



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

*Promoting choice and
value for all customers*

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Dear colleagues,

Open letter consultation on changes to Ofgem¹ licensing policy for gas traders

This letter sets out and invites responses to our proposal that certain parties who currently hold a gas shipper licence but who are not involved in the physical conveyance of gas on the Great Britain (GB) network system, ie those only trading gas as a commodity at the National Balancing Point (NBP) (gas traders), should not be required to obtain a gas shipper licence in future in order to carry out gas trades, sign up to the Uniform Network Code (UNC) or access the Gemini system.²

In summary, our initial view is that:

1. As gas traders' activities do not fall into the prohibition of unlicensed activities contained in the Gas Act 1986 (the 'Gas Act'), we should no longer issue a gas shipper licence to these parties.
2. Requiring a gas trader to have a gas shipper licence represents an inappropriate barrier to entry, especially for small parties.
3. Clearly defining gas trading as a separate activity from gas shipping would make the status of industry parties more transparent.
4. Removing this barrier is also consistent with our duty in respect of better regulation and the Government's red tape challenge.

This letter also summarises and sets out our initial views on related matters raised by industry.

We would like your views on whether you agree with our initial assessment that we should remove the requirement to hold a gas shipper licence for gas traders on the basis that they are not shipping gas on the GB network, but only trading gas as a commodity. This letter also considers feedback from industry during the development of UNC338 and as a result of our earlier consultation (see further below). We also seek views on these matters and on whether there are any risks or unintended consequences associated with our proposed approach that have not yet been considered.

We welcome written responses to this open letter consultation on or before 15 March 2012.

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

² For the avoidance of doubt, all those parties intending to become involved in shipping activities, as defined in the Gas Act 1986, will continue to require a gas shipper licence.

Background

During 2010, we commenced a review of our licence application process. We undertook this review in part because we became aware of public statements raising concerns regarding the potential risk of value added tax (VAT) fraud in European energy markets.

As part of this review, we analysed all gas shipper licences and noted a marked increase in gas shipper licence applications during 2009, with 22 new licences issued. To get a clearer picture we asked Xoserve to provide us with details of parties that were using their systems for shipping and found that many applicants were not using the licence for the purpose of physically conveying gas. We attributed this result to the requirement to hold a gas shipper licence in order to access the UNC and the Gemini system.

In June 2010, we launched consultation 74/10 'Proposed changes to the current Application Regulations and Revocation Schedules of future licences'.³ As part of this consultation we welcomed views on whether parties should no longer be required to hold a gas shipper licence in order to be able to carry out gas trades and sign up to the UNC. The majority of respondents agreed that it was not appropriate to require parties to obtain a gas shipper licence prior to being able to carry out gas trades.

In October 2010, National Grid Gas Transmission (NGG Transmission) raised modification proposal UNC 338 'Remove the UNC requirement for a 'gas trader' User to hold a Gas Shipper Licence'.⁴ Modification UNC 338 is currently being considered by the industry and it is anticipated that it will proceed to consultation in the near future.

Reasons for potential change

Principles of Better Regulation

Under the Gas Act it is an offence to carry out certain activities without a licence, or an exemption from the requirement to hold a licence under the Gas Act. In particular, section 7A(2) of the Gas Act states that "*the Authority may grant a licence authorising any person to arrange with any gas transporter for gas to be introduced into, conveyed by means of or taken out of a pipe-line system operated by that transporter, either generally or for purposes connected with the supply of gas to any premises specified in the licence*".

Therefore, the activity for which a shipper licence is required is arranging the physical conveyance of gas from one point to another (gas shipping), as opposed to trading in gas.

As the Gas Act refers to gas shippers and not gas traders, we do not think it is appropriate for Ofgem to continue to issue licences to gas traders. This would be in line with our function in respect of granting licences and more broadly with our duty in respect of 'better regulation'. The Authority in carrying out its functions must 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 it considers represent best regulatory practice).

Barrier to entry

Ensuring that Britain's energy market is competitive and works efficiently in the interests of consumers is central to our statutory functions. Subject to the views of respondents, our initial view is that this proposal would remove an inappropriate barrier to entry to the market that is not prescribed by the Gas Act.

Although the licence fee for a shipper licence is only £350, requiring a non-physical trader to have a shipper licence still represents a barrier to entry and an administrative burden,

³ Consultation 74/10 can be found at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=App%20Regs%202010%20Consultation.pdf&refer=Licensing/Work>

⁴ This Modification Proposal can be found on the Joint Office website <http://gasgovernance.co.uk/0338>

especially for small parties. We note that this barrier does not exist in the electricity market, where there is no requirement to hold a licence to trade. We also believe that the added transparency of separate rules for shippers and traders, discussed below, would help small parties enter the market.

Status of Industry Parties

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

We also want to highlight that parties should not rely on a licence in place of industry pre-contractual checks as a form of due diligence. In issuing a licence, we do not give any guarantee, warranty or endorsement of any applicant, their financial status, or business methods.

The issues raised and our initial views

As set out above, UNC 338 and the review of Ofgem licensing policy to differentiate between a gas shipper and a gas trader have been discussed by the industry during the past year. We have summarised the main issues which have been raised below, together with our initial view on these issues.

Compliance with EU legislation

Some industry parties are worried that Ofgem will change its licensing policy without taking into account future EU developments, in particular the discussions regarding an EU trading passport and the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT).⁵ Our initial view is:

- 1) The proposals for an EU trading passport are part of a consultation document from the European Regulators group CEER (Council of European Energy Regulators). It should be noted that the CEER position does not translate into legislation and we are not aware of any immediate plans to create a trading passport regime for energy wholesale market trading. Furthermore, the CEER proposals state that any trading passport should only apply to financial traders, ie those that do not need to sign up to the UNC and are not involved in balancing at the NBP. It would therefore appear not to have any impact on the gas shipper licensing policy.
- 2) The Authority will be given additional powers for monitoring and enforcement through the implementation of the REMIT scheme, which prohibits insider trading and market manipulation in the energy sector. This will place a requirement on National Regulatory Authorities, including Ofgem⁶, to create and maintain a register of market participants in their national markets.

We note, however, that registration under the REMIT scheme is not a substitute for national licensing regimes and it does not qualify market participants to trade, nor does it imply a licence is a pre-requisite to trade. Therefore our view is that it does not impact our licensing policy at this time. As REMIT is implemented in the UK, we will continue to monitor the regulation of gas traders to ensure that no regulatory gaps or double regulation arise as a result.

⁵ Regulation (EU) No 1227/2011 of the European Parliament and the Council on wholesale energy market integrity and transparency available online at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:326:0001:0016:en:PDF>

⁶ The Authority is designated as the regulatory authority for Great Britain under section 3A of the Utilities Act 2000.

Provision of information to the Authority

Standard Condition 10⁷ of the gas shipper licence requires the licensee to furnish the Authority, in such manner and at such times as the Authority may reasonably require, with information and reports which may be necessary for the purpose of performing the Authority's functions under the Gas Act and the Utilities Act 2000.

Some parties are therefore concerned that by not issuing a shipper licence to the non-physical traders Ofgem will lose its powers to request information from such traders.

We have considered this issue and our initial view is that the type of information we are likely to request from traders could in the first instance be requested informally, as is already the case for electricity traders, or could be obtained from National Grid or Xoserve.

In addition, in the event of suspected market abuse we would be able to launch an investigation under the Competition Act 1998 (Competition Act). Ofgem's powers under the Competition Act enable us to access any information required to investigate the suspected abuse and to address any abuse that is occurring.

We will also have further monitoring powers in relation to market abuse, as well as further powers to request information, under the REMIT scheme, which will be implemented from this year.

Enforcement powers and security of supply

Industry has also highlighted the issue of security of supply, which could be hindered by the loss of enforcement powers in the shipper licence. It is theoretically possible that the activities of a gas trader could cause an imbalance on the system which could have a consequential impact on network safety. As the trader would have no licence, Ofgem would have no enforcement powers to address the situation.

A related matter is that the obligation in paragraph 6(e) of the Gas Safety (Management) Regulations 1996 (the Regulations),⁸ which requires cooperation by those holding a gas shipper licence in the event of an emergency, would not apply to gas traders. As traders would not hold a licence, they would not have an obligation to adhere to the Regulations.

We have considered these matters and our initial view is that:

- 1) These obligations are best placed in and enforced through the UNC. Thus the requirement not to act in a manner that could jeopardise the safe and efficient operation of the system and the duty to cooperate with the network operator and with the National Emergency Committee in an emergency should be imposed on traders through the UNC. The necessary UNC changes should be brought in through Modification UNC 338 and Ofgem has been working with NGG Transmission to ensure that these obligations are contained in the modification proposal.
- 2) As stated above, Ofgem also has enforcement powers in cases of suspected market abuse under the Competition Act 1998 and will be given additional powers under the REMIT scheme, once this has been implemented in GB. We therefore consider that we will have sufficient powers to address market abuse by traders.

Risk of a regulatory gap or a doubling up of regulation

Industry parties have suggested that removing the obligation for gas traders to acquire a gas shipper licence could create either a void in regulation, as they would not be regulated by Ofgem, or a doubling up of regulation, as they would then also be regulated by the FSA.

⁷ "Gas Shipper Licence: Standard Conditions" can be found at <http://epr.ofgem.gov.uk/index.php?pk=doc508972>

⁸ See <http://www.legislation.gov.uk/uksi/1996/551/regulation/6/made>

Ofgem has been asked to clarify how the proposed changes will impact exemptions from FSA registration.

Our interpretation of paragraph 42(3) of the Financial Services and Markets Act (Exemption) Order 2001⁹ is that in relation to the activities specified in the exemption, gas shippers currently holding a licence are exempt from regulation by the FSA. As gas traders would no longer hold a shipper licence, our initial view is that they would fall outside of this particular exemption. Any licensee affected by this change in policy would therefore need to determine for which of their activities they should obtain authorisation from the FSA.¹⁰ In our view, no doubling up of regulation would occur as a result of this policy change because any gas shipper who continues to be licensed by us continues to benefit from the relevant exemption.

Our initial view is that this change in policy will not create a gap in regulation.

Revocation

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

This open letter consultation seeks views on the following questions:

- 1) Do you agree that traders who are not involved in the activities prescribed by the Gas Act should not be required to have a gas shipper licence?**
- 2) Do you agree with our assessment of the issues raised by this proposal?**
- 3) Do you agree with our initial views on addressing these issues?**

Next steps

We welcome views from interested parties on the issues set out in this open letter consultation. Responses to this open letter consultation should be submitted on or before 15 March 2012 to:

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Industry Codes and Licensing Manager
Ofgem
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London
SW1P 3GE

Or by email to: industrycodes@ofgem.gov.uk

All non-confidential responses will be published on our website. Therefore, if respondents do not wish their response to be made public, they should clearly mark their response as "Confidential".

Yours faithfully,

Declan Tomany
Associate Partner Legal - Smarter Grids & Governance

⁹ See <http://www.legislation.gov.uk/ukxi/2001/1201/made>

¹⁰ Details of FSA authorisation and contacts in the FSA are available at www.fsa.gov.uk