

To gas transporters and other network operators, generators, shippers, suppliers, consumers and their representatives, the sustainable development community, investors and other interested parties.

9 March 2016

Dear Colleague,

Proposal to modify Standard Licence Condition 2 (Application of Section C (Transportation Services Obligations)) of the Gas Transporters Licence

1. This letter seeks views on our proposal to modify Standard Licence Condition 2 (Application of Section C (Transportation Services Obligations)) (SLC 2) of the Gas Transporters Licence.

Background

2. SLC 2 is applicable to all gas transporter licensees and sets out provisions under which the conditions contained in Section C of the standard conditions can be brought into effect, or taken out of effect for individual licensees which, in broad terms are:

- (i) a scheme made by the Secretary of State under Schedule 7 to the Utilities Act 2000;
- (ii) a Transportation Services Direction by the Gas and Electricity Markets Authority (the Authority); and
- (iii) the variation of a Transportation Services Direction or a provision by the Authority for Section C conditions to cease to have effect.

3. Amongst other things, Schedule 7 to the Utilities Act 2000 included transitional provisions allowing the Secretary of State to make schemes to incorporate standard conditions in gas licences ahead of section 81(2) of the Utilities Act 2000 coming into force. No further schemes can now be made under this provision. However, the Authority does issue Transportation Services Directions from time to time to configure Gas Transporter Licences, most commonly when granting licences to new independent gas transporters (IGTs).

4. At present, there are three requirements in SLC 2 for the Authority to obtain the licensee's consent before doing certain things:

- (i) Paragraph 3 of SLC 2 requires the Authority to obtain consent from the licensee before issuing a notice ending the suspension of paragraphs 4 to 8 in SLC2. Paragraphs 4 to 8 contain the provisions set out in points (ii) and (iii) in paragraph 2 above.
- (ii) Paragraph 4 of SLC 2 requires the Authority to obtain consent from the licensee before issuing a Transportation Services Direction.
- (iii) Paragraph 6 of SLC 2 requires the Authority to obtain consent from the licensee before varying the terms of a Transportation Services Direction or providing for Section C conditions to cease to have effect.

Inconsistency with the EU Third Internal Energy Package (the 'Third Package')¹

5. Article 39(4) of the Gas Directive requires the independence of the national regulatory authority (NRA). Detailed provisions are set out in Appendix 2 for reference.

6. We consider that the present drafting of SLC 2, insofar that it requires the Authority to obtain the licensee's consent to bring conditions into effect or take them out of effect, should be amended to ensure full compliance with the requirements of the Third Package. A requirement to obtain the licensee's consent to bring conditions into effect could be interpreted as suggesting that the Authority's decision is dependent on the licensee's consent and is therefore not fully independent and that the Authority is being influenced by the licensee's instruction.

Proposed changes and effects

7. We propose to modify SLC 2 by deleting the three instances of the wording "*with the consent of the licensee*" in the condition as shown in Appendix 1. This would mean that the Authority would no longer need the consent of the licensee to:

- (i) issue a notice ending the suspension of paragraphs 4 to 8 of SLC 2;
- (ii) issue or vary a Transportation Services Direction; and
- (iii) provide for Section C conditions to cease to have effect.

8. The proposed modifications would mean that SLC2 would be compliant with the requirements of Article 39(4) of the Gas Directive, as the Authority will be able to make independent decisions on whether to switch certain licence conditions on or off. The proposed modifications will also ensure that SLC2 is compliant with Article 41(16) of the Gas Directive which provides that decisions of the NRA shall be subject to judicial review, as the licensee would retain its underlying right to seek judicial review of the decision by the Authority.

Next steps

We would welcome the views of stakeholders, particularly gas transporters, on the proposed changes to the Gas Transporters Licence we have outlined above. Responses should be received by 22 April 2016 and should be sent to [regulatoryfinance@ofgem.gov.uk].

Unless marked confidential, all responses will be published in our library and on our website, www.ofgem.gov.uk. You may request that your response be kept confidential. We will respect this request, unless the law requires us to disclose anything, for example under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

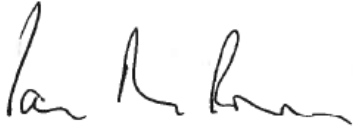
If you'd like your response to remain confidential, clearly mark the document to that effect and include the reasons for confidentiality. Put any confidential material in the appendices to your response.

¹ The term "Third Package" refers to Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity (Electricity Directive) and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas (Gas Directive) as well as three Regulations (Regulation 713/2009, Regulation 714/2009 and Regulation 715/2009).

If we decide to proceed with formal modification proposals we will issue a statutory consultation Notice that will be open for responses for a minimum of 28 days. After considering responses, we may make changes to the licence, which will take effect not less than 56 days after the publication of our decision.

If you have any queries on the matters referred to in this letter please feel free to contact Ofgem's Regulatory Finance team ([mail to: regulatoryfinance@ofgem.gov.uk](mailto:regulatoryfinance@ofgem.gov.uk)).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Ian Rowson', written in a cursive style.

Ian Rowson
Associate Partner, Regulatory Finance

Appendix 1 – Draft of possible changes to Standard Licence Condition 2 (Application of Section C (Transportation Services Obligations)) of the Gas Transporters Licence

The proposed modification is to delete the text shown crossed out in red below.

Condition 2: Application of Section C (Transportation Services Obligations)

1. Where the Secretary of State has provided, by a scheme made under Schedule 7 to the Utilities Act 2000, for Section C (in whole or in part) to have effect within this licence:
 - (a) paragraphs 4 to 8 shall have effect in the licensee's licence; and
 - (b) the licensee shall be obliged to comply with the requirements of Section C (in whole or, as the case may be, in part) of this licence.

Such provision made by the Secretary of State in the said scheme shall be treated, for the purposes of paragraphs 5, 6, and 7 of this condition, as if it were a Transportation Services Direction made by the Authority.

2. Unless or until: -
 - (a) the Secretary of State has provided, by a scheme made under Schedule 7 to the Utilities Act 2000, for Section C (in whole or in part) to have effect within this licence; or
 - (b) the Authority has issued to the licensee a direction pursuant to paragraph 4 the standard conditions in Section C (in whole or, as the case may be, in part) shall not have effect within this licence; and the licensee shall not be obliged to comply with any of the requirements of Section C (in whole or, as the case may be, in part) of this licence.
3. Except where paragraph 1 applies to the licensee, paragraphs 4 to 8 of this standard condition shall be suspended and shall have no effect in this licence until such time as the Authority, ~~with the consent of the licensee~~, issues to the licensee a notice in writing ending the suspension and providing for those paragraphs to have effect in this licence with effect from the date specified in the notice.

4. The Authority may, ~~with the consent of the licensee~~, issue a direction (a “Transportation Services Direction”). Where the Authority has issued to the licensee a Transportation Services Direction the standard conditions in Section C (in whole or, as the case may be, in part) shall have effect within this licence from the date specified in the direction; and the licensee shall be obliged to comply with the requirements of Section C (in whole or, as the case may be, in part) to the extent and subject to the terms specified in such direction.
5. A Transportation Services Direction:
 - (a) may specify that the standard conditions in Section C (in whole or in part) are to have effect in this licence; and
 - (b) shall specify or describe an area (the “transportation Services area”) within which the licensee shall be obliged to comply with any of the requirements of Section C (in whole or, as the case may be, in part).
6. The Authority may, ~~with the consent of the licensee~~:
 - (a) vary the terms (as set out in the Transportation Services Direction or elsewhere) under which Section C (or parts thereof) has effect in this licence; or
 - (b) provide for Section C (or parts thereof) to cease to have effect in this licence.
7. The variation or cessation provided for in paragraph 6 shall take effect from the date specified in the variation or cessation notice given to the licensee by the Authority.
8. With effect from the date of cessation referred to in paragraph 7, paragraphs 4 to 7 of this condition shall be suspended and shall cease to have effect in this licence, but the Authority may at any time thereafter, with the consent of the licensee, give to the licensee a notice ending the suspension and providing for those paragraphs to have effect again in this licence with effect from the date specified in the notice.

Appendix 2 – Provisions of Article 39(4) of the Gas Directive

" Member States shall guarantee the independence of the regulatory authority and shall ensure that it exercises its powers impartially and transparently. For this purpose, Member States shall ensure that, when carrying out the regulatory tasks conferred upon it by this Directive and related legislation, the regulatory authority:

(b) ensures that its staff and the persons responsible for its management:

(i) act independently from any market interest; and

(ii) do not seek or take direct instructions from any government or other public or private entity when carrying out the regulatory tasks."

The Commission Working Paper issued at the time explained that *"The new legislation also prohibits the NRA's staff and the persons responsible for its management from seeking or taking direct instructions from any government or other public or private entity. This provision aims to tackle the situation where someone working for the NRA is seeking or taking direct instructions. According to the Commission's services, this provision also implies that it is forbidden for anyone to give such instructions. An instruction in this context is any action calling for compliance and/or trying to improperly influence an NRA decision and thus includes the use of pressure of any kind on NRA's staff or on the persons responsible for its management."*

Article 41(4) of the Gas Directive also requires that the NRA should have the powers to issue binding decisions on gas undertakings, subject to the right for the decision to be judicially reviewed, in the broad sense of being subject to judicial scrutiny. This is provided in Article 41(16) of the Gas Directive.

Regulation 41 of the regulations amended the Gas Act 1986 to enable the Authority to make licence modifications, following consultation, independently of industry and government, subject to appeal provisions to comply with the requirements of the Gas Directive for the Authority to issue binding decisions independently of government or of industry. The previous licence modification procedure under the Gas Act 1986, which required consent from individual licensees or classes of licensees in order for the modification to be made was replaced by a modification procedure which allows the Authority to make the licence modification, but with a right for affected licence holders and other specified bodies to appeal licence modifications to the Competition and Markets Authority.