of bona fide and complete and accurate applications, while filtering out for greater scrutiny any applications which contain unexplained omissions, discrepancies or misstatements of fact or demonstrate no clear intention to use the licence for its purpose within a reasonable period of time.

1.3. At the same time, we identified a number of improvements to make the process of applying for a licence clearer and easier for applicants. These changes have mainly been driven by feedback from users on the ease of use of the Application Regulations.

1.4. We also reviewed the status of existing licensees to assess the extent of licences which are granted but unused and proposed changes to the Application Regulations and the licence revocation schedules to address this issue.

1.5. On 17 June⁹ we published a consultation setting out our proposals to revise our licence application process and introduce these changes by amending the Application Regulations. The June consultation closed on 29 July 2010 and 5 responses were received.

1.6. Finally, our June Consultation also sought views on why unused licences appear to be particularly prevalent amongst gas shippers and invited views as to whether it was appropriate and proportionate to remove existing industry requirements for parties intending to carry out non-physical trades to hold a gas shipper licence.

⁹ Gas and electricity licences - Proposed changes to the Application Regulations and Revocation Schedules of future licences.
<http://www.ofgem.gov.uk/Licensing/Work/Documents1/App%20Regs%202010%20Consultation.pdf>

Purpose and structure of this document

1.7. Following consideration of responses to our June Consultation, this document sets out our decision on our proposed changes to the:

- Application Regulations and Guidance Document; and
- Revocation Schedules of all future licences.

1.8. This document also sets out a way forward to address the particular issue of unused gas shipper licences.

1.9. Our decisions are set out in the following chapters:

- Chapter 2: Decision on proposed changes to the Application Regulations and Guidance Document;
- Chapter 3: Decision on proposed changes to the Revocation Schedules;
- Chapter 4: Gas shipper licences and changes to industry requirements;
- Appendix 1: Consultation questions and summary of responses;
- Appendix 2: Detail on changes made to Application Regulations;
- Appendix 3: Revised Revocation Schedules for all future licences.

1.10. We have also published the following Supplementary Appendix documents today:

- Supplementary Appendix 1 - New Application Regulations; and
- Supplementary Appendix 2 - Updated Guidance Document

2. Decision on proposed changes to the Application Regulations and Guidance Document

→ This chapter sets out respondents views to our proposed changes to the Application Regulations and Guidance Document and our decision on these proposed changes following consideration of views received.

Key changes to the Application Regulations and Guidance Document

2.1. We consider that changes are required to the Application Regulations to ensure that they remain fit for purpose and proportionate. We propose a shift from the current 'one size fits all application process' to a new risk based, tiered application process.

2.2. The Application Regulations set out the manner and form in which applications for licences (or extensions or restrictions of licences)¹⁰ should be made and the fee payable for each type of application. In addition, they specify the information that applicants must provide in order for us to consider an application.

Risk based tiered application process

2.3. The proposed tiered, risk based process consists of the following three tiers for the provision of information and documents in support of a licence application:

- Tier 1 - Information to be provided by all applicants;
- Tier 2 - Additional information and evidence to be provided on request by Ofgem;
- Tier 3 - Review of original identification documents and interview with Ofgem.

2.4. The key purpose of the proposed tiered application process is to bring our application procedures more in line with processes used in other sectors whereby greater scrutiny is applied and additional information requested, only where deemed necessary, rather than in all cases.

2.5. All applicants will start the application process in tier 1 and as such will be required to submit all the information and documents specified in section 1 of the proposed new licence application forms.

¹⁰ The Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations 2009 SI No. 3190 http://www.legislation.gov.uk/uksi/2009/3190/pdfs/uksi_20093190_en.pdf and The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2009 SI No. 3191 http://www.legislation.gov.uk/uksi/2009/3191/pdfs/uksi_20093191_en.pdf

2.6. We will conduct a number of checks with the relevant company registry and other sources as part of our procedures for assessing a licence application. The results of such checks inform our assessment of risk for each licence application.

2.7. All licence applications will be scored against the risk assessment criteria published in our Updated Guidance Document. We will conduct an initial risk assessment on receipt of application and build on this risk assessment throughout the application process. Applicants that accumulate an overall risk assessment score equal to or greater than the thresholds stated in our Updated Guidance Document may be moved to the next tier.

2.8. Applicants that are moved to tier 2 will be required to submit the additional information and documents on request by Ofgem. Applicants that are moved to tier 3 may be required to produce original identification documents and attend an interview with us. Tier 3 applicants may also be asked to bring their original company documentation (such as company records) with them.

Change in format and language throughout

2.9. In response to feedback from past licence applicants we also propose to make some changes in order to make completing an application more user-friendly.

2.10. We proposed substantive changes to the format so that it resembles more a conventional application form and set out our plans to include a new summary guidance section and, wherever possible, change the language with a greater use of plain English.

2.11. We also proposed corresponding changes to the Guidance Document.

Respondents' comments and our view

2.12. Respondents broadly supported our proposed changes to the Application Regulations and Guidance Document. All respondents supported our proposed shift from a 'one size fits all' application process to a tiered application process, based on risk profiling. They were also supportive of our improvements to format and language.

2.13. We welcome respondents' broad support of our proposed changes to the Application Regulations and Guidance Document. We set out below our views on the key issues raised by respondents. A summary of the responses received is provided in Appendix 1.

2.14. One respondent disagreed with our proposed requirement for applicants to provide details of 'all' revoked licences. The respondent believes that in the interests of efficiency and avoiding unduly onerous reporting requirements that this

requirement should be amended to only requiring applicants to provide details of licences which have been revoked without the applicants' consent.

2.15. While in general we do not consider this requirement to be unduly onerous, we acknowledge that it may be burdensome on applicants that are (or are related to) long established market participants. Such participants may have held or acquired a number of licences over the years which were been revoked over the years as and when they became surplus to requirements. We have therefore amended this requirement so as to only require applicants to provide details of licences revoked in the last 3 years, from the date the application is made.

2.16. One respondent suggested an enhancement to the proposed tier 2 requirement for applicants to provide copies of documents confirming the applicant's key details. This respondent suggested that applicants should be required to provide certified copies of such documents

2.17. We agree that this requirement should be further enhanced by requiring such documents to be certified. This will ensure that all key documents that we will rely on in assessing an applicant will be certified. This also reflects the higher risk profiling of tier 2 applicants. We have amended the New Application Regulations accordingly.

2.18. Only 1 of the 5 respondents suggested additional questions be included in the proposed New Application Regulations. This respondent suggests that we include additional fitness/propriety measures such as a requirement for applicants to provide details of any investigations into alleged misconduct or malpractice by the applicants directors.

2.19. However, in deciding whether or not to grant a licence, we do not generally consider it appropriate to take into account allegations that are, at the time of licence application, unproven and on which no formal decision has been made by the courts or other relevant body.

2.20. One respondent commented on the refusals and appeals process which sets out the process we will follow following a decision not to grant a licence and currently contained within the Guidance Document. The respondent suggests that, given the importance of the refusals and appeals procedure, the process should be placed within the New Application Regulations themselves rather than solely in accompanying guidance.

2.21. We do not consider there to be any additional benefit in placing the refusals and appeals procedure in the Application Regulations, either in terms of greater applicability of the refusal and appeals process or in terms of increased transparency.

2.22. The respondent further suggests that consideration should be given to putting in place arrangements whereby any appeal following a licence refusal is considered by an independent person/body rather than the Authority. However in our view, the

changes that we propose to make are not intended to materially affect the likelihood of refusal and we do not therefore consider that such a change is warranted. We consider that the existing appeal process involving the Authority to be appropriate and note that a route of appeal via judicial review against a decision of the Authority also exists.

2.23. Another respondent expressed general concern that some of the proposed additional requirements at tier 2 may be unduly onerous, particularly for new entrants and smaller participants. The respondent suggests that consideration be given to moving some of the proposed tier 2 questions into tier 3 in order to improve proportionality of the overall process. However, given that there are only four additional questions at tier 2 and two additional requirements at tier 3, we consider our existing proposal to be broadly proportionate and that there is limited benefit to be gained from moving some of the tier 2 questions to tier 3 given the number and nature of the questions.

2.24. Our proposed tier 2 requirements include a requirement for applicants to:

- provide copies of any official documents held by the applicant that verifies 'key details' provided in the licence application; and
- provide details of any actions that may have been taken with respect to any licence or authorisation etc granted by another relevant regulatory body.

2.25. One respondent suggested consideration be given to providing further information in support of the above requirements. In particular, providing further clarity for applicants on which 'key details' may require supporting evidence; and listing the 'relevant' regulatory bodies referred to in the tier 2 question seeking details of any censure by another regulatory body.

2.26. We have considered the above suggestions, in our view:

- we consider our proposed guidance already provides sufficient clarity (including examples) on which 'key details' tier 2 applicants may be asked to provide supporting evidence for; and
- as we have stated in our guidance, actions by some regulatory bodies are likely to be considered more relevant than others. For example, any action taken by the relevant regulatory body for energy in another European jurisdiction is highly likely to be considered relevant to our decision on granting a licence. We will consider both the regulatory body taking the action and the nature of the action being taken to assess whether it is relevant to our decision on licence grant. We do not therefore consider it feasible to provide a comprehensive list of all regulatory bodies that may be relevant.

2.27. Lastly one respondent expressed specific concerns about the proposed requirement for applicants to provide details of the arrangements they propose to commence the relevant licensable activity. This respondent raised concerns about

the potential impact of this requirement on its business, which is to facilitate market entry by selling pre licensed and pre industry accredited companies to third parties.

2.28. The respondent stated that they would be the applicant for the licence but not the eventual user of the licence, i.e. the eventual purchaser of the pre licensed company would be the party that actually uses the licence. The requirement to provide details of arrangements to commence the relevant licensable activity may result in applications submitted by the respondent being moved to tier 2 or tier 3 as a matter of course as it may not be able to provide, at the licence application stage, sufficient details of the eventual purchaser's proposed arrangements for commencing licensable activities.

2.29. The proposed requirement in the application process to provide details of arrangements to commence the relevant licensable activity is intended to assist us in identifying those applicants that have little, if any, intention to use the licence for its purpose. The process is not designed to restrict or limit market entry or restrict parties involved in supporting market entry but it is our intention to limit speculative licence applications. We consider that the arrangements proposed provide us with the ability to achieve this aim.

Ofgem decision

2.30. We have considered the proposed amendments suggested by respondents and have concluded that only the following amendments are appropriate, we will ;

- amend the requirement for applicants to provide details of 'all' revoked licences to only requiring applicants to provide details of licences revoked in the last 3 years (from the time of application); and
- enhance the proposed requirement for tier 2 applicants to provide copies of official documents that confirms key application details by requiring that those documents be certified.

2.31. In addition, we have identified the need to make the following minor amendments to the Application Regulations for greater clarity and ease of reference, we will:

- insert a definition for the existing reference to the Point of Single Contact (PSC) website; and
- align the text of the Application Regulations with that of the relevant gas and electricity interconnector standard licence conditions¹¹ with respect to the requirement for interconnector applicants to provide¹² a statement confirming that the interconnector will be owned by a natural or legal person.

¹¹ Standard condition 12 of the gas and electricity interconnector licences

¹² Where an exemption from standard condition 10 and 11 (gas interconnector) or standard condition 9,10 and 11 (electricity interconnector) is sought by the applicant

2.32. On 31 August 2010, the Authority made the proposed amendments to the current Application Regulations in the form of new Statutory Instruments. These New Application Regulations¹³ shall come into force on 22 September 2010.

2.33. The Office of Public Sector Information (OPSI) will shortly be publishing the New Application Regulations (expected to be on 3 September 2010). The New Application Regulations repeal and replace the current Application Regulations.

2.34. We have today also published an Updated Guidance Document which accompanies the New Application Regulations¹⁴.

2.35. The changes to the Application Regulations are set out in more detail in Appendix 2. A copy of the New Application Regulations can be found in Supplementary Appendix 1.

¹³ The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2010 SI 2154
http://www.legislation.gov.uk/uksi/2010/2154/pdfs/uksi_20102154_en.pdf
and The Gas (Applications for Licences and Extensions and Restrictions of Licences) Regulations 2010 SI 2155.
http://www.legislation.gov.uk/uksi/2010/2155/pdfs/uksi_20102155_en.pdf

¹⁴ See Supplementary Appendix 2

3. Decision on proposed changes to the Revocation Schedule of all future licences

→ This chapter sets out respondents' views to our proposed changes to the Revocation Schedule of all future licence and our decision on these proposed changes following consideration of views received.

Proposed changes to the Revocation Schedules

3.1. The Revocation Schedule¹⁵ of a licence sets out the circumstances that may result in its revocation. As part of our review of the licensing process we also considered the arrangements in place to revoke licences and proposed changes to the Revocation Schedule in our June Consultation.

3.2. To more effectively address the issue of unused licences in the future, reduce the risk of fraud and in line with our better regulation duties, we proposed to change the Revocation Schedule provisions relating to the time period for revocation where the licensee has ceased or has not commenced licensable activity within the specified time¹⁶ for all future licences.

3.3. We proposed to amend these specific provisions with a view to aligning the provisions across all licence types for gas and electricity (for future licences) as follows:

- from the current 3 years in gas licences and 5 years in electricity licences to 1 year for all licence types in respect of non-commencement of the relevant licensable activity; and
- remove the time limit for revocation in supply licences in instances where the licensee has ceased the relevant licensable activity¹⁷. This is already standard in most licences and will bring supply licences into line in this regard.

Respondents' views

3.4. Respondents supported the proposed intention to rationalise and reduce time periods before revocation of a licence. However there were a number of concerns that 1 year may be too short for some types of licences. One respondent considered that our proposed changes to the Revocation Schedules may hinder a licensee's financial and development plans. The respondent cited a generation licence as an example of a type of licence which might be required well in advance of when

¹⁵ Schedule 2 of gas and electricity licences

¹⁶ Paragraph 1(e) of Schedule 2 of gas and electricity licences

¹⁷ Currently a gas or electricity supply licence may be revoked where the licensee has ceased to supply for a period of 3 years or 5 years respectively. We proposed to remove these time limits to bring supply licences into line with other licence types.

licensable activities will commence. This is because, amongst other things, the licence confers compulsory purchase powers which might be necessary to progress the development.

3.5. A number of other respondents expressed very similar concerns with regard to licensees with physical assets and further that there may be legitimate reasons why a licensee with physical assets has 'temporarily' ceased licensable activities for a prolonged period. For example to carry out maintenance/replacement of plant or during periods of excess available capacity.

3.6. One respondent suggested the time limit for those licensees with physical assets should be at least 3 years rather than the proposed one year.

3.7. One respondent noted that, as a matter of procedure, we should contact a licensee prior to making any decision on whether to revoke a licence for non use to allow the licensee to make representation as to why the licence should not be revoked. The respondent suggests consideration be given to formalising this procedural step by introducing a mechanism to formally extend the proposed 1 year revocation period where the licensee, following contact by Ofgem, has provided good reasons for non-use.

Ofgem view

3.8. We consider it important to reiterate that the revocation of a licence is a discretionary power. We will not automatically revoke a licence in instances where the proposed new revocation provisions are met and where no other grounds for revocation exist. In such instances, we will always provide a licensee with an opportunity to make representations as to why its licence should not be revoked and fully consider any representations that are made before making any final decision on whether to revoke the licence.

3.9. We consider that our existing procedures in this regard provide an adequate safeguard against a licence being revoked where the relevant activity has not commenced for legitimate reasons. We do not consider that any further procedure is required.

3.10. Despite this being a discretionary power to revoke licences, we acknowledge and see merit in respondent views that the proposed 1 year revocation period may be too short for licences held by licensees that have relevant physical assets. We agree that in such instances a longer period before revocation is appropriate.

3.11. However, we still consider it appropriate for the time period for revocation of licences held by licensees with no relevant physical assets to be aligned and shortened to 1 year as proposed.

Ofgem decision

3.12. The Revocation Schedules of all future licences will be amended as follows;

- for gas shipper, gas and electricity supply licences - the revocation period for non-commencement of the relevant licensable activity will be reduced to 1 year; and
- for all other licence types - the revocation period for non-commencement of the relevant licensable activity will be reduced to 3 years;
- for supply licences - the time limits for revocation in instances where the licensee has ceased the relevant licensable activity will be removed. This will bring supply licences into line with other licence types.

3.13. Appendix 3 illustrates the changes to be made to the Revocation Schedules.

3.14. These revised Revocation Schedules come into force with immediate effect and all future licences, from the date of publication of this decision document, will be issued with the revised Revocation Schedules.

4. Gas shipper licences and changes to industry requirements - way forward

Key issues with respect to gas shipper licences

4.1. A gas shipper licence authorises the licensee to arrange with a Gas Transporter (GT) for gas to be introduced into, conveyed through, or taken out of a pipeline system operated by that GT, either generally or for purposes connected with the supply of gas to premises¹⁸.

4.2. In order to be able to carry out gas shipping activities a licence holder, in addition to holding a licence, needs to be party to the Uniform Network Code (UNC)¹⁹ and have successfully set up an account on xoserve systems²⁰.

4.3. In our June consultation we referred to information provided by xoserve which indicated that as many as 45% of gas shipper licences²¹ were not being used actively. The information provided also indicated that a further 35% of gas shipper licensees were using xoserve's systems solely for the purposes of trading. It may therefore be that only a minority of gas shipper licensees are actually using the licence for the purpose set out, namely to ship gas across the GB transportation network.

4.4. We noted that one reason for the apparent surplus gas shippers licences may be the prerequisite being set by trading platforms/exchanges and xoserve to hold a gas shipper licence before parties are able to access the Gemini system²² and trade.

4.5. We further noted that this market entry requirement stems from the current wording of the UNC. The code governs transportation arrangements and access to systems run on behalf of the gas transporters by xoserve. At present, the code makes no distinction between physical shippers and non-physical traders. This is different from the situation in the electricity market where non-physical traders are unlicensed but still able to access and use systems alongside licensed parties.

4.6. We concluded that the UNC and, consequently, other market arrangements could, in principle, distinguish fully between those parties who intend to carry out physical and non-physical trades. This could extend to appropriate market entry requirements and arrangements to deal with any out of balance trades, to the extent they would not already be adequately covered in inter-party agreements. This will also offer more clarity on the nature of entities market participants are contracting

¹⁸ As defined under s5(1)(c) of the Gas Act 1986

¹⁹ As required by standard Special Condition A11 of the gas transporter licence

²⁰ xoserve manages the commercial interfaces between the major gas transporters operating in Great Britain and Gas Shippers

²¹ As at 14 April 2010

²² Gemini is used by both gas shippers and the Transporters to manage Energy Balancing, Entry and Exit Regimes of the gas transportation system

with, facilitate more appropriate and targeted risk management and, in our view, result in better regulation and administration.

4.7. We sought views on the reasons behind the existence of licences not being used for the purpose they were granted, the extent to which the current arrangements do impose barriers to market entrants and whether modifications to UNC and other agreements are proportionate and an effective remedy to these issues.

4.8. We also sought views as to whether respondents agreed that parties should not be required to hold a gas shipper licence prior to being able to carry out non-physical gas trades.

Respondents' views

4.9. The majority of respondents agreed that it was not appropriate to require parties to obtain a gas shipper licence prior to being able to carry out activities which do not require a licence from the Authority. Respondents also generally agreed with our view that the large number of shipper licences not being used for their intended purpose was likely due to UNC requirements and pre-requisites set by trading platforms and exchanges.

4.10. Respondents also broadly considered further action in the form of modifications to the UNC to remove the requirement for non-physical traders to have to hold a shipper licence to be necessary and proportionate.

4.11. However, we note that the majority of respondents also stated that the work required to make modifications to the UNC is likely to be extensive and time consuming with one respondent suggesting that the work could take up to 1 year to complete. Another respondent stated that any proposal to remove the requirement for gas traders to hold a shipper licence should be subject to a full impact assessment.

4.12. One respondent suggested that we consider our proposals in the wider context of potential European developments; such as potential movement towards central clearing instead of bilateral contracts and development of proposals to implement a reverse charge tax procedure for power and natural gas trading to mitigate against VAT fraud.

Ofgem view and way forward

4.13. We welcome the general consensus amongst respondents that further action to remove the UNC requirement for gas traders to have gas shipper licences is considered to be both necessary and appropriate. However, we also note that implementing such a change to the UNC may be a material and lengthy process.

4.14. We therefore consider that prior to any formal modification proposal(s) being raised, it would be appropriate to first conduct a thorough review of the existing UNC provisions, assessing the implications of removing the existing requirements and/or introducing a new UNC user category in the form of a non-physical participant. Such a review would provide an opportunity to consider alternative, potentially more proportionate remedies to this issue, together with the appropriate timescales over which to effect such a change. This approach will also enable any developments across Europe to be considered, to the extent they are relevant, in more detail.

4.15. Under existing UNC Modification Rules, Ofgem is unable to raise such a UNC Review²³ itself and we consider that this matter should appropriately be taken forward by National Grid, working with other relevant industry parties. We therefore welcome National Grid's commitment to raise a UNC Review on this issue later this year.

4.16. We look forward to the conclusions of the UNC Review and, to the extent they remain the most appropriate and proportionate means of addressing this issue, any subsequent modification proposals to remove any unnecessary barriers to legitimate market participation.

²³ As provided for in paragraph 11 of the UNC Modification Rules.

Appendices

Index

Appendix	Name of Appendix	Page Number
1	Consultation Questions and summary responses	18
2	Detail of changes made to the Application Regulations	24
3	Revised Licence Revocation Schedules	28
4	The Authority's Powers and Duties	30

We have also published the following supplementary Appendix documents today:

- Supplementary Appendix 1 - The New Application Regulations; and
- Supplementary Appendix 2 - Updated Guidance Document.

Appendix 1 - Consultation Questions

1.1. In our consultation document, Gas and electricity licences - Proposed changes to the Application Regulations and Revocation Schedules of future licences (Ref: 74/10), We sought the views of respondents about a number of questions as set out below:

CHAPTER: Two

Question 1: Do you agree with the proposed changes to the Application Regulations and the Guidance Document?

Question 2: Are there any additional questions which you consider could be included in the New Application Regulations?

Question 3: Do you have any additional comments on the content and format of the Updated Guidance Document?

Question 4: Do you have any views on the proposed introduction of a tiered application process, based on risk profiling?

CHAPTER: Three

Question 1: Do you have any views as to why such a high number of gas shipper licences are not being used for their intended purpose?

Question 2: Do you think further action is necessary or proportionate given the issues raised in the chapter in relation to gas shipper licences?

Question 3: Do you agree that parties should not be required to obtain a gas shipper licence prior to being able to carry out non-physical trades of gas?

CHAPTER: Four

Question 1: Do you agree with our proposed changes to the Revocation Schedule of future licences? In particular:

Question 2: Do you agree we should align the Revocation Schedule between the gas and electricity sectors?

Question 3: Do you agree that we should reduce the time period to 1 year before a licence can be revoked in cases where parties have not commenced the licensable activity?

List of Respondees

List	Name
1	Centrica Plc
2	EDF Energy
3	National Grid
4	Scottish and Southern Energy Plc
5	Utiligroup Limited

Summary of Responses

Responses received by Ofgem have been published on Ofgem's website www.ofgem.gov.uk. Copies of non-confidential responses are also available from Ofgem's library.

The following is a summary of those responses which were received together with our views.

Question	Respondents views	Ofgem view
Do you agree with the proposed changes to the Application Regulations and Guidance Document?	<ul style="list-style-type: none"> ▪ All respondents broadly supported the proposed changes. ▪ One respondent disagreed with proposed requirements for applicants to provide details of all revoked licences - suggests that it's limited to having to provide details of licences revoked without the applicants consent. ▪ One respondent expressed concern about impact of proposed requirement for applicants to provide details of arrangements for commencing the relevant licensable activity. Specifically, in 	<ul style="list-style-type: none"> ▪ Welcome respondents broad support. ▪ We have amended to require details of all licences revoked in the last 3 years. ▪ Requirements intended to assist us in identifying those applicants that have little if any intention to use the licence for purpose. We consider that it's actually in the respondent's interests for the licence to be acquired and used for its purpose as soon as possible given its investment in securing the licence and market accreditation.

	<p>instances where the licence was being applied for well in advance with the intention of selling the licensed entity at a later date.</p>	
<p>Are there any additional questions which you consider could be included in the New Application Regulations?</p>	<ul style="list-style-type: none"> ▪ One respondent suggested consideration be given to additional fitness/propriety measures such as a requirement for directors to provide details of any investigations of alleged malpractice/misconduct. ▪ The same respondent suggested amending the proposed requirement for applicants to provide copy documents confirming key application details at tier 2 by requiring that such documents be certified true copies. 	<ul style="list-style-type: none"> ▪ We do not generally consider it appropriate to take into account allegations that are, at the time of licence application, unproven and on which no formal decision has been made by the courts or other relevant body. ▪ We agree and have amended the proposed New Application Regulations accordingly.
<p>Do you have any additional comments on the content and format of the Updated Guidance Document?</p>	<ul style="list-style-type: none"> ▪ One respondent stated that the refusal and appeals process should be placed in New Application Regulations themselves rather than in Guidance Document as is currently the case. ▪ The same respondent states that consideration should be given to any appeal following a licence refusal being considered by independent person/body rather than the Authority. ▪ One respondent suggested that the proposed application form should be automated to ensure no relevant fields are missed by applicants 	<ul style="list-style-type: none"> ▪ We do not consider there to be any additional benefit in doing so, either in terms of greater applicability of the refusal and appeals process or in terms of increased transparency. ▪ The changes that we propose to make are not intended to materially affect the likelihood of refusal and therefore we do not consider that such a change is warranted. ▪ Automated version of proposed application forms will be available via the Point of Single Contact website in due course. Do not consider provision of generic templates appropriate given the anticipated applicant specific nature of responses to tier 2 questions.

	and that we provide templates for applicants to complete in answer to certain tier 2 questions.	
Do you have any views on the proposed introduction of a tiered application process, based on risk profiling?	<ul style="list-style-type: none"> ▪ All respondents broadly supported the proposed changes. ▪ One respondent sought clarification as to whether a third party who buys an existing licensee would be subjected to principles of risk profiling and more information on scope and scale of fraudulent activity. ▪ One respondent stressed that applicants should be informed ASAP if their application is to be moved to tier 2/3. Also, asks for further clarity to be provided in the Guidance Document as to what frequent company changes may attract a higher risk rating as there may be legitimate reasons for frequent changes. 	<ul style="list-style-type: none"> ▪ We welcome broad support for introduction of tiered application process. ▪ Out of scope - the proposed changes relate to new licence applicants and not to changes in company structure/ownership of existing licensees. ▪ We will inform applicant as soon as reasonably practical of any decision to move their application to tier 2/3. ▪ We recognise that there may be legitimate reasons for company changes. Any frequent company changes will not be considered in isolation but as part of the overall assessment of the application.
Do you have any views as to why such a high number of gas shipper licences are not being used for their intended purpose?	<ul style="list-style-type: none"> ▪ Respondents broadly agreed with our view that this may be linked to existing UNC and trading platform/exchanges requirements for parties only wishing to trade gas to hold a gas shipper licence. 	<ul style="list-style-type: none"> ▪ We note respondents generally agreed with our view that this may be linked to existing UNC and trading platform / exchanges requirements.
Do you think further action is necessary or proportionate given the issues raised in the chapter in relation to gas shipper licences?	<ul style="list-style-type: none"> ▪ All respondents generally considered it appropriate and proportionate to make changes to the UNC so that parties intending to only trade gas are not required to have a gas 	<ul style="list-style-type: none"> ▪ We welcome the general consensus amongst respondents that changes to the UNC are appropriate and proportionate. ▪ We consider a review group to

	<p>shipper licence.</p> <ul style="list-style-type: none"> ▪ Three respondents stressed that required changes to UNC likely to a significant and time intensive exercise. ▪ One respondent stated that the proposals need to be considered in the context of potential developments in Europe. ▪ One respondent considers any proposal changes should be subject to a full impact assessment. 	<p>discuss what changes would be required to the UNC to be the next step and expect a review group to be raised in Autumn 2010.</p> <ul style="list-style-type: none"> ▪ Any developments across Europe and the extent to which they are relevant can be considered in more detail as part of the review group process.
Do you agree that parties should not be required to obtain a gas shipper licence prior to being able to carry out non-physical trades of gas?	<ul style="list-style-type: none"> ▪ Respondents generally agreed that a shipper licence should not be required for carrying out non-physical gas trades. ▪ One respondent stated that it had no particular objection to a shipper licence being required. 	<ul style="list-style-type: none"> ▪ We note that respondents generally agreed that a licence should not be required if not carrying out the licensable activity of physical gas shipping.
Do you agree we should align the Revocation Schedule between the gas and electricity sectors?	<ul style="list-style-type: none"> ▪ No respondent objected to proposed alignment of the Revocation Schedule between the gas and electricity sectors. ▪ A number of respondents expressed concerns that the proposed 1 year time period may be inappropriate for licensees with physical assets given the need to secure amongst other things planning permission, financing and compulsory purchase powers conferred by the licence etc. 	<ul style="list-style-type: none"> ▪ We note that whilst no respondent objected to the alignment of the Revocation Schedules a number expressed concerns that the proposed timescale of 1 year may too short for licensees with physical assets. ▪ We acknowledge and see merit in respondents' views that the proposed 1 year revocation period may be too short for licences held by licensees that have physical assets.
Do you agree that we should reduce the time	<ul style="list-style-type: none"> ▪ One respondent disagreed on the basis 	<ul style="list-style-type: none"> ▪ We agree that a longer period before revocation is

period to 1 year before a licence can be revoked in cases where parties have not commenced the licensable activity?

that 1 year is not appropriate for licensees with assets. A number of respondents raised similar concerns.

appropriate for licensees with physical assets and have amended the time period to 3 years is for such licences.

- One respondent suggested that it should be at least 3 years for such licences.
- One respondent suggested we formally extend by one year where applicant provides good reasons for doing so.

- We have amended the Revocations Schedules as set out in Appendix 3.
- There is no mechanism to formally extend the revocation terms.

Appendix 2 – Detail on changes made to the Application Regulations

1.1. We have set out below in more detail the changes made to the Application Regulations and which are reflected in the New Application Regulations.

General improvements

- substantive changes to the format of Schedules 1 and 2 of the Application Regulations to turn the questions into an application form as a Schedule to the New Application Regulations; and
- amended the language of the questions throughout the proposed application forms to make it clearer and easier to understand.

Risk based, tiered application process

Tier 1

Additional information concerning an applicant's current directors and major shareholders or persons in effective control of the applicant

1.2. Inserted a new requirement to provide the following additional information about all of the applicants' current directors, major shareholder(s) (where it is an individual) or person(s) in effective control:

- Date of birth;
- Date of current appointment as director/shareholding effective date; and
- Previous home address (if less than 3 years at current address).

Names of directors of parent undertaking²⁴

1.3. Inserted a requirement for applicants to provide the names of directors of any parent undertaking for consistency and also to allow us to conduct the same checks on the directors of the parent undertaking, that we currently carry out for the directors of the ultimate holding company.

VAT registration number and certified copy of VAT registration certificate

1.4. Inserted a requirement for applicants to provide their VAT registration number together with a certified copy of their VAT registration certificate²⁵.

²⁴ Within the meaning of section 1162 of the Companies Act 2006

²⁵ Where an applicant is registered for VAT purposes

Details of trading names (if any) and company registration number of any parent undertaking or ultimate holding company

1.5. Inserted a requirement for applicants to provide details of any trading name to allow for more thorough searches/checks to be carried out.

1.6. Inserted a requirement to provide the company registration number of any parent undertaking or ultimate holding company to facilitate our checks to verify the information provided.

Name of the commercial register in which the applicant is registered in its country of incorporation and certified copy of its certificate of incorporation

1.7. Extended existing requirements by requiring the name of the relevant company register to be specified and Certificate to Incorporation provided to be certified.

1.8. Requirement to provide details of proposed arrangements (including indicative timetable) to commence the relevant licensable activity

1.9. Inserted a requirement for applicants to provide details of proposed arrangements to commence the relevant licensable activity to gauge an applicant's readiness to commence licensable activities and intent to use the licence for the purpose stated in the application.

Details of previously refused licence applications or revoked licences

1.10. Inserted requirement for applicants to provide details of any:

- licences previously held by the applicant or a related person (under the Acts) that have been revoked in the last 3 years; and
- licence applications previously made by the applicant or a related person (under the Acts) which were refused.

Tier 2Certified copies of any official documents held by the applicant that verifies key details provided in licence application

1.11. Inserted a requirement for applicants moved to tier 2 to provide certified copies of any official documents held by the applicant that verifies key details provided in the licence application.

Copy correspondence confirming applicant's contact with relevant industry parties and details of the applicant's bank, solicitors and auditors

1.12. Inserted a requirement for tier 2 applicants to provide:

- copy correspondence confirming their contact with relevant industry code owners/administrators and, where appropriate, the electricity distribution and transmission and gas transportation and distribution system operators; and,
- details of their bank, solicitors and auditors.

Details of any actions taken by any other relevant regulatory in respect of any licence or authorisation etc issued

1.13. Inserted a requirement seeking confirmation as to whether an applicant, any partner, trustee or director (including shadow directors within the meaning of section 251 of the Companies Act 2006) has ever been refused, had restricted, terminated or revoked, any licence, authorisation, registration, notification, membership or other permission granted by any other regulatory body.

Tier 3

Provide original identification documents and attend interview

1.14. Inserted a requirement for tier 3 applicants to:

- Provide original identification documents (or produce at interview); and
- attend an interview with Ofgem.

Additional amendments

1.15. We have considered the proposed additional amendments suggested by respondents and have decided to make the following changes:

- in relation to tier 1, amend requirement for applicants to provide details of 'all' revoked licences previously granted under the Acts to only requiring applicants to provide details of licences revoked in the last 3 years (from the time of application); and
- in relation to tier 2, enhancing the proposed requirement to provide copies of official documents that confirm key application details by requiring that those documents be certified.

1.16. In addition, we have made the following minor amendments for clarity:

- inserted a definition for the Point of Single Contact (PSC) website in the New Application Regulations;

- aligned the text of the existing requirement for applicants to provide a statement confirming that the interconnector will be owned by a natural or legal person with the text given in the relevant gas and electricity interconnector standard licence conditions in the New Application Regulations; and
- minor simplifications/clarifications to format and language of the application form and summary guidance in the New Application Regulations.

Appendix 3 - Revocation Schedules of all future licences

We have set out below the relevant revised paragraphs²⁶ in the Revocation Schedules for all the different licence types.

Gas Supply Licence

"(e) if the licensee:

(i) has not within 1 year after the date on which this licence comes into force, commenced the supply of gas to any premises within the specified area in Schedule 1 to the licence; or

(ii) has ceased to supply gas to all of those premises within the specified area in Schedule 1;"

Gas Shipper Licence

"(e) if the licensee:

(i) ceases to carry on its business as a gas shipper; or

(ii) shall not have commenced business as a gas shipper within a period of 1 year from the date on which the licence takes effect;"

Gas Transporter Licence

"(e) if the licensee:

(i) shall not have commenced business as a gas transporter within a period of 3 years from the date on which this licence takes effect; or

(ii) ceases to carry on its business as a gas transporter;"

Gas Interconnector Licence

"(e) if the licensee:

(i) has not commenced participation in the operation of the interconnector to which this licence relates within 3 years of the date on which the licence comes into force;

(ii) has ceased to participate in the operation of the interconnector to which this licence relates;"

²⁶ Paragraph 1(e) of the Revocation Schedule (The Revocation Schedule is contained within Schedule 2 of gas and electricity licences)

Electricity Supply Licence

"(e) if the licensee:

- (i) has not within 1 year after the date on which this licence comes into force, commenced the supply of electricity to any premises within the specified area in Schedule 1 to the licence; or
- (ii) has ceased to supply electricity to all of those premises within the specified area in Schedule 1;"

Electricity Generation Licence

"(e) if the licensee:

- (i) has ceased to carry on the generation business;
- (ii) has not commenced carrying on the generation business within 3 years of the date on which the licence comes into force;"

Electricity Distribution Licence

"(e) if the licensee:

- (i) has ceased to carry on the distribution business; or
- (ii) has not commenced carrying on the distribution business within 3 years of the date on which the licence comes into force;"

Electricity Transmission Licence

"(e) if the licensee:

- (i) has ceased to carry on the transmission business; or
- (ii) has not commenced carrying on the transmission business within 3 years of the date on which the licence comes into force;"

Electricity Interconnector Licence

"(e) if the licensee:

- (i) has not commenced participation in the operation of the interconnector to which this licence relates within 3 years of the date on which the licence comes into force;
- (ii) has ceased to participate in the operation of the interconnector to which this licence relates;"

Appendix 4 - The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.²⁷ Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.²⁸

1.4. The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

²⁷ Entitled "Gas Supply" and "Electricity Supply" respectively.

²⁸ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

1.7. In performing these duties, the Authority must have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them²⁹; and
- the need to contribute to the achievement of sustainable development.

In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.³⁰

Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed³¹ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply,
- and shall, in carrying out those functions, have regard to the effect on the environment.

1.8. In carrying out these functions the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.9. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation³² and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

²⁹ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.

³⁰ The Authority may have regard to other descriptions of consumers.

³¹ Or persons authorised by exemptions to carry on any activity.

³² Council Regulation (EC) 1/2003.

Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

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