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Utilities Bill

Bill 49 of 1999-2000

Following a consultation process lasting over two years, the Government published its *Utilities Bill* on 21 January 2000. The second reading is scheduled for 31 January. Covering the energy, telecommunications and water industries, the Bill aims to modernise the framework for utility regulation. It allows the Secretary of State to issue guidance on social and environmental objectives to the regulatory authorities, establishes consumer councils with wider powers, and provides for monetary penalties on utilities in breach of licence conditions.

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Summary of main points

In 1997, the Government initiated a wide-ranging review of the regulation of the utility industries, focusing on electricity, gas, telecommunications and water. The initial results were published in March 1998 in a Green Paper, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation*. The response to the consultation which followed identified the need for more detailed consultations in areas such as consumer representation.

At the same time, the government was conducting reviews of energy policy against a backdrop of declining coal markets and commitments to tackle climate change. Further consultation on the electricity and gas industries led to a completion of the utilities review and a decision to legislate.

The Utilities Bill brings together these strands of consultation in legislation designed to update and rationalise the framework for the regulation of the privatised electricity, gas, telecommunications and water industries. A single Gas and Electricity Markets Authority comprising a chairman and at least two others would regulate the energy utilities. Similar arrangements would pertain to the Telecommunications Authority. The economic regulation of the water industry would continue to reside with an individual director, though he would now be guided by a new Water Advisory Panel.

Under the Bill, all the industry regulators would now have a primary, rather than secondary, duty to protect the interest of consumers, preferably through the promotion of competition. Independent consumer councils would be established with powers to require information from the regulator and utility companies.

The regulators would all enjoy the powers the gas regulator already has to levy fines on companies in breach of licence conditions and other requirements. Price-regulated utility companies operating in non-competitive markets would be required to publish the links, if any, between directors' remuneration and standards of service.

Ministers would be given new powers to issue guidance to regulators on social and environmental objectives.

Reform of the electricity industry is one notable focus of the Bill, with emphasis being given to new wholesale trading arrangements, and their possible impact on prices.

Since privatisation the number of utility customers having their service disconnected has generally fallen and the number of complaints received by the various regulatory bodies has generally increased.

The number of people employed by each of the utilities has fallen post-privatisation. The average or typical real bills for domestic customers of the privatised gas, electricity and telecommunications industries have all fallen by around 25%. However, the average annual real bills for each of the privatised water companies have increased.

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I Initiation of the utilities review

When the Labour government came to power in May 1997 it initiated a range of reviews to inform its future policy including one on regulation of the utilities. It had inherited a situation in which a number of utilities had been privatised by the previous administration and, although their regulation had been established, it was clear that there was need for some restructuring of the regulatory regime. Background to the regulation of the energy industries up to this time is contained in a Library Research Paper.¹

The utilities review was initiated by the then President of the Board of Trade, Margaret Beckett. In answer to a parliamentary question on 30 June 1997, she set out the objectives and terms of reference, focusing mainly on the gas, electricity, telecommunications and water industries:

Mrs. Beckett: I am announcing today an inter-departmental review of the regulation of the utility industries. My aim is for the review to report to Ministers by the end of the year.

The Government's objective for the review is to set a long-term stable framework for utility regulation which is seen as fair by all the interest groups involved, particularly by consumers. Without fairness, there can be no long-term stability. We want the regulatory framework to deliver value, quality and choice to consumers while providing incentives to managers to innovate and improve efficiency. The guiding principles must be transparency, consistency and predictability of regulation.

The terms of reference for the review are to consider whether changes are required to the system of regulation of the utility industries in order to ensure open and predictable regulation, fair to all consumers and to shareholders, and which promotes the Government's objectives for the environment and sustainable development, whilst providing sufficient incentives to managers to innovate, raise standards and improve efficiency.²

Mrs Beckett said that the review would be set in the context of development of competition in the regulated markets with the background of general competition law, which would be the subject of legislation the following autumn. The outcome would inform the development of regulatory principles of general applicability. The review would be mindful of the conclusions of other recent relevant reports about utility regulation including those to the Public Accounts Committee, the Trade and Industry Select Committee, and the UK Round Table on Sustainable Development. She stated that the independence of regulators would be preserved, but the balance between Ministers and regulators would be investigated. Part of the remit of the review was to examine the formula for determining prices, but rate of return regulation was excluded. Comments were invited by 5 September 1997, and any consequent changes proposed would be subject to full consultation.

¹ Library Research Paper 98/19, *Regulating Energy Utilities*, 2 February 1998

² HC Deb 30 June 1997 cc 20-21w

II The Green Paper

The results of the review were published in a Green Paper, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation*, on 25 March 1998.³ It set out strategic proposals for regulation over the next decade. The title reflected Government commitment to put consumers at the heart of regulation, while accommodating the interests of investors. The proposals were designed to anticipate changes in market structure and the development of multi-utilities, the emergence of competition in energy supply, and the liberalisation of the telecommunications sector. The review only related to the regulation of water (except in Scotland), gas, electricity and telecommunications. The railway and airport industries were not covered, and were therefore excluded unless stated otherwise.

Mrs Beckett announced the publication in answer to a parliamentary question.⁴ A summary of the key proposals was included in an accompanying press notice:

- The Government should set a clear framework for regulation. Within this framework, regulators should operate at arms length from Ministers. The Government should issue statutory guidance for each sector on how the utility industries should contribute to its social and environmental objectives (including energy efficiency).
- The regulators should be given a new primary statutory duty to protect the interests of consumers. The consumer bodies for each sector should be put on an independent basis.
- RPI-x⁵ should be retained as the fundamental basis for price regulation, if the regulators consider this best serves consumers' interests. We also invite views on whether RPI-x could be supplemented with clear and in-built mechanisms to share unearned benefits promptly between consumers and shareholders when companies benefit from specific factors outside their control, or when they have deliberately misled the regulator by providing incomplete or inaccurate information when the price cap was set.
- To strengthen the openness and accountability of the system, the regulators should provide reasons for key decisions and should consult on, publish and follow a code of practice governing their decision-making processes.

³ *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation*, 25 March 1998, CM 3898

⁴ HC Deb 25 March 1998 c 149w

⁵ Retail Price Index minus a fixed number

- Regulation of gas and electricity supply should be integrated, by bringing OFFER and OFGAS together to reflect convergence in the energy market. The licensing of electricity supply and distribution should be separated.

Overview of the Electricity Industry

In Great Britain the electricity industry comprises four main activities: generation, transmission, distribution and supply. Generation is the production of electricity from primary and renewable energy sources. Transmission is the transportation of electricity at high voltages from power stations to companies that distribute it to users. This is the National Grid Company in England and Wales. The transport of electricity at lower voltages from the transmission network to individual customers is termed distribution. There are fourteen public electricity suppliers that are responsible for distribution in their own areas. Suppliers buy electricity in bulk, pay for it to be transmitted across the National Grid, and sell it to customers. They publish prices, issue bills, receive payments and answer customer enquiries. From September 1998 domestic customers have been able to choose their supplier.

- The energy regulators, with the energy companies, should develop an action plan to ensure that disadvantaged consumers benefit from improved efficiency, more choice and greater fairness.⁶

This summary was further elaborated in the same press notice.

⁶ DTI Press Release P/98/240, *Government Publishes Green Paper on Utility Regulation*, 25 March 1998

III The response to consultation

Views on the Green Paper proposals were invited by 31 May 1998. The Government undertook extensive consultation, considering over 250 written representations besides holding discussions with a wide range of interested parties. The outcome was the document, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: The Response to Consultation*, published on 27 July 1998.⁷ Its publication was announced by Margaret Beckett. She mentioned that further consultations would take place in some areas, but that in the light of these, the Government intended to legislate to implement the proposals as soon as parliamentary time permitted.⁸ Key decisions were set out in a press notice:

- the regulatory framework should be able to address structural change in the utility markets, including multi-utilities;
- OFFER⁹ and Ofgas¹⁰ should merge;
- consumer protection should be the regulators' primary duty;
- independent consumer councils should promote consumer interests;
- RPI-X should be retained as the fundamental system of price regulation; however regulators should consider the exceptional circumstances where it may be appropriate to refine RPI-X to reflect the Green Paper principles on price regulation;
- a clearer link should be made between the prices utilities can charge and the customer service standards they achieve;
- full information should be available on companies' performance on customer service standards and on the links between this performance and the remuneration of directors;
- Ministers should issue statutory guidance on social and environmental objectives; and
- the energy and telecommunications regulators should be replaced by executive boards.¹¹

Further elaboration was contained in the press notice.

⁷ DTI, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation. The Response to Consultation*, July 1998

⁸ HC Deb 27 July 1998 c 53-54w

⁹ OFFER (the Office of Electricity Regulation)

¹⁰ Ofgas (the Office of Gas Supply)

¹¹ DTI Press Notice P/98/602, *A Fair Deal for Consumers-Margaret Beckett*, 27 July 1998

IV The energy sector

A. Energy sources for power generation

Following the *Coal Industry Act 1994*, British Coal's mines were privatised, and RJB Mining emerged as the UK's principal deep mining company. Initially, the company flourished, but in time its fortunes began to decline. Because of traditional Labour sympathy for the coal industry, expectations of support grew after the election of the new Labour Government in May 1997. This, however, failed to materialise and towards the end of 1997 the company was in crisis with RJB about to announce up to 5,000 job losses just before Christmas.

There were several contributory factors in the run-up to this situation. One was the so-called "dash for gas". The previous Conservative Government's policy of giving approval for gas-fired power stations, which was initially endorsed by Labour at the beginning of its term in office, inevitably displaced coal-fired generating capacity and reduced the market for coal. Another factor was that other European coal producers were eligible for state aid and hence coal mined in the UK was not competing on a level playing field in the markets. The final crisis arose as the termination of the coal supply contracts with the major UK electricity generators loomed on 31 March 1998. The old contracts had been brokered on favourable terms before privatisation. Richard Budge, chief executive of RJB Mining, attempted to renegotiate the contracts but faced stiff competition from other suppliers. Although some contracts were secured they were for insufficient coal and RJB was forced to consider redundancies.

These events led the Government to initiate a review of energy sources for power generation to investigate perceived distortions in the energy markets which might disadvantage coal. Margaret Beckett, announced the terms of reference of the review on 22 December 1997.¹² Initially, the main aim was to examine energy policy considerations relevant to applications for power station and generating plant consents. As the review progressed it became clear that the issues were more wide-ranging and the review was broadened to include design, operation and structure of the electricity market.

Provisional conclusions of the review were announced in the House of Commons on 25 July 1998.¹³ The final conclusions were published in October 1998.¹⁴ The principal of these was that security and diversity of supply could be put at risk by new gas-fired generation plant. This led to a stricter consents policy while the Government initiated a major programme of reform in the electricity market. The review confirmed the Government's view that there were significant distortions in the operation of this market which had kept prices up, had a

¹² HC Deb 22 December 1997 cc 519-520w

¹³ HC Deb 25 June 1998 cc 1169-1172

¹⁴ *Conclusions of The Review of Energy Sources for Power Generation and Government response to fourth and fifth Reports of the Trade and Industry Committee*, Cm 4071

significant effect upon the pattern and pace of development, and encouraged the growth of gas generation to the detriment of coal. The programme comprised:

- Reform of the electricity trading arrangements in England and Wales;
- Seeking practical opportunities for divestment by the major coal-fired generators;
- Pressing ahead with competition in electricity supply for all customers;
- Separating supply and distribution in electricity markets;
- Resolving the technical issues about the growth of gas, including the proper remuneration of flexible plant; and
- Continuing to press for open markets in Europe.¹⁵

The structure of the electricity trading arrangements, commonly called the Pool, was singled out as responsible for one of the most significant distortions in the operation of the electricity market. The reform of electricity trading arrangements (RETA) and the separation of distribution and supply, which both required legislation, were carried forward as part of the utilities review. The outcome of the RETA is the New Electricity Trading Arrangements or NETA.

B. Further consultation on energy regulation

On 21 October 1998 John Battle announced the publication of a further consultation on energy regulation, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Public Consultation Paper on the Future of Gas and Electricity Regulation*.¹⁶ Key proposals on which views were sought included legislation to merge the two energy regulatory systems, Ofgas (the Office of Gas Supply) and OFFER (the Office of Electricity Regulation), and the two proposals in the White Paper: to separate distribution and supply of electricity to boost competition, and RETA. The detailed proposals reflected the increased convergence of some companies which operate in both the gas and electricity sectors. This is also evident in the Government's announcement of its intention to appoint one individual, Callum McCarthy, as the Director General of Gas Supply (DGES), the head of Ofgas, and the Director General of Electricity Supply (DGES), who controls OFFER, with a view to combining the posts into a single regulator.

¹⁵ *ibid*

¹⁶ DTI, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Public Consultation Paper on the Future of Gas and Electricity Regulation*, 21 October 1998

In summary, views were sought on:

- the ways in which the existing regimes will need to be modified to align the regulatory systems to underpin the combined functions of the single gas and electricity regulator. These are aimed at ensuring that the regulator will have a flexible yet robust set of powers, able to act across the gas and electricity sectors and to respond to changing market structures;
- obtaining the full competitive advantages of separately licensed supply and distribution by requiring licences for supply and distribution to be held by different legal entities, even if they remain in common ownership;
- ending the present distinction between the supply activities of public electricity suppliers (who hold combined distribution and supply licences) and second-tier suppliers.¹⁷ The document considers how the rights and obligations attaching to a public electricity supply (PES) licence - for instance, the obligation on a PES to supply on request - should be allocated between suppliers and distributors;
- requiring the generation, transmission, distribution and supply activities of the integrated Scottish companies to be carried on by separate companies, with independent operation of the transmission activities of the integrated companies;
- ways of encouraging further competition in providing and reading meters;
- circumstances in which an administrator might be appointed when an energy supplier fails; and
- legislative changes to underpin the proposed changes in electricity trading arrangements (the Pool).¹⁸

The closing date for comments was 16 November 1998.

1. The response by OFFER

The then DGES, Professor Stephen Littlechild, published his response to the consultation paper on the future of gas and electricity regulation on 19 November 1998.¹⁹

On the issue of the separation of distribution and supply he concluded:

¹⁷ Until recently the fourteen public electricity suppliers in Great Britain were responsible for supply within their own areas. Since September 1998 customers have been able to choose their supplier. A second-tier supplier is an electricity supplier other than the host electricity company

¹⁸ DTI Press Notice P/98/809, *John Battle Sets Out the Future Shape of Energy Regulation*, 21 October 1998

¹⁹ OFFER, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Public Consultation Paper on the Future of Gas and Electricity Regulation: Response by the Office of Electricity Regulation, November 1998*

Effective competition in electricity supply requires the effective separation of supply and distribution, including separate licensing. As in gas, separate licensing would facilitate separate ownership of supply and distribution which would facilitate competition and effective regulation.²⁰

He commented further that, in his view, separate ownership was desirable, but separate companies commonly owned would be acceptable:

“I still consider that the detriments to competition associated with the common ownership and operation of electricity distribution and supply businesses would best be addressed by requiring separate ownership. However, if common ownership is to continue to be permitted, then it is essential that the supply and distribution businesses are held by separate companies within the group. This will enable financing of the two businesses to be separated, and for the monopoly distribution to be financially ring-fenced from supply and other competitive activities”²¹

He stressed the need for flexibility in the licensing of different activities within the electricity sector under a new regulatory regime:

The framework of licensing of different electricity activities has proved capable of adaptation to changing circumstances, for example, to take account of a competitive market in supply to smaller customers. The regulatory regime for gas and electricity must continue to be flexible to accommodate further changes of this sort.²²

On the combined regulator he concluded:

It will aid clarity and consistency for the duties of the combined regulator in gas and electricity matters to be expressed in identical terms.²³

His views on RETA were summarised as follows:

The new electricity trading arrangements in England and Wales will enhance competition in generation and supply and provide a greater and more flexible range of opportunities for market participants, including the ability to strike contracts at prices that better reflect individual circumstances and requirements.

Arrangements for the operation of a balancing market and associated imbalance and settlement process could be achieved by the introduction of new licence conditions on

²⁰ OFFER Press Notice R87/98, *OFFER Response to the Government's Consultation on the Future of Gas and Electricity Regulation*, 19 November 1998

²¹ *ibid*

²² *ibid*

²³ *ibid*

NGC (The National Grid Company), requiring it to establish a Balancing and Settlement Code which would address governance.²⁴

2. The response by Ofgas

Ofgas published its response to the consultation paper in November 1998.²⁵

Like OFFER, Ofgas welcomed the Government proposal for the effective separation of electricity distribution and supply businesses which is already in place for gas. Ofgas' view is that distribution and supply companies held in separate legal entities are a prerequisite for successful competition.

On the issue of a combined energy regulator, Ofgas agreed it would be sensible to bring the gas and electricity regimes under one regulatory umbrella because of convergence of their markets. It noted that a similar, but not identical, situation is in operation in Northern Ireland, and its success indicates that such a system works in principle. The appointment of Callum McCarthy as both Director General of Gas Supply (from 1 November 1998) and of Electricity Supply (from 1 January 1999) was a signal that the process had already begun. Ofgas agreed with the Government that the combined regulator should operate under one combined set of duties which are aligned for both gas and electricity wherever possible. It also stressed the need for flexibility of the combined regulator's powers to enable him to operate effectively in both markets.

C. The finalisation of the energy review

In the light of further consultation on gas and electricity regulation the Government set out its response with the publication of proposals for legislation on the regulation of these utilities on 13 October 1999.²⁶ It did not cover broader cross-utility issues which had been dealt with in the earlier response to consultation of 27 July 1998. The main features of the legislative proposals relating to the energy utilities were:

- Separation of electricity supply from distribution;
- Alignment of the regulatory regimes for electricity and gas;
- Modifying licensing arrangements in order to update and increase flexibility of the regulatory frameworks for both electricity and gas;
- Measures to implement the NETA;
- A framework for encouraging renewable electricity generation and energy efficiency.²⁷

²⁴ *ibid*

²⁵ Ogas, *Ogas' Response to the Government's Consultation on the future of Gas and Electricity Regulation*, November 1998.

²⁶ DTI, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: The Future of Gas and Electricity Regulation: the Government's Proposals for Legislation*, 13 October 1999

²⁷ DTI Press Notice, P/99/811, *Consumers First With New Energy Rules Says Liddell*, 13 October 1999

V Consumer Councils

A central part of the Government's aim during the utilities review was to place consumers at the heart of utility regulation. The response to consultation of 27 July 1998 confirmed that the Government intended to merge the existing consumer bodies into consumer councils which would be established on an independent statutory basis. These councils would be responsible for investigating customer complaints that the utilities concerned did not resolve. To assess views the Energy and Industry Minister, John Battle, published a consultation paper on 30 September 1998 about the future of consumer representation as part of the utilities review.²⁸ The document dealt with consumer councils for the water (except in Scotland), energy and telecommunications industries. It covered arrangements for England, Wales and Scotland, but not Northern Ireland where arrangements differ. Views were sought on the proposals as set out in the review for consumer councils that would:

give a strategic, independent view of consumer interests to Government, Parliament and to the media;

publish information and advice to assist consumers in getting a fair deal from the utility companies;

work constructively with companies to reduce causes of complaints, and also providing a consumer-friendly "one-stop-shop" for consumer complaints which have not been resolved satisfactorily;

help regulators to develop policy that takes account of consumer needs and interests; and

monitor and report the impact of competition and any changes on disadvantaged consumers.²⁹

The consultation document set out further details about a number of important issues such as:

the functions and powers of the future consumer councils; their structure and organisation, including regional organisation and complaints handling; and the framework for establishing strong and constructive links with the regulators' offices.³⁰

Responses were requested by 16 November 1998. The Government received 130 responses and held discussions with a wide range of interested parties. These indicated strong support for the proposals in the consultation document. The Government published the response to consultation on 8 April 1999.³¹ These proposals are generally intended to apply to consumer

²⁸ *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Public Consultation Paper on Consumer Councils*, DTI, 30 September 1998

²⁹ DTI Press Notice, P/98/742, *John Battle Proposes a Stronger Voice for Consumers*, 30 September 1998

³⁰ *ibid*

³¹ *Consumer Councils: Response to Consultation*, DTI, 8 April 1999

arrangements in the whole of the UK. They do not, however, extend to the water and energy sectors in Northern Ireland nor to the water sector in Scotland. A summary of the full proposals was issued as a press notice.³² The main aspects of the new proposals are as follows:

A. Functions of the consumer councils

Within the regulatory system it is intended to give the councils broad functions:

They will act as public advocates for all utility consumers in their sectors, and will be expected to provide information and advice on consumer issues to regulators, Government, Parliament, the Scottish Parliament, the Welsh Assembly, the media and others. They will draw attention to areas requiring action by the companies, utility regulators and others. And they will publish information and advice of interest and assistance to consumers, such as advice on securing the best deal from utility companies. These broad functions will ensure that the councils have flexibility to investigate and advise on the consumer issues of the moment.³³

To inform their policy the consumer councils will be given a research capacity to investigate consumer concerns, in particular those of disadvantaged customers, small businesses and matters with a regional interest.

The function of resolving consumer disputes with the utilities will fall to the councils:

we propose giving the councils the specific task of handling consumer complaints against utility companies where these have not been resolved by the company concerned. Where possible, we will expect the councils to try to mediate a satisfactory outcome between the company and the complainant. Where further action such as enforcement action may be required, the council will also pass the complaint on to the appropriate regulatory authority. We also anticipate the councils working constructively with the utility companies to reduce the causes of complaints.³⁴

B. Relationship between councils and regulators

To facilitate co-operation it is intended that there will be an effective framework for collaboration between the councils and the utility regulators:

To achieve this, we intend to place a duty on the council and the relevant utility regulator to agree and then publish a memorandum of understanding (MoU). The detailed content will be a matter for the parties to agree, but we expect it to cover such matters as the practical arrangements for consultation between them, the co-ordination of requests for information from the utility companies, the exchange of

³² DTI Press Notice, P/99/301, *Battle "Putting the Customer in Control"*, 8 April 1999

³³ *ibid*

³⁴ *ibid*

information, and the co-ordination of work on consumer-related issues. We also propose that the water consumer council and the drinking water inspectorate should be placed under a similar duty to agree and publish an MoU to cover co-operation between them on water quality issues and the handling of water quality complaints.³⁵

C. Access to information

The councils will be given statutory powers to access information from the utilities to assist them in the resolution of consumer complaints:

The councils' powers to access information will need a basis in statute. We intend to give the councils direct rights of access to the information they need from utilities so that unresolved customer complaints can be investigated. In addition, we propose that councils should receive copies of any monitoring returns that utility companies are required to send to the utility regulators to demonstrate compliance with codes of practice on complaints handling. This is intended to assist the councils in their task of tackling the causes of consumer complaints at source.³⁶

The regulatory body will be given powers to access information from the utilities for their own use and to pass this onto the councils:

We propose that other types of information should be obtained by making a request to the relevant utility regulator, or to the drinking water inspectorate, where it cannot be obtained from the utility companies on a voluntary basis. Consistent with their existing functions, we intend to give the utility regulators and the drinking water inspectorate powers to obtain information from the utilities on behalf of the councils as well as for themselves, and we intend to make the councils bodies to whom they can disclose information. These bodies will be required to comply with reasonable requests from the councils for information, both information that they hold already or have generated themselves, and new information which needs to be obtained from the utility companies. Where a request is declined, these bodies will need to give reasons. There will be reciprocal obligations on the councils to provide information to the utility regulators or to the drinking water inspectorate on similar terms.³⁷

D. Organisational issues

To ensure independence of the councils from the regulators the Government intends to make appointments to the councils and approve their budgets itself. The funds will be raised through licence fees where possible. In other areas, such as the number of members appointed to councils and need for regional offices, flexible arrangements will be allowed. More detailed operational matters such as call centre arrangements will be left to the councils and will not feature in legislation. To ensure that membership of committees is professional and attractive to a wide cross-section of the community the councils will be given powers to remunerate members of regional or specialist committees. Councils will be encouraged to

³⁵ *ibid*

³⁶ *ibid*

³⁷ *ibid*

establish links with other regulators and consumer bodies by giving them powers to establish MoUs or similar arrangements with these bodies.

Brief details of other, more minor, issues are set out in the press notice.³⁸

E. Reaction to proposals

The Electricity Consumers Committees Chairmen's Group (ECCCG) welcomed the proposals. The chairman, Rodney Brooke, particularly welcomed the proposal to create an influential energy consumer council with a voice at the heart of the regulatory process. He was pleased that there was to be a regional presence, which would ensure that consumers have the service they need, where they need it. He highlighted the proposed access to information from the utilities as a suitable means of ensuring transparency and openness in their services.³⁹

Following publication of the March 1998 Green Paper, Sue Slipman, the then Director of the Gas Consumers Council, set out her views in the *Utilities Journal*.⁴⁰ She welcomed the proposals as significant progress for consumer interests as expected following the Government's commitment to place consumers at the centre of regulation. She believed that special consideration should be given to disadvantaged customers such as the less well off, the chronically sick, the elderly and the disabled. The GCC recognised the need for a clear remit for regulators and consumer councils and a clear framework for them to work within. The new energy consumer councils should be independent organisations with a responsibility for consumer complaints while the regulator takes an over-arching view of all issues confronting the industry. The GCC supported the need for the regulator to be more open, transparent, accountable, consistent and predictable.

After the publication of the response to the consultation on the consumer councils, the new chairman of the GCC, Jenny Kirkpatrick, spelt out the importance of consumer interests and how these might be measured in the liberalised gas market.⁴¹ She mentioned that the Labour Government had effected a shift in regulatory emphasis towards the consumer. This was reflected in the utilities review and is enshrined in the *Utilities Bill*. She welcomed the "greater role proposed for consumer councils in terms of consultation on specific decisions and a greater exchange of information and coordination with regulators".

³⁸ *ibid*

³⁹ ECCCG Press Notice 6/99, *Energy Consumers Need Strong Consumer Representation*, 8 April 1999

⁴⁰ *Utilities Journal*, June 1998. p 26

⁴¹ *Utilities Journal*, June 1999, p 38

VI Changes to proposals since response to utility consultation

Modifications to the Government's proposals for changes to utility regulation since the response to consultation of July 1998 were set out in answer to a written question in the Commons answered by John Battle on 27 July 1999:

Mrs. Gilroy: To ask the Secretary of State for Trade and Industry if he will make a statement setting out the significant changes in the Government's proposals for the reform of utility regulation made since publication of the White Paper in July 1998.

Mr. Battle: Since July 1998, the Government have been working on the detail of its proposals for the reform of utility regulation. This further work has resulted in the modification of some of the proposals.

First, the Government originally concluded that, for the energy and telecommunications sectors, individual regulators should be replaced with full-time executive boards composed of a chairman and two others. In the light of further analysis, the Government have decided that Ministers should be able to appoint any number of board members, who may be full or part-time, and executive or non-executive, so that the size and composition of each regulatory board meets the requirements of each office, and can change, over time, in response to developments. For the water sector, where the demands and pressures on the regulator are somewhat different from the other sectors, the Government now intend to retain the existing provision for an individual regulator. However, the Government intend to introduce a provision requiring the individual regulator to be supported by an advisory panel appointed by Ministers.

Second, the Government originally concluded that they would introduce legislation to extend to all regulators powers of the type held by the gas regulator to impose monetary penalties for breach of overall and individual service standards. Those powers related only to current and likely future breaches of licence conditions and other relevant requirements. They would not, as currently drafted, allow the imposition of penalties in relation to breaches, however serious, which were discontinued by the company when an enforcement notice was issued, or which ceased before enforcement action could be taken. This significantly weakens the effectiveness of monetary penalties as an enforcement mechanism. The Government now intends, therefore, to give regulators powers to impose penalties for past as well as for continuing breaches of licence conditions and other statutory requirements (but not including breaches committed before the legislation to introduce the powers is enacted). These powers will not extend to likely future breaches. Similar powers have recently been proposed for the Strategic Rail Authority.⁴²

⁴² HC Deb 27 July 1999 cc 306-307w

VII Completion of the utilities review

On 13 October 1999 the Government not only finalised the energy aspects of the review, it published draft appraisals of the regulatory, environmental, and equal treatment impacts of the conclusions of the utilities review for comment.⁴³ The utility companies were specifically asked to comment upon the appraisals by 15 November 1999.

The draft appraisals:

- Anticipate significant downward pressure on prices, arising principally from the reform of electricity trading arrangements;
- Hold out the prospect of a more certain regulatory environment for companies;
- Identify positive environmental benefits through the proposed statutory environmental guidance to regulators from Ministers, the powers to oblige fuel companies to achieve energy savings and to support fuel companies to achieve energy savings and to support fuel generation from renewables sources;
- Note that existing duties on regulators to have regard to the interests of various categories of potentially disadvantaged consumers will be extended to include low-income consumers⁴⁴

The Government's intention to legislate in the 1999/2000 session was included in the Queen's Speech. A final version of the impact assessments is being published with the *Utilities Bill*. Primary legislation will set the overall structure of regulation for each utility, but detailed provisions will be in secondary legislation and licence conditions to allow for flexibility. Specific legislative proposals planned for inclusion in the Bill were set out in the annex to the impact assessments:

UTILITIES BILL - SUMMARY OF KEY LEGISLATIVE PROVISIONS

Achieving a fairer balance between interests of consumers and shareholders

- (i) a new primary duty for regulators to exercise their functions in the manner best calculated to protect the interests of consumers, wherever possible and appropriate through promoting effective competition;
- (ii) a requirement for all regulators, in performing the new primary duty, to take into account the interests of low income consumers, the chronically sick, the disabled, pensioners and consumers in rural areas;

⁴³ DTI, *A Fair Deal for Consumers :Modernising the Framework for Utility Regulation: Regulatory, Environmental and Equal Treatment Appraisals*, 13 October 1999

⁴⁴ DTI Press Notice P/999/812, *Consultation on Regulatory Environmental and Equal Treatment Impacts of the Review's Conclusions*, 13 October 1999

- (iii) the establishment of independent consumer councils for each sector with duties to investigate complaints, to provide information of assistance to consumers, and to advocate the interests of all consumers to regulators, Government and others with an influence on regulation;
- (iv) powers for all regulators to be able to impose monetary penalties on companies for past and ongoing breaches of licence conditions and other specified requirements;
- (v) powers for the regulators and the new consumer councils to publish utility information where this is in the interests of consumers;
- (vi) a requirement for price-regulated utilities to publish the links, if any, between directors' pay and customer service standards.

Improving the transparency, consistency, predictability and accountability of regulation

- (vii) in the telecommunications and energy sectors, the replacement of individual regulators by regulatory boards;
- (viii) in the water sector, the appointment by Ministers of an advisory panel to support the individual regulator;
- (ix) a requirement for the regulators to give reasons for key decisions, to publish and consult on their forward work programmes, and to establish a code of practice on their consultation and decision-making procedures;
- (x) a requirement for regulators to give collective consideration to matters of common interest, and to publish the results;
- (xi) a power for the Competition Commission to veto licence modifications developed by a regulator following a reference which, in its opinion, do not remedy or prevent the adverse effects identified by the CC in its report on the reference;
- (xii) abolition of the Competition Commission's sector-specific utility panels, and their replacement with a single cross-utility panel;

Ensuring that regulation can keep pace with market developments

- (xiii) new collective licence modification procedures for the water and energy sectors enabling the regulator to modify standard licence conditions without a Competition Commission reference even if some companies disagree;
- (xiv) a requirement for the regulators to take into account the implications of their decisions for other regulated sectors within a multi-utility;

Ensuring that regulation has regard to wider social and environmental objectives

- (xv) a duty on each of the regulators, in the exercise of their statutory functions to have regard to guidance issued by Ministers on the social and environmental objectives relevant to their sector;
- (xvi) in the energy sector, broad enabling powers for Ministers to make regulations to promote energy efficiency, and the generation of electricity from renewable sources;
- (xvii) in the water sector, new powers for Ministers to initiate new or amended customer service standards, normally only in respect of standards raising environmental and public health issues;

Modernising the regulatory regime for the gas and electricity sectors

- (xviii) legislation to underpin the New Electricity Trading Arrangements (NETA);
- (xix) a requirement for separate licensing of electricity supply and distribution, and the introduction of a bar on supply and distribution licences being held by the same legal person;
- (xx) powers for the regulatory authority to adapt the licensing regime to changing market structures in future without additional primary legislation (by statutory instrument under affirmative resolution, and following a recommendation from the Competition Commission);
- (xxi) alignment where appropriate of the licensing and regulatory systems for gas and electricity, so that companies active in both fields are not subject to differing requirements and procedures without good reason.⁴⁵

A. Reactions to the proposals

The Office of Gas and Electricity Markets, (Ofgem), the combined gas and electricity regulator which anticipates the merger of OFFER and Ofgas, welcomed the forthcoming utilities legislation.⁴⁶ The main features it highlighted were the primary duty on the regulator to protect consumer interests, greater regulatory powers against anti-competitive practices, and enabling powers for the introduction of NETA. Ofgem expects the NETA to create further competition in generation and consequently drive prices down. If legislation proceeds as planned the Director General of Gas and Electricity Markets (DGGES), Callum McCarthy, expects the NETA to be operational in October 2000. To this end, invitations to tender for service providers were published and appointments made (subject to final contract) in December 1999.⁴⁷

Dieter Helm reviewed the legislative proposals in an editorial of the *Utilities Journal*.⁴⁸ He said the new proposals could “charitably be described as tinkering with the system” and “failed to address the core issues”. He believes that the current regulatory regime provides too much discretion to regulators, and personalises the role to an unhealthy degree. The broad general duties which underpin the regulators’ powers are actually to be further broadened in the legislation to include promotion of consumer interests. This leads to unpredictability and a high cost of capital, a comment reiterated by the chief executive of the Electricity Association, Philip Daubney:

(He) said the new powers had the potential to destabilise the regulatory regime and must be exercised with care. “Predictable regulation benefits all stakeholders, not least customers. For example, it reduces the risk premium on companies’ costs, and

⁴⁵ DTI, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Regulatory, Environmental and Equal Treatment Appraisals*, 13 October 1999

⁴⁶ Ofgem Press Notice R/45, *Ofgem welcomes utilities legislation*, 17 November 1999

⁴⁷ Ofgem Press Notice R/64, *New Electricity Trading Arrangements (NETA) Programme: Preferred Service Providers Selected*, 21 December 1999

⁴⁸ *Utilities Journal*, November 1999, p 30

allowing companies to make long-term investment decisions with greater confidence.”⁴⁹

Notwithstanding this, Dieter Helm accepts that there are many sensible proposals in the new legislation, including the merger of OFFER and Ofgas, and regulatory control by a board of individuals rather than one person.

Other press articles^{50,51,52} focus on the new powers to be given to regulators to protect consumer interests by promoting competition, and to impose stiff fines for breaches of licence conditions. Two of the articles mention that the initial plan to link directors’ pay explicitly to service standards had been dropped, but that their pay will be monitored although it was unclear how ‘excessive’ pay awards will be defined and controlled. The *Financial Times* article noted that the legislation will give the energy regulator the power to implement the NETA, and once this is in operation the Government may relax the strict consents policy currently applying to new gas-fired power stations. It also mentioned the plan to make regulators more transparent and accountable by requiring them to give reasons for their decisions, and the provision to replace individual regulators by boards or panels. The utilities are, however, concerned that the legislation will tighten regulation at a time when increased competition should allow it to be reduced.

⁴⁹ David Wighton, “Utility watchdogs will be able to impose unlimited fines”, *Financial Times*, 18 November 1999

⁵⁰ *ibid*

⁵¹ Roland Gribben, “Ministers drop plans for ‘fat cat’ salary sanctions”, *Daily Telegraph*, 18 November 1999, p 41

⁵² Roland Watson, “Utilities to be fined for failing customers”, *Times*, 16 November 1999

VIII The Bill

Sections I-VII of this paper have chronicled the development of government policy on utility regulation, culminating with a set of proposals for modernisation and reform. Confirmation of the key aspects of the Bill came with the Queen's speech:

To put the consumer first, cut prices and make utility regulation more transparent and accountable, a Bill will be introduced to modernise the utility regulation system.⁵³

The main provisions of the Bill were outlined in an accompanying background note from the DTI press office. It will:

- give regulators a new primary duty to protect consumer interest, wherever possible and appropriate through promoting effective competition;
- give regulators powers to impose monetary penalties for breaches of licence conditions and other requirements;
- establish independent consumer councils for each utility sector with the job of investigating complaints, providing information of assistance to consumers, and advocating the consumer interest;
- require price-regulated utilities to publish the links, if any between directors' pay and service levels achieved;
- replace the individual telecommunications and energy regulators with regulatory boards; and in the water sector, provide for the appointment by Ministers of an advisory panel to support the individual regulator;
- increase the transparency, accountability and consistency of regulation, for example by requiring regulators to give reasons for key decisions, to consult on their forward work programmes, and to give consideration collectively to matters of common interest, and to publish the results;
- give each regulator a duty to have regard to Ministerial guidance on social and environmental objectives relevant to their sector;
- give Ministers powers to make regulations to promote energy efficiency, and the generation of electricity from renewable sources;
- provide the energy regulator with powers to implement the New Electricity Trading Arrangements;

⁵³ HC Deb 17 November 1999 c 5

- facilitate further competition in energy markets by providing for the separate licensing of electricity supply and distribution;
- align the regulatory systems for gas and electricity under the single regulatory authority (OFGEM).⁵⁴

When the Bill was finally published on 21 January 2000, great emphasis was placed on the projected impact of New Electricity Trading Arrangements (though in legislative terms this is quite a small part of the Bill). Accordingly, this is one of the issues on which the paper will focus later. A DTI press release on the day of publication confirmed that the Government would be proceeding with each of the measures outlined above. In addition, further provisions dealing with cross utility issues and energy specific measures would be brought in at a later stage through Government amendments at the House of Commons committee stage.⁵⁵ To a large degree, the Bill as it stands already acknowledges the growth of multi-utility companies at least in so far as the regulatory arrangements would now be more alike for gas, electricity and telecommunications. Launching the Bill the Secretary of State for Trade and Industry (Stephen Byers) said:

This Bill will ensure that consumers and businesses get a fair deal from our utilities. It will tackle the rigged electricity market created when the industry was privatised and put in place a modern framework for utility regulation...

... It is now 15 years since the first utility, British Telecom, was privatised. It is time to modernise utility regulation and provide a more consistent, transparent and accountable regulatory framework. This will be good for customers and good for the utilities.

The *Daily Telegraph* reacted critically:

It is almost as if this Government has forgotten that the utilities have been privatised. They are none of them perfect, but the standards of service and efficiency in gas and electricity have been transformed since they were sold. Competition in both industries is growing, and prices are coming down as a result.

Despite the evidence from health and education, there remains a widespread belief that government controls can improve things, which is what encourages this sort of useless legislation. If Mr Byers must interfere, it should be to ensure more competition, not more rules on irrelevances such as directors' pay.⁵⁶

⁵⁴ DTI Background Note, *Utility Regulation Bill*, 17 November 1999

⁵⁵ DTI Press Notice P/2000/38, *Byers puts power with the customer*, 21 January 2000

⁵⁶ "Now is the hour for our finest snoopers and form-checkers" [city comment], *Daily Telegraph*, 22 January 2000

A. Gas and electricity

Part I of the Bill covers gas and electricity, the first three chapters of which cover issues common to the energy utilities. Chapter I details the new regulatory arrangements, including the abolition of the offices of Director General of Gas Supply and Director General of Electricity Supply. These will be replaced by the Gas and Electricity Markets Authority, comprising a chairman and no fewer than two other members, appointed by the Secretary of State [**clause 1** and **schedule 1**]. In effect, this single regulatory authority for electricity and gas will formally combine Ofgas and OFFER into Ofgem, though this has already been to some degree effected administratively. Following publication of the Bill, the current Director General of Electricity and Gas Supply (Callum McCarthy) said:

I welcome the creation of the Gas and Electricity Markets Authority (Gema) with the regulator as chairman. This will further depersonalise the role of the regulator, and will build on principles, already implemented at Ofgem in our management board, which has a majority of independent and expert members.⁵⁷

Interestingly, the Ofgem corporate plan reportedly indicates an increase in staff numbers from 400 (the Ofgas and OFFER total) to 550. This could either be an indication of past understaffing or "a warning to the companies that the regulator is gearing up for what may be a more information-intensive, supervisory position in the future."⁵⁸ Recently, the Director General of Ofgem was questioned on related matters by the House of Commons Trade and Industry Committee - the Committee is currently conducting an inquiry into the work of the Office of Gas and Electricity Markets. Christopher Chope drew attention to the Ofgem's £64.5m budget for 2000-1, which he compared with a combined spend by Ofgas and Offer of £29.8m three years ago. Callum McCarthy stated that the much of the additional costs were associated with the implementation of the New Electricity Trading Arrangements, together with redundancy payments to Offer staff unwilling to move from Birmingham to the London headquarters of Ofgem.⁵⁹

Clause 2 establishes the Gas and Electricity Consumer Council, replacing the Gas Consumers Council and the consumers committees for electricity. **Schedule 2** provides the terms of reference for the new Council, its regional and other committees. Co-operation and exchange of information between the regulatory Authority and the Council will take the form of a memorandum of understanding [**clause 6**].

Clause 7 provides powers for the Authority to insert licence conditions to allow for the recovery of the costs of the Council, and costs relating to the establishment of both the Authority and the Council. The Secretary of State may issue directions to the Authority on how the power should be exercised.⁶⁰

⁵⁷ Ofgem Press Notice R/5, *Ofgem welcomes Utilities Bill*, 20 January 2000

⁵⁸ "Supply Regulation: A New Direction?", *Utilities Journal*, December 1999

⁵⁹ "Ofgem's costs face MPs' fire", *Daily Telegraph*, 26 January 2000 p 30

⁶⁰ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

Chapter II of Part I covers the objectives of regulation of the gas and electricity industries. Protecting the interests of consumers now becomes the principal objective of the Secretary of State and the Gas and Electricity Markets Authority. Wherever possible this objective is to be secured by the promotion of effective competition. Similar wording is now used for the duties in relation to gas (**clause 8**) and electricity (**clause 12**) reflecting the convergence of the energy markets. Ensuring that reasonable demands for energy can be met, and that utility companies are able to finance their licensed activities, remain as general duties of the Secretary of State and the Authority. In addition to having regard to the interests of the disabled and the pensionable, individuals with low incomes, or those living in rural areas have to be considered. A duty to have regard to the chronically sick would now apply to electricity companies as well as gas.

While the interests of consumers are a feature of both the *Gas Act 1986* and the *Electricity Act 1989*, the new clauses described above substantially raise the profile of these. It may be significant that "consumers" will be taken to include both existing and future consumers [**clause 8(6)**, **clause 12(6)**]. This might have consequences both for sustainable development and investment outcomes.

Clause 9 and **clause 13** relate to statutory guidance on social and environmental matters for, respectively, gas and electricity. In fact, the wording of the clauses is identical, other than the references to the Acts into which they are to be inserted. As a result of these measures, the Authority will have to have regard to any guidance from the Secretary of State "about the making by the Authority of a contribution towards the attainment of any social or environmental policies set out or referred to in the guidance." This guidance will be published and laid before each House of Parliament, either of which may resolve (within 40 days) that it should not be issued. In other words this is akin to the negative procedure for statutory instruments and, as such, provides for a limited degree of parliamentary scrutiny and control. One criticism of this measure has been advanced by Dieter Helm, co-editor of the *Utilities Journal*:

The treatment of separation issues, the uncertainty over the new electricity trading arrangements, embedded generation and, critically the impact of the new utilities bill with its social and environmental obligations and even more general overarching duty to the consumers - these all increase regulatory risk.⁶¹

This paper will return briefly to the issue of embedded generators (i.e. power stations connected to a local distribution grid, rather than the national transmission grid) when dealing with renewable energy. More to the current point, regulatory risk is an important factor since it raises the cost of capital for new investment, influencing the rate of return a company can expect, as well as the price cap a regulator imposes. Ultimately this feeds in to prices paid by consumers, including those who are customers in competitive markets, not directly subject to

⁶¹ "Short-termism and Regulation" [editorial], *Utilities Journal*, December 1999

price regulation. Under OFGEM proposals, the latter should include all gas and electricity supply, probably within two years.⁶²

The Electricity Association welcomed the broad thrust of the Bill though its chief executive, Philip Daubeney, also drew attention to the issue of regulatory risk:

The government is giving itself considerable new powers to direct regulation. We want to see these used judiciously and transparently, with proper consultation, avoiding regulatory shocks which have the effect of increasing uncertainty, which in turn leads to increased costs.⁶³

Before issuing guidance, the Secretary of State would be required to consult the Authority, the Gas and Electricity Consumer Council, licence holders (i.e. utility companies) and any other persons he considers appropriate.

Clause 10 and **clause 14** change the wording of the *Gas Act 1986* and the *Electricity Act 1989* in relation to health and safety. In these Acts, the Secretary of State and the regulator had a duty to exercise their functions in "the manner which he considers is best calculated to protect the public from dangers" arising from gas or electricity supply. In the present Bill, the Secretary of State and the Authority are to "take into account" any advice given by the Health and Safety Executive. Though there is no suggestion of a weakening in safety measures, this might reflect a shift of responsibility towards increasingly independent and competitive utilities.

The functions of the Gas and Electricity Consumer Council are detailed in Chapter III (**clauses 16-24**). Chief among these are the provision of information to consumers, and the investigation of their complaints about energy utilities. In addition, **clause 17** provides for the Council to issue advice to public authorities and utility companies. The information to consumers has to include the periodic publication of statistical information about standards of performance, energy efficiency targets, and consumer complaints [**clause 18**]. So far as the latter are concerned, the Council would become the first point of contact with customers in the vast majority of cases. The regulator ("Authority") would continue to be able to redirect complaints to this quarter. In the event of the Council coming across a complaint which could attract a regulatory enforcement order or a penalty (a new development, introduced in **clause 47** and **clause 75**), then it will have to inform the Authority. **Clause 21** gives the Council similar, though somewhat wider, powers to investigate matters of interest to electricity and gas consumers than was the case for its predecessors. There are safeguards as to what may be published, which would be important in the context of commercial confidentiality for example. Consumer groups will be pleased that the Council may require the utility companies [**clause 22(2)**] as well as the Authority [**clause 22(1)**] to supply it with such information as it "may require in the exercise of its functions".

⁶² "Supply price restraints", *Utilities Journal*, December 1999

⁶³ "Bill promises 10% cut in electric fees", *Guardian*, 22 January 1999

The Council will have to take into account the cost of providing information before requesting it. Furthermore, the Secretary of State will be able to make regulations (by SI, and subject to annulment by either House of Parliament) prescribing the type of information which may be withheld or the circumstances in which it may be so [**clause 22(6)**]. Similar controls will govern information the Authority requests from the Council [**clause 24**].

The initial reaction from consumer group appears to have been positive. Rodney Brooke, chairman of the National Electricity Consumers Council, claimed the Bill would promise better protection and lower prices for consumers. At the same time he undertook to look at the small print "to make sure that the Bill delivers the Government's promises", particularly with regard to disadvantaged consumers.⁶⁴

B. Electricity

Chapter IV of the Bill deals exclusively with amendments to the *Electricity Act 1989*. Particularly important measures relate to: the separate licensing of distribution and supply; new enforcement powers (including financial penalties); information on links between directors' pay and service standards; renewable energy development; and electricity trading arrangements. The last of these featured in many of the headlines following the Bill's publication, with a claim that a 10% reduction in electricity prices would result.

1. Electricity licensing

In July 1998 the Government confirmed its intention to legislate for the separate licensing of electricity distribution and supply. Currently, public electricity suppliers (e.g. the regional electricity companies in England and Wales) are responsible for the distribution infrastructure in their areas, though other ("second-tier") companies can now compete to supply customers. With the introduction of competition in domestic electricity supply, the need for regulatory intervention should diminish. However, the more naturally monopolistic distribution business (the local "wires") is likely to remain subject to regulation and price caps for significantly longer. Though the Government wants to see distribution and supply licences held in separate companies, it will not require separation of the ultimate ownership of these companies.⁶⁵ When Ofgas succeeded in ring-fencing the transportation and supply businesses of British Gas, the company ultimately decided to "demerge" these voluntarily.⁶⁶

Clause 25 introduces separate distribution and supply licences; a company engaged in either of these activities will require such a licence unless it has been granted an exemption. **Clause 26** gives the Secretary of State more scope for varying the terms of, and for ending, an exemption than the section it replaces in the 1989 Act. Under the present Bill, the Authority will take the lead in issuing licences for generation, transmission, distribution, and supply

⁶⁴ Electricity Consumers Committees Chairman's Group Press Notice NECC/2, *Utilities Bill promises better customer protection and lower prices*, 21 January 2000

⁶⁵ DTI, *The Energy Report*, 1999 p.114

⁶⁶ "Separating PESs Activities", *Utilities Journal*, June 1998

[**clause 27**]. One new condition is that the same person will not be able to hold a distribution licence and a supply licence, an acknowledgement of the conflicts of interest which could arise. **Clauses 29-33** cover the conditions that may attach to licences, their modification and their transfer (in whole or in part). When the Authority or the Secretary of State makes a decision in respect of licence modification (and other specified matters), a notice of the reasons will have to be given [**clause 34**]. This is clearly aimed to satisfy calls for greater transparency in regulatory decisions.

Clauses 36-41 relate to the duties of electricity distributors, mirroring obligations to meet reasonable demands for a connection that hitherto rested with public electricity suppliers.

2. Standards of service

Clauses 42-48 deal with the setting and enforcement of service standards. The Gas and Electricity Markets Authority will be responsible for making regulations prescribing service standards for electricity suppliers and distributors. The regulations, made after consultation and with the Secretary of State's consent, can provide for compensation to be paid to a customer when standards are not met. In cases where the customer and utility company are in dispute, the Authority can issue an enforcement order. Similar measures already apply. The Bill differs from the 1989 Act in that it acknowledges the separation of distribution and supply, and that it provides for more consultation and information in the drawing up of service standards [**clauses 44-46**].

A significant development is the option given the Authority, in **clause 47**, to impose financial penalties on licence holders that contravene "any relevant condition or requirement", or who fail to achieve any prescribed standard of performance. The penalty may be "of such an amount as is reasonable in all the circumstances of the case." Examples of bad practice or poor performance which could attract fines include mis-selling, interruptions to supplies and the speed of reconnecting customers. Fines could also be imposed if a licence holder did not meet obligations in respect of renewable energy use.⁶⁷ An aggrieved licence holder will be able to appeal to the High Court (the Court of Session in Scotland).

The regulator will have to prepare a policy statement on the imposition of penalties and the determination of their amount.

Clause 49 will have a high profile in that it relates to "fat cat" salaries. The Government has opted for what the *Daily Telegraph* has referred to as a "name and shame" approach.⁶⁸ price-regulated companies will be required to make an annual statement to the Authority on what, if any, links exist between the remuneration of directors and levels of performance in respect of service standards.

⁶⁷ DTI Press Notice P/2000/38, *Byers puts power with the customer*, 21 January 2000

⁶⁸ "Byers pledges 10pc off power bills", *Daily Telegraph*, 22 January 2000

3. Renewable energy

Under section 32 of the *Electricity Act 1989*, public electricity suppliers have been subject to orders requiring them to contract for a specified amount of electricity generating capacity from renewable sources. Originally designed as a subsidy for nuclear power, the resulting non-fossil fuel obligations have provided a significant spur to the development of renewable energy sources, such as wind farms, waste incinerators and landfill gas. Operational projects sell their electricity to the public electricity suppliers at an above market price, the difference being funded by the fossil fuel levy. Similar procedures exist in respect of a Scottish Renewables Obligation (SRO) and a Northern Ireland Non-Fossil Fuel Obligation (NI-NFFO). However, in the latter case, a formal levy is not applied, general electricity tariffs providing for the premium price.⁶⁹

The Fossil Fuel Levy is payable by all licensed suppliers, and passed on to consumers as a percentage of their electricity bills. Condition 3 of the PES licence, which sets out the restrictions on charges made by the public electricity supplier, makes provision for the levy. All electricity generated from fossil fuels and nuclear fuel, and under NFFO contracts, is leviable.

The levy rate for England and Wales is determined according to the prescription given in the *Fossil Fuel Levy Regulations* SI 1990/266 (as amended by SI 1996/1309). In Scotland, the relevant regulations are the *Fossil Fuel Levy (Scotland) Regulations* SI 1996/293 (as amended by SI 1996/1512). The Director General of Electricity Supply collects the levy, using the proceeds to reimburse the public electricity suppliers for the excess costs involved in purchasing renewable electricity from generators. Section 33 of the *Electricity Act 1989* provides the general terms of reference under which the levy operates.

Clause 54 of the *Utilities Bill* abolishes the fossil fuel levy while, at the same time, providing for the continuation of existing obligations by allowing for an electricity reference price to be set by regulations. This market reference price serves to define the excess paid to a generator of renewable electricity, and hence the required rate of the fossil fuel levy. **Clause 55** in effect allows the Secretary of State to preserve existing non-fossil fuel obligations, despite the replacement of section 32 and the repeal of section 33 of the 1989 Act.

Environmental groups like the Worldwide Fund for Nature have lamented the passing of the non-fossil fuel obligation, expressing concern for the future development of renewable energy - a central plank of the Government's commitments to reduce greenhouse gas emissions. However, **clause 50** does replace the non-fossil fuel obligation with a new renewables obligation. Though the mechanics of this are as yet unclear, it is interesting that any orders made under this will refer to an "amount of electricity generated" - rather different from a commitment to contract for generating capacity. In keeping with market liberalisation, the renewables obligation will apply to all electricity suppliers (not just the public suppliers as before), though there will be greater flexibility as to how this may be satisfied.

⁶⁹ DTI, *The Energy Report – Transforming Markets*, 1998, p 163

Government policy on renewables is still under development. Of particular importance is the DTI consultation document, *New & Renewable Energy – Prospects for the 21st Century*, which was published at the end of March 1999. The consultation period that followed came to an end on 28 May, and a summary of responses published on 30 July. A DTI press release provided details of these, including:

Renewable energy should be developed as part of a balanced energy policy that gives appropriate consideration to energy efficiency, demand reduction and nuclear energy;

There is general support for the Government's target of working towards providing 10% of UK electricity supplies from renewable sources by 2010 as soon as possible, and hoping to achieve this by 2010. There was also some questioning of the Government's commitment to this target, and of the target's achievability given current planning and financial constraints and the limited level of development achieved to date;

Any future NFFO/Fossil Fuel Levy arrangement should be an improvement on the existing mechanism. There should be greater consideration of environmental and planning issues at an early stage, and support should be given to a wider range of technologies and to projects of varying scale;

Any obligation to supply electricity from renewable sources should rest with suppliers;

Both the benefits and the problems of embedded generation are highlighted, and there are calls for further studies of the issue as well as for improvements;

There is recognition and considerable concern that the reform of the electricity trading arrangements (RETA) will disadvantage small-scale, intermittent generators of electricity from renewables.

4. Electricity trading

New electricity trading arrangements (NETA) are due to come into effect in Autumn 2000. This section provides a brief synopsis of some of the more important points associated with electricity trading in the UK, beginning with the current system and the drivers of reform. In terms of the *Utilities Bill*, the measures to facilitate the introduction of new wholesale trading arrangements are confined to **clause 56**.

The present arrangements are embodied by the Electricity Pool of England and Wales – an unincorporated association of its members, comprising the major generators and suppliers in the electricity market.⁷⁰ Its functions, to schedule generation to meet demand and to create the market place for electricity, are performed on its behalf by the National Grid Company. The precise procedures are detailed in a document called the Pooling and Settlement Agreement, but in essence these involve individual generation companies (i.e. power station operators) offering to the Pool, in advance, a quantity of electricity at a particular price over a

⁷⁰ "Swimming in the Pool" *MagTech* (Magnox Electric, April 1997)

half-hour period. Prices paid to the generators will depend on the highest bid selected; some more expensive bids will receive capacity payments to provide a commercial incentive to maintain the power station for higher demand periods, such as winter.

Electricity suppliers, such as regional electricity companies, buy electricity from the Pool, the total price being based on metered demands adjusted for transmission losses. All licensed generators and suppliers are required to be members of the Pool, as a condition of their licences. The House of Commons Trade and Industry Committee's report, *Aspects of the Electricity Supply Industry* detailed the workings of the Pool as follows:⁷¹

The Pool operates as follows:

- Generators tell NGC a day ahead how much electricity each of their generating units is able to provide and the price for each half-hour period;
- NGC ranks the stations in order of bid prices and selects the cheapest to meet estimated demand; the System Marginal Price (SMP) for each half-hour period is determined by the bid price of the most expensive station selected to run; all stations selected to run in each half-hour period receive the SMP;
- The price paid by those taking electricity from the Pool (the same for all purchasers in any half-hour period) consists of the SMP plus 'uplift' plus the cost of 'capacity credits';
- 'Uplift' covers costs incurred to ensure the security and stability of the transmission system, such as the cost of plant kept on standby as reserve;
- 'Capacity credits' are determined chiefly by the degree to which total available capacity matches expected demand, and, in those half-hour periods when payments are due, are paid to all stations declared available, whether selected to operate or not.

The Pool is not a legal or physical entity: instead, there is a multi-lateral contract (the Pooling and Settlement Agreement) which governs the working of the wholesale electricity market. As already indicated, the great bulk of electricity traded is covered by contracts, but the Pool price remains important, since contract prices are very closely related to the expected Pool prices for the contract period (a process made easier at present by the price cap).

Protection from being exposed to unexpectedly high Pool prices (which can be quite volatile) can be afforded to some degree by suppliers entering into "contracts for differences" with individual generators. Usually, these will involve the generator making payments to a supplier equal to any excess of the Pool price over an agreed "strike price" for a particular

⁷¹ Trade and Industry Committee, *Aspects of the Electricity Supply Industry*, 19 July 1995, HC 481-I 1994-95

quantity of electricity. The generator receives a fee for granting such a contract.⁷² Contracts for Difference and Electricity Forward Agreements represent bilateral trading agreements which together cover some 90% of electricity consumption in England and Wales.⁷³

Some aspects of the pre-privatisation merit ordering of power stations have been retained by the Pool system. For example, nuclear power plants can submit zero price bids to the Pool to ensure they are selected for base-load capacity (i.e. they run all the time they are available). In the days of the state-owned CEGB (Central Electricity Generating Board), coal-fired power stations would supply the rest of the base-load, and the mid-merit load. It is possible for large power producers to exercise market power and raise the system marginal price above that which would pertain in a “truly competitive” situation. This in turn can encourage the construction of new gas-fired plant, at the expense of existing coal-fired power stations which might otherwise have been the most economical option. With shorter construction times and payback periods, and low gas prices, small gas-fired power stations are more commercially attractive than capital-intensive nuclear and coal-fired plant.⁷⁴ The growth of gas as a fuel for electricity generation has led to concerns that fuel diversity, and hence security of supply, might be compromised. Coal has an advantage here in that it can be stockpiled at power stations. One projection had coal’s share of the fuel mix falling to less than 10% by 2003, with gas exceeding 60%.

The DTI’s energy white paper⁷⁵ has compared estimates of electricity generation costs for coal and Combined Cycle Gas Turbine power stations:

New CCGT versus new coal

5.32 Nearly all responses took the view that CCGTs represented the cheapest form of new baseload (high load factor) generating capacity although some argued that clean coal technologies are becoming more competitive particularly when located close to economic coal supplies. Many respondents put the cost of new CCGT generation at high load factor within the range 1.8 – 2.2 p/kWh with several quoting a figure of 2.0 p/kWh. These estimates are based on respondents’ own views of gas prices and are for CCGTs being built now or capable of being built in the near future. Some respondents indicated that about half the total CCGT cost would be fixed and the other half variable. A small number of respondents put the cost of CCGTs much lower than the range 1.8 – 2.2p/kWh but this may have been as a result of ignoring interest during construction or the need to earn a return on capital. Both these factors ought to be included for new plant.

⁷² *Guide to Economic Regulation of the Electricity Industry* Oxera Press 1995

⁷³ London Business School, *A Model-based Comparison of Pool and Bilateral Market Mechanisms for Electricity Trading*, November 1999 p 5

⁷⁴ Katerina Rousaki, Andrew Bushell and Alessandra McConville, *Liberalisation of electricity markets and coal use*, IEA Coal Research, October 1999

⁷⁵ Cm 4071, October 1998

5.33 Many respondents put the cost of new coal capacity at close to 3.0 p/kWh, with a range from 2.6 – 3.25 p/kWh. Once again, about half the total costs were fixed and with coal stations having higher fixed costs than new CCGTs, they would be less competitive at lower load factors.

5.34 The Government does not see any reason to disagree with these views; it agrees that at present fuel prices, new CCGTs are cheaper than new coal plant in nearly all likely circumstances. Any distortions in the market which encourage excessive new entry will therefore benefit gas rather than coal.

The white paper was published in October 1998 against a backdrop of a moratorium on new gas-fired generation plant, imposed by the Government in December 1997.⁷⁶ A “stricter consents policy” (whereby environmentally-friendly combined heat and power gas plants have been approved) replaced this the following year, as signalled by the white paper:

10.19 Accordingly, having taken into account all the above points, the Government has reached the judgment that it is necessary to put in place interim measures, in the form of a stricter consents policy, to protect diversity and security of supply while market distortions are being addressed. During the period of the policy, there will therefore be a general presumption that new gas-fired stations will normally be inconsistent with its policy objective. Certain types of plant may, however, have benefits that outweigh the concerns and may therefore be looked on more favourably. These are discussed below; however, first the duration of the policy and its application to the various types of consent and clearance are discussed.

Indeed, the white paper was the outcome of a review of energy sources for power generation, originally established in December 1997. Two months earlier, government concern over possible distortions in the electricity market led the then Minister for Science, Energy and Technology (John Battle) to commission a review from the Director General of Electricity Supply (then Professor Littlechild). The white paper provided details of the proposed new trading arrangements:

6.39 The DGES has proposed radical reform of the electricity trading arrangements, comprising a new set of trading arrangements which would effectively replace the Pool and its associated contracts market. The proposals are very similar to other commodity markets and those already in place in the gas market. The central elements include: the involvement of the demand side in the setting of pricing through allowing direct contracting between customers and generators; firm bidding so that people are tied to their contracts as they are in other markets; and simple understandable bids to aid transparency. Trading through the electricity Pool would no longer be compulsory and prices would be set in most of the market through bilateral contracts, not through a single Pool price. The effect of these changes would be that generators would each need to compete for customers. They would be paid the rate they had negotiated with those customers, not at a single Pool price. All of these

⁷⁶ HC Deb 3 December 1997 c 348

elements differ from the current arrangements. The key features of the new trading arrangements under the DGES's proposals are:

- a forward market where customers and suppliers can contract directly with generators for electricity. They might contract for some time ahead – perhaps months or years;
- a short term screen-based market where simple offers and bids for electricity can be traded. Such a market will enable people to adjust their contract positions in the light of current information (such as the weather). This market might open some time ahead of the actual delivery of electricity (say, a day) and close around 4 hours ahead (exact times have yet to be decided) so that NGC has time to balance the grid system;
- a balancing market, which NGC will use to balance actual supply and demand on the system as well as to solve transmission constraints. This market will open around four hours ahead until the moment of delivery. Through this mechanism NGC will be able to contract for increases or decreases in generators' output, or decreases in customer demand where these are offered into the balancing market;
- a settlements process to cash out trades;
- associated derivatives markets.

6.40 The Government has considered these proposals. It considers the direction set out in the proposals to be the right way forward and that work needs to be progressed accordingly.

In July 1999, Ofgem published for consultation detailed proposals for the new electricity trading arrangements.⁷⁷ Six key issues were identified by respondents:

- Imbalance of cash-out prices;
- The timing of contract notification;
- Separation of production and consumption imbalance volumes;
- Meter splitting and aggregation;
- Governance; and
- CHP [combined heat and power] and renewables.

⁷⁷ Ofgem, *The New Electricity Trading Arrangements*, July 1999

These issues have been discussed in an Ofgem/DTI conclusions document, representing a culmination of the review of electricity trading arrangements. The document, *The New Electricity Trading Arrangements*⁷⁸ marks the metamorphosis of RETA into NETA. An overview of the trading arrangements is given in the executive summary:

The trading arrangements are designed to be more efficient and provide greater choice for market participants whilst maintaining the operation of a secure and reliable electricity system. The proposals are based on bilateral trading between generators, suppliers, traders and customers. They include:

- Forwards and futures markets (including short-term power exchanges), which evolve in response to the requirements of participants, that will allow contracts for electricity to be struck over timescales ranging from several years ahead to on-the-day markets;
- A Balancing Mechanism in which NGC, as System Operator, accepts offers of and bids for electricity to enable it to balance the system; and
- A Settlement Process for charging participants whose contracted positions do not match their metered volumes of electricity, for the settlement of accepted Balancing Mechanism offers and bids, and for recovering the System Operator's costs of balancing the system.

It is envisaged that the present Pooling and Settlement Agreement will be replaced by the Balancing and Settlement Code (BSC) incorporating the rules of the Balancing Mechanism and Settlement Process. NGC, as System Operator, will be obliged to maintain the Code. Licensees will be obliged to conform to it. The Code will include flexible and effective governance arrangements to allow for modifications to the rules.

The switch from a central Pool mechanism to a system of bilateral contracts between suppliers (e.g. regional electricity companies) and generators is more feasible now than in the past. One reason is the experience gained through the operation of contracts for differences, another the development of IT systems suitable to monitor and control both the balancing mechanism and settlement process. At the time of electricity privatisation in 1990 it was not possible for a supplier to identify and make direct payments to a generator.

Under NETA, generators will finalise contracts for the sale of their electricity to suppliers at least four hours in advance, though much longer term (a year or more) contracts will be possible. Nearer delivery time (the start of a trading period), the balancing mechanism comes into play, whereby a generator who delivers less than the contracted amount will be liable to charges. Similarly a supplier who consumes more than contracted. Buyers and sellers of "imbalance electricity" will attract different prices, these constituting a two part cash-out

⁷⁸ Ofgem/DTI Conclusions Document, *The New Electricity Trading Arrangements*, October 1999

regime. Generators who provide an excess of electricity would attract lower prices, encouraging longer term contracts.

One concern is that renewable electricity generators, such as wind farms, have greater difficulty in predicting their output in advance. This could discourage suppliers from entering into bilateral contracts with renewable generators. However, many such generators (including all current wind farms) are too small to need a licence and will not be required to sign the new balancing and settlement code (BSC). Their customers are likely to be signatories who will be mindful of exposure to cash-out (i.e. imbalance charges). Flexible arrangements with respect to metering and the aggregation of generation capacity should help to allay these fears, and these form part of the new arrangements. Even so, it seems likely that NETA will create a more difficult environment for renewable electricity, which exemption from the climate change levy may only partially mitigate.⁷⁹

A House of Lords written answer addressed these concerns:⁸⁰

Earl Howe asked Her Majesty's Government: How they intend to treat electricity generated from wind energy under the current review of electricity trading arrangements.[HL4039]

Lord Sainsbury of Turville: We do not intend to require licence-exempt generating plants (i.e. those which have a capacity of below 50 megawatts, or a capacity of up to 100 megawatts of which less than 10 per cent. is exported) to participate directly in the new trading arrangements. All current wind generators would fall into this category. Exempt generating plants will still be exposed to imbalance charges, but only indirectly, through the suppliers with which they contract. The Office of Gas and Electricity Markets published a consultation document *The New Electricity Trading Arrangements* on 31 July setting out detailed proposals for the new wholesale electricity trading arrangements in England and Wales. It contains further details about the proposed treatment of the generation of electricity from renewable sources.

Another issue relates to the governance of the balancing and settlement code. Though this will be administered by the National Grid Company, a Balancing and Settlement Code Panel will be established to supervise proposed modifications to the rules. The Director General (Callum McCarthy) will approve modifications to the code and appoint the chair of the BSC panel; the latter will comprise industry and consumer representatives as well as independent experts. This arrangement will allow for any tweaking needed to ensure an effective market becomes established. Some respondents to the July 1999 consultation expressed concern that the complexity of the balancing mechanism might deter participation, conferring market power on large portfolio generators able to accommodate short term fluctuation in demand – which would act to push up electricity prices overall. Ofgem and DTI will be encouraged to

⁷⁹ “Electricity trading reforms bad for environment, DTI admits”, *ENDS Report*, October 1999

⁸⁰ HL Deb 11 October 1999 c 50WA

proceed by the fact that ten power companies have already conducted a mock two-day simulation of the new arrangements.⁸¹

A briefing paper by Oxford Economic Research Associates questions whether Ofgem's proposals will lead to the establishment of an effective market without further action. In October, *The Utilities Journal* commented:⁸²

However, the fear is that, under the current conditions, the new trading arrangements will be characterised by the dominance of long-term contracts, with very little short-term liquidity because the costs of participating are so high as to outweigh the penalty of facing imbalance cash-out prices. The prospects for market development would look much brighter if the government were to look more carefully at industry structure *before* implementing the new proposals, to avoid making a leap of faith which might make things worse.

It might therefore be appropriate to treat with caution the headline claim that the *Utilities Bill* will bring about a 10% reduction in electricity prices. Professor Richard Green of Hull University has suggested that the sale by PowerGen and National Power of generating capacity could make the electricity market more competitive. He does not, however, believe that the new trading arrangements will do so.^{83,84}

C. Gas

The opening up of the gas supply market to competition preceded that of electricity. Domestic customers now have a choice as to who supplies their gas and electricity needs. However, there remain a larger number of alternative suppliers of gas. Some 27% of domestic customers have switched away from British Gas Trading, representing an average of 32,000 switches per day over the last year.⁸⁵ Still, British Gas retains a dominant position in the domestic supply market, justifying the continuation (for another year) of price controls imposed by the regulator.⁸⁶

In addition to gas suppliers there are gas transporters, of which the largest is BG Transco. These operate the pipelines through which gas shippers arrange for gas to be sent from beach terminal to final customer. It might be helpful to think of gas shippers as being analogous to electricity generators, and of gas transporters as performing functions analogous to electricity transmission and distribution. Indeed, Transco has operated a New Gas Trading

⁸¹ "Progress on NETA", *The Utilities Journal*, October 1999, p 4

⁸² "A NETA Electricity Market", *The Utilities Journal*, October 1999, p 24

⁸³ "Draining the Pool: the reform of electricity trading in England and Wales", *Energy Policy*, September 1999

⁸⁴ "What Buyers Might Get", *Utilities Journal*, July 1999

⁸⁵ "Supply competition", *Utilities Journal*, January 2000, p 8

⁸⁶ "Supply Regulation: A New Direction?", *Utilities Journal*, December 1999, p 28

Arrangement since its inception last Autumn. This wholesale market in gas has many features in common with electricity's NETA described above.⁸⁷

As has already been noted, the gas and electricity industries have many other features in common, a fact reflected in Chapter V of the *Utilities Bill*. This is solely concerned with amendments of the *Gas Act 1986* (amended itself by the *Gas Act 1995*). Thus, this chapter contains analogous clauses on licensing, performance standards, enforcement of obligations and remuneration and service standards. For example, two clauses grouped together under the *Miscellaneous* heading relate to help for disadvantaged customers [**clause 78**] and energy efficiency requirements [**clause 79**]. These are directly analogous to clauses 57 and 58 in Part IV. Clause 78 begins:

If the Secretary of State considers that members of any group (a "disadvantaged group") of customers of persons who supply gas are treated less favourably than other customers of theirs as respects charges for gas, he may make an order containing a scheme for the adjustment of charges for gas with a view to eliminating or reducing the less favourable treatment.

Clause 79 also provides the Secretary of State with powers to make orders, in this case requiring gas transporters and suppliers to meet energy efficiency targets. In effect, the gas companies would have to find ways of helping their customers reduce demand (one example might be the promotion of more efficient central heating boilers). References to "distributors" in subsection 6 are presumably a throwback to the analogous clause (58) for electricity. The latter includes, in addition, scope for the promotion of combined heat and power schemes whereby waste heat from the generation of electricity is put to use - for example through district central heating schemes. Orders in relation to helping disadvantaged customers or promoting the efficient use of energy will take the form of statutory instruments subject to the affirmative procedure.

Another "miscellaneous" measure common to gas and electricity relates maximum resale prices. The DTI's explanatory notes elaborate:

111. *Clauses 61 and 82: Maximum prices for reselling electricity and gas.* The existing provisions in the 1989 Act and the 1986 Act share the overall objective of preventing excessive prices being charged when electricity or gas is resold (e.g. by landlords to tenants), but differ in their details. These clauses reconcile the differences so that the powers granted to the Authority are the same for the two fuels (except for the exemption for gas used for propelling motor vehicles).

112. *Clause 61: Maximum prices for reselling electricity.* This clause makes the power in electricity more flexible:

⁸⁷ Ofgem Press Release PN43, *Success of new gas trading system bodes well for NETA*, 3 November 1999

instead of having to fix actual prices, the Authority will be able to set a formula by which maximum prices are calculated;

the Authority may direct that interest be paid on sums charged in excess of the maximum price, and not just the value of the overpayment itself as at present; and

the Authority may direct that resellers provide information on their prices to purchasers (and the Authority may direct that the maximum price be reduced by an amount or percentage if the reseller fails to comply with this requirement).

113. These three changes align electricity with the relevant aspects of the current position in gas.⁸⁸

Other clauses in Chapter V also demonstrate an intention to bring about a more uniform regulatory system for the energy utilities. For example, **clauses 62, 65-68** which amend the *Gas Act 1986* in so far as licensing is concerned, have close analogues in clauses in Part IV dealing with the same subject for electricity.

Clauses 70-77 cover gas performance standards, enforcement of obligations, remuneration and service standards. They closely mirror the analogous clauses amending the *Electricity Act 1989*. Standards of performance will now be brought to bear on gas transporters; hitherto only gas suppliers were covered. The underlying reasons for this will in part reflect the separation of transportation and supply (acknowledged by the *Gas Act 1995*), together with the emergence of smaller transporters competing with Transco. The measures in respect of financial penalties [**clause 75**] are the same as for electricity. It may be noted, however, that the Director General of Gas Supply has had powers to levy fines since the passage of the 1995 Act. Gas "fat cats" will have to publish any links between their remuneration and customer service standards in the same way as their electricity counterparts. In both industries this will only apply to licensed activities subject to price regulation. Once the gas and electricity supply markets are deemed to be fully competitive (so that price caps are no longer imposed), such links between salary and service will not have to be identified.

As the utilities review leading up to the Bill has unfolded, regulators have already begun to adjust their approach within existing powers. Another Dieter Helm editorial in *Utilities Journal* has already commented that "naming and shaming" is the new weapon in the regulators' armour.⁸⁹ He goes on:

In the short term (which is what politicians care about), the impacts of this tightening of the regulatory screw are likely to be disguised. However, in the longer term, the new style does not bode well for the future infrastructure of Britain. New-style regulation will encourage short-termism by companies, too, and investment and network maintenance will be closer to the margin. The regulatory response - to be

⁸⁸ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

⁸⁹ "New-style Regulation", *Utilities Journal*, January 2000, p 1

tough on outputs and the causes of output failures, with enforcement, fines and naming and shaming - has already given investors a fright. In the short term, however, the sharp falls in share prices do not seem to bother regulators or politicians. But Labour should remember that it needs the utilities to do the investing, given its aversion to raising taxes. The longer Labour plans on staying in office, the more it should ask itself whether the new style of regulation is really such a good idea.⁹⁰

D. Telecommunications

The *Telecommunications Act 1984* established the office of Director General of Telecommunications with responsibility for regulating utilities such as BT, Mercury, local cable companies, mobile network operators and others.⁹¹ These telecommunications operators are licensed by the Office of Telecommunications (OfTel), with some of BT's businesses remaining subject to price cap controls (a recognition of the advantages enjoyed by an incumbent). Consumer interests are currently represented by OfTel's own Advisory Committees on Telecommunications - with separate ones for England, Scotland, Wales and Northern Ireland. Another two ACTs represent the interests of businesses and elderly or disabled people.⁹²

The current retail and network price controls on BT came into effect in 1997 and are due to end next year.⁹³ Back in 1996, OfTel suggested that the retail price caps would be the last, given the anticipated growth in competition. More recently, a consultation has been initiated into whether further controls of this kind will be needed.⁹⁴ The situation with regard to interconnection charges levied by BT on competitors for access to its network is even more complex, given increasing demand, largely internet-led. Ironically, successful regulation of BT's charges could inhibit switching to competitors, delaying the time when the regulator can rely on competition law. New powers to enable him to do so will be in place in March when the *Competition Act 1998* comes into force. At the same time, the European Commission is conducting a review of the regulatory framework for communications, the results of which will inevitably feed into the work of national bodies like OfTel. Writing in the September 1999 issue of *Utilities Journal*, OfTel's Director General (David Edmonds) outlined OfTel's overall approach:

For the foreseeable future, communications markets will continue to be defined by rapid change. In response, the EU needs a regulatory framework that can adapt to these changes and not act as a brake on innovation. OFTEL believes that this requires principles and high-level objectives agreed at a European level, which are then implemented at a national level in a transparent and objective way best adapted to take account of national circumstances. Where regulation is applied, it must be both

⁹⁰ *ibid.*

⁹¹ <http://www.oftel.gov.uk/about/oftguide.htm>

⁹² <http://www.acts.org.uk/>

⁹³ "Telecommunications: costs, accounts and interconnection", *Regulating Utilities: A New Era?*, London Business School 1999, p.109

⁹⁴ "BT Price-control Review 2001", *Utilities Journal*, August 1999, p 27

proportionate and effective, and so promote the interests of European consumers. It should also be possible to regulate speedily where market problems occur, and to withdraw from regulation equally speedily where it is no longer needed. Over time, as competition increases, we should rely more on competition law and move away from sectoral regulation.

This statement was followed by Oftel's announcement, in January 2000, of a "new strategy for regulation":

At the heart of the strategy is a rolling back of formal regulation where competition is effective and already protects consumers. There will be more self-regulation by the industry and co-regulation where some control is still needed, with a stronger emphasis on preventing anti-competitive practices.⁹⁵

The *Independent* dismissed the announcement as "woolly", pointing to the continued dominance which BT exerts on the industry.⁹⁶ New regulatory arrangements in Part II of the *Utilities Bill* mirror those for gas and electricity. **Clause 84** establishes the Telecommunications Authority, having the same working arrangements as its Gas and Electricity counterpart. Consumer interests would now be represented by a Telecommunications Consumer Council, replacing the ACTs described above [**clause 85**].

Schedule 7 provides for the abolition of the section 54(4) advisory bodies for matters affecting small businesses and for matters affecting persons who are disabled or of pensionable age. The regulatory authority will retain the section 54(3) power to establish such advisory bodies as it thinks fit.⁹⁷

As with gas and electricity, the telecommunications regulatory authority (with the Secretary of State) will have a primary duty to protect the interests of consumers. Similarly, it shall have regard to the interests of the disabled or chronically sick, and individuals of pensionable age, on low incomes, or those residing in rural areas. This is a wider remit than that specified in section 3 of the *Telecommunications Act 1984*, contributing to a broad uniformity in the new approach to the gas, energy and telecommunications utilities.

The Secretary of State and the Authority also have a range of other objectives, recognising the international nature of telecommunications services - be they international calls or EC directives. The importance of the latter is underlined by **clause 91** which makes clear the international implications, as well as national security concerns, associated with telecommunications. This is not to diminish the significance of gas and electricity directives which have come into force in recent years, but the impact of these has been relatively limited due to the advanced nature of energy market liberalisation in the UK.

⁹⁵ Oftel Press Release 02/00, *Oftel announces new strategy for regulation*, 18 January 2000

⁹⁶ "Regulatory capture", *Independent*, 19 January 2000

⁹⁷ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

As with electricity and gas, the Secretary of State will be able to issue the Telecommunications Authority with guidance on how it might contribute towards the attainment of social and environmental policies. One particular issue could conceivably relate to the erection of telecommunications masts which have excited concerns both about visual intrusion and the impact of radiofrequency radiation on health. Though there is no firm evidence, and even less reason to believe that everyday exposure represents a significant health risk, genuine public concern is a valid planning consideration.⁹⁸ **Clause 90** might thus provide the Secretary of State with a means of encouraging the kind of prudent avoidance policy adopted in other countries, particularly if it can be done so without overly compromising duties to encourage telecommunications development.

Clauses 97-98 provide for additional enforcement powers for the Telecommunications Authority, including the imposition of fines. The main difference with the energy sector is that, from the initiation of enforcement action, the Authority will have less time to impose a financial penalty - 2 months in the case where a provisional enforcement order has been confirmed (one month less than the energy sectors). This difference is a consequence of requirements imposed by EC Directive 97/13 ('the Licensing Directive').⁹⁹ Furthermore, penalties would be levied in respect of breaches of licence conditions or standards of performance. They would not apply to conditions relating to the application of the telecommunications code (schedule 2 of the *Telecommunications Act 1984*). This sets out powers which can be used by companies to enable them to install and maintain apparatus.¹⁰⁰

Clause 99 requires price-regulated licensed telecommunications companies (e.g. BT) to publish the links, if any, between service standards and directors' pay.

Clause 100 requires the Authority to give notice of the reasons for decisions on licensing and other some enforcement matters. Commercial confidentiality will have to be respected, and the clause would furthermore "not apply in relation to ... a decision made by the Authority in the interests of national security."

Clause 102 provides for financial penalties against mobile telephone service providers. The explanatory notes elaborate:

This clause applies the provisions on financial penalties to systemless service providers in the telecommunications sector in respect of obligations imposed by the Telecommunications (Open Network Provision) (Voice Telephony) Regulations 1998. A "systemless service provider" means a person who provides publicly available telecommunications services, but does not run a telecommunications system within the meaning of Section 4 of the 1984 Act. Systemless service providers provide retail services to customers by reselling the network services of network

⁹⁸ House of Commons Library Standard Note, *Telecommunications masts - planning and health*, 19 January 2000

⁹⁹ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

¹⁰⁰ <http://www.oftel.gov.uk/about/manage97.htm>

operators (eg mobile service providers who resell mobile network operators' airtime to retail customers).¹⁰¹

E. Water

It is perhaps unnecessary to point out that water is different to other utilities such as electricity, gas and telecommunications. There is no equivalent of a national network like the electricity grid, though some limited "common carriage" of water across regional boundaries is beginning to take place, bringing with it the possibility of further competition.¹⁰²

The present Director General of Water Services (Ian Byatt) acts as an economic regulator, with a remit to ensure that water and sewerage companies are able to finance their functions and environmental obligations. The latter, in particular water quality standards, are implemented and enforced by the Environment Agency in England and Wales. There is scope for regulatory failure and tension between competing demands for economic efficiency and environmental standards, though the DGWS does have secondary environmental protection duties. His secondary duty towards customers is to some extent coupled to the promotion of financially viable water companies.¹⁰³ One critic of the regulatory system for water is Professor Colin Robinson:

Water is an industry where market forces hardly intrude. There is practically no real competition of the sort enjoyed by customers of the other utilities, except for a few extremely large consumers. The regulator effectively runs the industry with occasional incursions by government by way of 'water summits' or other types of Old Labour exhortation. Unless the present regime is changed so it more closely resembles those in the other utilities, the future seems bleak for customers, the water companies and even the regulator - whose functions may eventually be taken over by a government jealous of the power he wields under the present system. It requires little imagination to see that the industry could easily revert to *de facto* government control, if not government ownership.¹⁰⁴

In Scotland, the water industry is owned by the Scottish Executive which is also responsible for the regulation of environmental, public health, and efficiency matters. There are no plans to take ownership of the Scottish industry out of the public sector,¹⁰⁵ and the *Utilities Bill* relates only to England and Wales on this subject. Further information on water regulation is given in Library Research Paper 98/117, *Water Industry Bill*.

The *Utilities Bill* retains the office of Director General of Water Services, as established by the *Water Act 1989* and continued by section 1 of the *Water Industry Act 1991*. Though there

¹⁰¹ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

¹⁰² "Towards Common Carriage", *Utilities Journal*, December 1999

¹⁰³ <http://www.open.gov.uk/ofwat/rolereg.htm>

¹⁰⁴ "A Competitive Water Industry?", *Utilities Journal*, July 1999 pp 38-9

¹⁰⁵ Statement to Parliament on Water Industry by Sarah Boyack, 16 September 1999

is no provision for a regulatory board, **clause 104** of the Bill inserts a new section into the 1991 Act beginning:

The Secretary of State shall establish a committee to advise the Director in the exercise of his functions.

This committee will be known as the Water Advisory Panel, the members of which will be appointed by the Secretary of State (after consulting the Director and the National Assembly for Wales). **Clause 105** establishes the Consumer Council for Water, replacing the existing Customer Service Committees. The chairmen of the latter were appointed by the Director General of Ofwat (after consultation with the Secretary of State¹⁰⁶). Under the arrangements in Part II of Schedule 4 of the Bill, the Secretary of State will be responsible for appointing the members of the Council and the chairmen of its regional committees. The only exception will be committees for companies operating wholly or mainly in Wales, where the chairmen will be appointed by the National Assembly for Wales.¹⁰⁷ Costs relating to the establishment of the Consumer Council for Water and the Water Advisory Panel will be recoverable from the water or sewerage undertakers appointed for areas of England and Wales [**clause 108**].

Protecting the interests of consumers (the "consumer objective") becomes an additional primary function. The DTI's explanatory notes on **clause 109** elaborate:

This clause amends existing general duties which affect the manner in which the Director, the Secretary of State and the National Assembly for Wales exercise specified functions under the Water Industry Act 1991 ("the 1991 Act). They are given a new consumer objective to protect the interests of consumers of regulated water and sewerage services, wherever appropriate through promoting effective competition. They are under a duty to further that objective, to secure that the functions of water undertakers and sewage undertakers are properly carried out throughout England and Wales and to secure that companies holding appointments are able to finance the proper carrying out of those functions.

Due regard will have to be given to the same categories of potentially disadvantaged consumers as with other utilities (the disabled or chronically sick, and those of pensionable age, on low incomes, or living in rural areas). Guidance on social and environmental matters can be issued by the Secretary of State, on similar terms as that which applies to electricity and gas. However, the National Assembly for Wales will be responsible for issuing such guidance as relates to the Principality. The different arrangements for Wales makes it even more convenient to rely on the DTI explanatory notes for an explanation of **clauses 111 and 112** dealing with standards of performance for water supply and sewerage:

¹⁰⁶ section 28, *Water Industry Act 1991*

¹⁰⁷ DTI, Explanatory Notes to the Utilities Bill, Bill 49-EN

157. *Clauses 111 and 112: Standards of performance in relation to water supply and sewage services.* These clauses amend the arrangements by which service standards can be set. Clause 111 deals with standards in relation to water supply. Clause 112 deals with standards in relation to sewerage services. Service standards define the standards customers are entitled to expect from the water and sewerage undertakers in the delivery of their services. Regulations may provide for compensation payments to customers in the event that a water or sewerage undertaker does not meet a minimum level of performance required.

158. Service standards can currently be set by the Secretary of State only in response to a specific proposition from the Director General of Water Services. These clauses will mean that the existing arrangements will be extended so that the Secretary of State (in respect of companies operating wholly or mainly in England), and the National Assembly for Wales (in respect of companies operating wholly or mainly in Wales) can initiate proposals for new or amended service standards on matters falling outside the remit or expertise of the Director.

159. Before using the new procedures the Secretary of State (or the Assembly) must ensure that the people or groups listed in new subsection (8) have been consulted. Before making any regulations under this procedure, the Secretary of State (or the Assembly) is required to ensure that there has been appropriate research to establish the views of a representative sample of persons likely to be affected by the regulations, and to consider the results of that research.

160. The new procedure will normally only be exercised by the Secretary of State and the National Assembly for Wales in respect of standards which contribute towards the attainment of policies relating to public health or the environment (for example, standards setting leakage targets preventing the waste of valuable water resources or standards requiring a wholesome supply of drinking water). The procedure, however, could also be exercised with respect to service standards which extend beyond these issues if the Secretary of State (or the Assembly) considers there to be exceptional reasons why it is otherwise in the public interest to set service standards.

The Environment Minister Michael Meacher chose to highlight these issues when commenting on the publication of the Bill:

Many of the Bill's provisions apply to the water industry, including a number that will directly benefit customers and the environment. There will be a new Consumer Council for Water to promote the interests of customers. We will have new powers to set service standards on environmental and public health matters.¹⁰⁸

The Consumer Council for Water will have powers to investigate a wide range of matters (beyond complaints) affecting the interests of consumers. However, it must first "consult" (rather than "notify" as in the other utilities) the Director of Ofwat and the Secretary of State (and the Welsh Assembly) [**clause 117**]. Water companies already concerned with

¹⁰⁸ DTI Press Notice P/2000/38, *Byers puts power with the customer*, 21 January 2000

"regulatory burden"¹⁰⁹ may be unhappy with the Council's powers to require the provision of information from them [**clause 114(2)**].

Clause 118 provides for fines on water companies, analogous to those pertaining to the other utilities. The power to levy fines will rest with the relevant enforcing authority which, in the case of water, could be either the Director, the Secretary of State or the Welsh Assembly.

Any company holding an appointment, under Chapter I of the *Water Industry Act 1991*, to supply water or sewerage services will have to publish an annual statement on the links between service standards and directors' remuneration [**clause 120**].

Ian Byatt, the present Director of Water Services, commented on the *Utilities Bill* during a recent speech to industry practitioners.¹¹⁰ He said the objective of the new Bill had been to raise the level of customer representation and protection. This was being done while giving equal priority to the duty to ensure that the functions of the water companies are properly carried out and can be financed. However, some areas of the Bill were over-prescriptive and bureaucratic.

It could raise the costs, but not the effectiveness, of regulation.

Because of some lack of clarity about whether the Secretary of State retains any function when the Director has been authorised to act, companies could face fines both from the Regulator and Secretary of State for the same failure. I understand the government will introduce amendments to prevent this double jeopardy.

Mr Byatt was also concerned that the proposed complaints procedures would be more bureaucratic than the "one-stop shop" currently offered by Ofwat and its Customer Service Committees. He looked forward to the development of market competition allowing the possible relaxation of regulation in the future. These sentiments represent a detectable echo from a lecture he gave on 13 September 1999 at the London School of Economics:

Our liberal civil society - a community of citizens - benefits from a plurality of institutions. Utility regulators are a recent but a significant addition. They can take their place alongside other non-Ministerial decision making bodies. They take their authority from their statutory duties, establishing their credibility through openness, integrity and fairness.

There are those, however, with a more centralised view of society who do not like the independence of the regulator from Ministers. They appear to want to counter the privatisation of utilities with the nationalisation of regulation.¹¹¹

¹⁰⁹ "The Periodic Review that Never Was", *Utilities Journal*, August 1999 p38

¹¹⁰ Ofwat Press Notice PN 01/00, *Details need to be clarified if the Utility Bill is to benefit water customers*, says Ian Byatt, 26 January 2000

¹¹¹ "Checks, Balances and Competing Pressures - Looking Forward at the Role of the Regulator", Lecture by Ian Byatt, Centre for the Study of Regulated Industries, 13 September 1999

F. The Competition Commission¹¹²

The *Competition Act 1998* which comes into force on 1 March 2000 initiates major reforms to UK competition legislation. Competition policy broadly aims to allocate the productive resources of the economy in an efficient manner by maintaining fair and effective markets. Markets in which firms are able to compete actively against each other should in theory both stimulate and reward innovation and productivity and at the same time deliver consumers with the quality of goods and services they want at the lowest possible cost. Other less strictly economic policy aims are, however, often also factored into competition policies.

In the UK, historically, competition policy has sought to control the exercise of monopoly power and the operation of anti-competitive cartels in order to allow competition to flourish. For monopolies, there was an investigative procedure which allowed action to be taken against dominant market firms if they were found to be operating against the public interest. Restrictive trade agreements and cartels were subject to separate legislation requiring notification of such agreements, and court investigations into whether they were acceptable.

Under the new Act restrictive agreements (or cartels) and abuse of dominant market positions (or monopoly power) are prohibited. The prohibitions are modelled on the wording of EC competition provisions, which already apply to agreements and dominance where there is an effect on intra-state trade. The new prohibitions are in general enforced by the Director General of Fair Trading (DGFT) who receives strong investigative powers and is able to levy substantial fines on companies which breach the prohibitions.

Among the purposes of utility regulation is fostering competition within the regulated sectors; in sectors where competition is non-existent or incompletely achieved regulation may also be a proxy for competition. Under the new Act the utility regulators will receive powers to enforce the new competition prohibitions concurrently with the Office of Fair Trading (OFT) and with essentially the same powers. These powers are available to the electricity, water, gas, telecommunications and rail regulators. In practice, competition matters which affect the regulated utilities will normally be handled by the regulators rather than the OFT except where it is more appropriate for the OFT to deal with a case.

Firms are able to seek informal guidance and formal decisions about whether their conduct or agreements infringe the competition law. Regulators will give such guidance and decisions where these requests relate to regulated sectors. They will also investigate complaints into alleged breaches of the prohibitions in their sectors. They can impose interim measures to prevent damage occurring as a result of illegal behaviour, and make decisions which instruct the parties to stop infringing the law. A particularly significant new power is the ability to impose substantial fines, based on turnover, for breaches.

¹¹² Christopher Blair, Business and Transport Section, House of Commons Library

The Act takes account of the need to ensure that competition law is applied consistently across the economy, and each regulator will be working closely with the Office of Fair Trading and other regulators to ensure this. There are also measures to prevent regulators using competition-law powers to secure purposes which derive from their regulatory duties. Broadly, when using competition law powers, regulators will only be able to take account of regulatory aims if the ordinary competition authorities (ie the Office of Fair Trading) would be able to take those factors into account if it were dealing with the case.

The Office of Fair Trading has issued a number of explanatory leaflets on the new Act, including one specifically on the relationship with the regulated sectors: *Concurrent application to the regulated industries*.¹¹³ The OFT and the regulators are also working on sector-specific guidance on the new Act: draft guidance covering the telecommunications and the water sectors are now available on the OFT internet site.¹¹⁴

Clause 124 of the Utilities Bill makes some changes to the working of the senior competition regulator, the Competition Commission (formerly the Monopolies and Mergers Commission). Under the new *Competition Act 1998*, the Competition Commission will still investigate merger references, but it will not normally investigate monopoly situations except in special circumstances (although it is more likely to do so when the regulated sectors are involved). Moreover, in the regulated sectors, where the Competition Commission has a specific role under sectoral legislation - for example investigating licence modification disputes - that work will continue. Hitherto the MMC maintained a number of separate panels of experts for the regulated sectors. Under the Bill the Competition Commission will have a single utilities panel, of at least eight members.

A new function of the Competition Commission will be to act as an appeals tribunal from decisions of the OFT. It will similarly hear appeals relating to competition decisions which have been made by the utilities regulators.

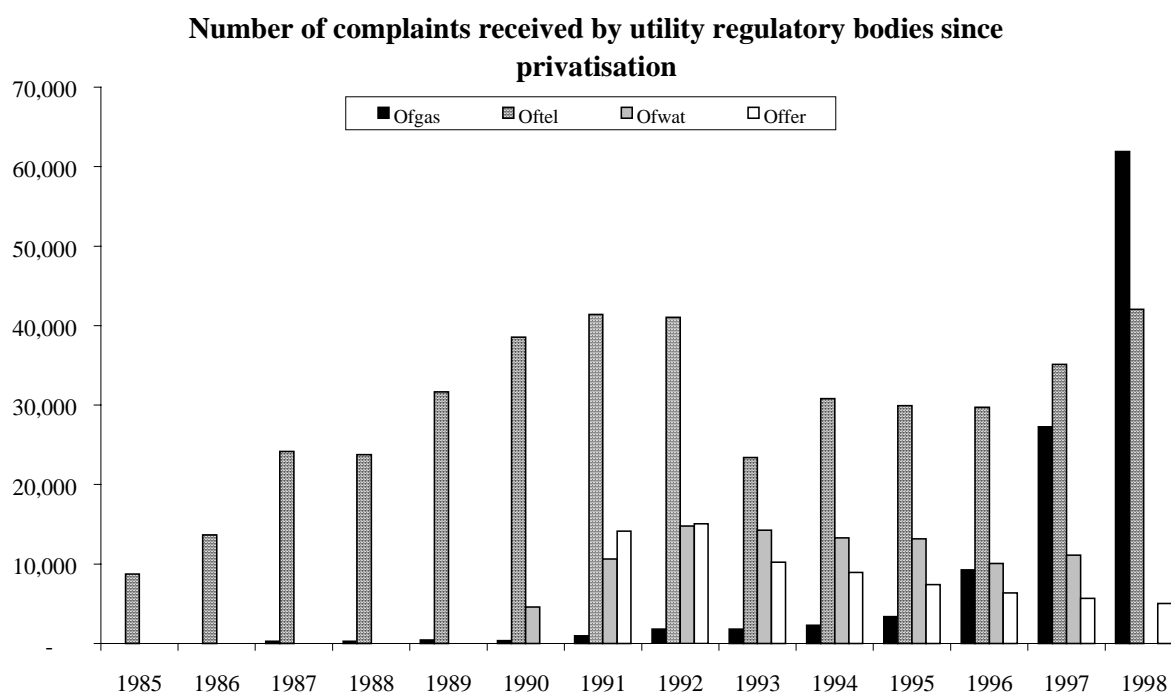
¹¹³ Office of Fair Trading, March 1999 (www.oft.gov.uk/html/comp-act/technical_guidelines/oft405.html)

¹¹⁴ A link to these documents is provided from www.oft.gov.uk/html/comp-act/technical_guidelines/oft405.html

IX Statistical information on utilities

A. Complaints to the regulators

The number of complaints received by the various regulatory bodies has generally increased since privatisation.¹¹⁵ The total number of complaints received by Ofgas has increased every year since privatisation. Between 1997 and 1998 complaints received increased by 127% to almost 62,000. The main areas of complaint concerned account disputes, marketing, doorstep selling and problems from transferring to a new supplier.¹¹⁶ The exception to the rise has been the number of complaints made to the electricity industry regulator Offer: during 1998 the number of complaints received fell to just over 5,000 or by 11%, the seventh year they have fallen in succession. Almost half of these complaints concerned disputed accounts.



B. Disconnections

The number of utility customers having their service disconnected has generally fallen since privatisation.¹¹⁷ For example, the number of domestic electricity customers who have been disconnected for non-payment has fallen by almost 99%, from nearly 50,000 during 1991 to 377 during 1998. The fall in the number of disconnections tends to reflect the initiatives, undertaken by both the regulators and the suppliers, to find alternative methods to deal with non-payment of bills. However, the increasing number of disconnections made by BT, from just over 330,000 net disconnections in 1995 to over 700,000 in 1998, has prompted Oftel to

¹¹⁵ see statistical appendix

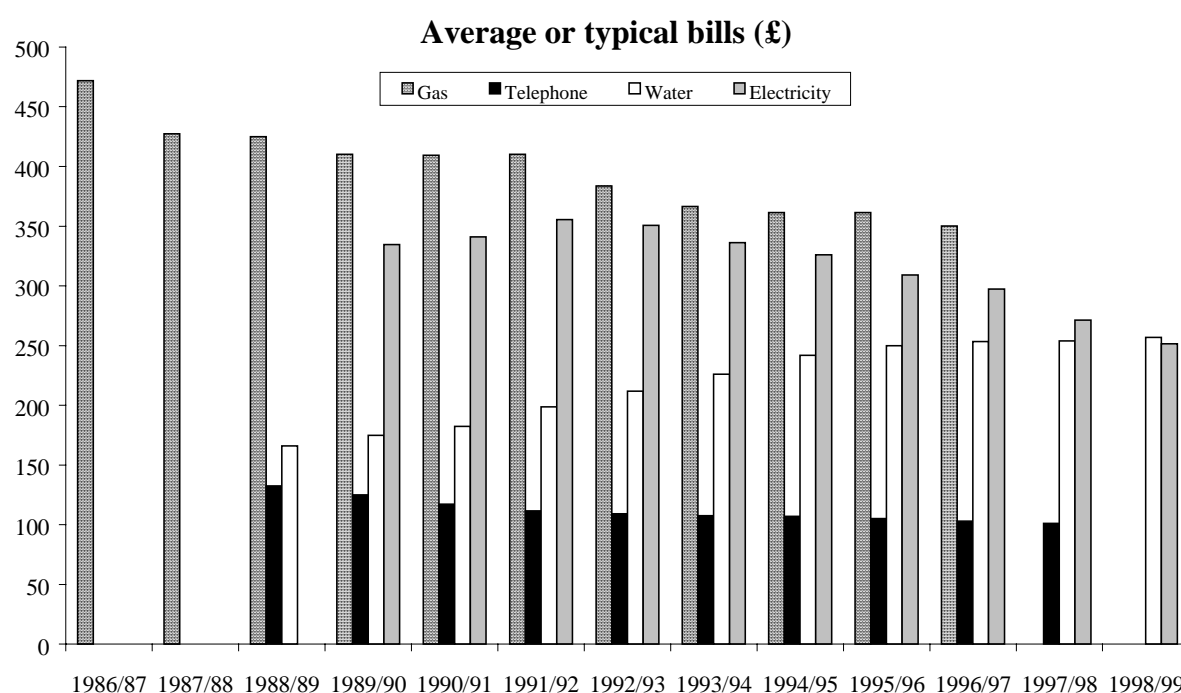
¹¹⁶ Ofgas *Annual Report* 1998

¹¹⁷ see statistical appendix

threaten the industry with formal regulation unless residential disconnections fall by 50% per annum.¹¹⁸

C. Average or typical bills

The average or typical real bills for domestic customers of the privatised gas, electricity and telecommunications industries have all fallen by around 25% since privatisation. However, the average annual real bills for each of the privatised water companies have increased. The size of the increase has ranged from 144% for Southern Water customers down to a 16% increase for South West Water customers.¹¹⁹ For the privatised water industry as a whole the (unweighted) average annual real bill has increased from £166 in 1988/89 to £257 in 1998/99, a rise of around 55%.



Industry average annual bill

£ real

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Gas	472	427	425	410	409	410	384	366	361	361	350	na	na
Telephone	..	..	132	125	117	112	109	108	107	105	103	101	na
Water	..	..	166	175	183	199	212	226	242	250	253	254	257
Electricity	..	..	..	334	341	356	351	336	326	309	297	271	251

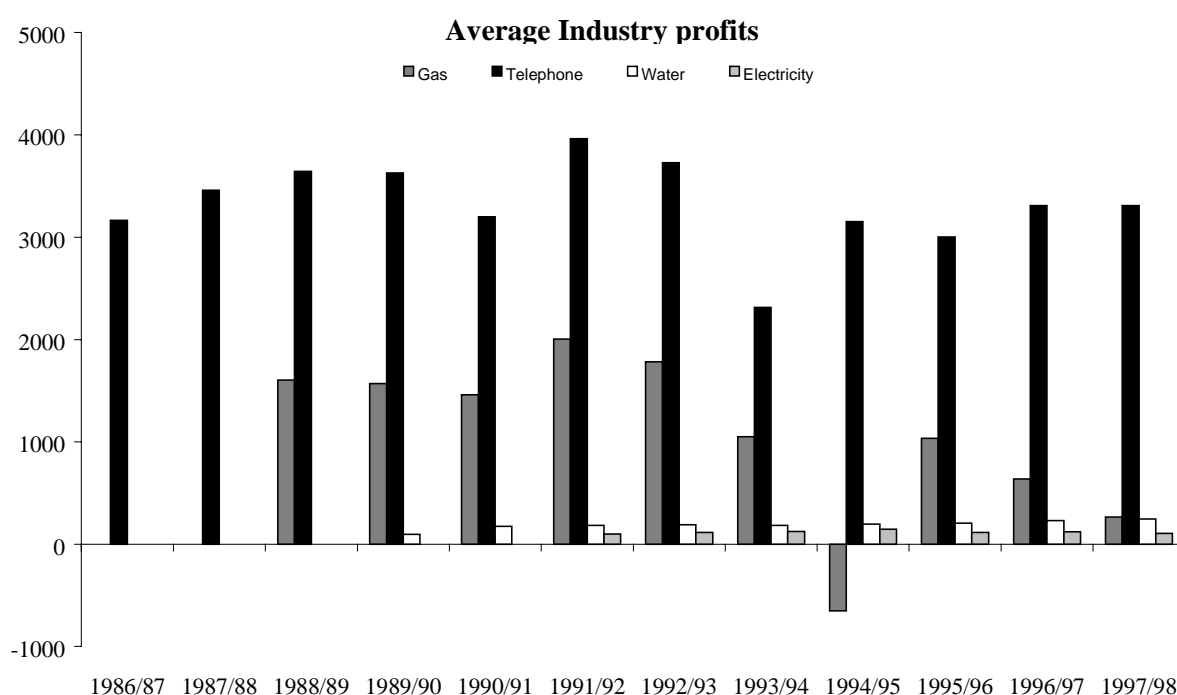
SOURCE: See statistical appendix

¹¹⁸ Oftel Annual Report 1997

¹¹⁹ see statistical appendix

D. Profits

The real pre-tax profits of BT have remained relatively constant since privatisation averaging around £3,000 million per annum. However, the real pre-tax profits of each of the privatised water companies have increased so that since privatisation the industry (unweighted) average has risen by 160% from £95 million in 1989/90 to £247 million in 1997/1998¹²⁰. The regional electricity companies have performed very differently since privatisation. For example, the operating profits, from electricity delivery and supply, have increased by as much as 127% in the case of SEEBOARD but have fallen by 32% in the case of East Midlands Electricity.¹²¹ This fall in profits though, may be due to exceptional ‘one off’ losses on contracts during 1997/1998. Unfortunately, due to changes in the accounting procedure the annual pre-tax profits of British Gas during the period cannot be compared directly.



Average Industry profits

real (1998/99 prices) £millions

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Gas	..	..	1,602	1,569	1,460	2,004	1,782	1,051	- 650	1,035	638	265
Telephone	3,164	3,460	3,642	3,627	3,197	3,961	3,727	2,315	3,152	3,001	3,308	3,308
Water	..	..	..	95	176	183	190	183	197	207	232	247
Electricity	..	..	..	..	..	99	117	126	144	114	119	104

Source: See statistical appendix

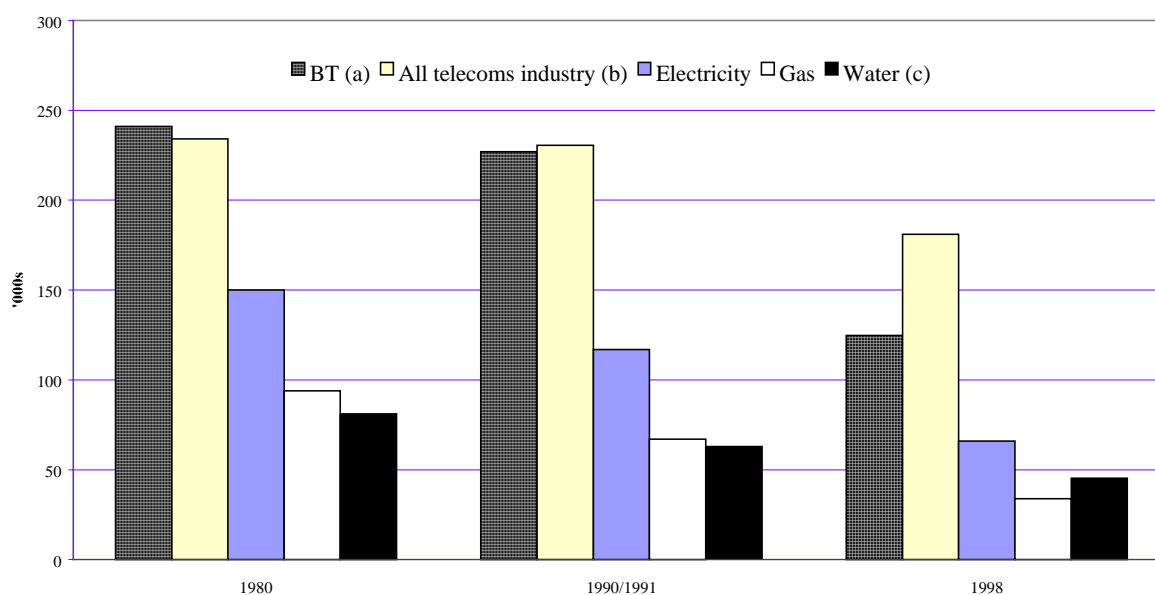
¹²⁰ For the rise in individual water companies profits see statistical appendix

¹²¹ see statistical appendix

E. Employment

The number of people employed by each of the utilities has fallen post-privatisation (looking at employment by individual company is complicated by the numerous takeovers and mergers that are occurring). The graph includes employees for the entire telecoms industry as well as BT, since this area has seen a number of new entrants and licences granted. According to the DTI, 'since privatisation increased competition has produced greater efficiencies in the electricity and gas sectors, which has led to a fall in employment.'¹²²

Employment in the utilities 1980-1998



Employment in the utilities

Thousands

	1980	1990/1991	1998	Change 1980-98
Electricity	150	117	66	-56%
Gas	94	67	34	-64%
BT (a)	241	227	125	-48%
All telecoms industry (b)	234	230	181	-23%
Water (c)	81	63	45	-44%

(a) BT is for 1981 and 1991 and is employees worldwide- in 1998 199 of the 125 thousand were in the UK

(b) Telecoms is for 1991 and 1997

(c) All UK water authorities/water and sewerage and water only companies. 1991, not 1990 shown

Energy Report 1999 DTI

Waterfacts, Water UK various years

Annual Employment Survey via Nomis

BT Annual Reports, BT offer for sale of shares, 1984

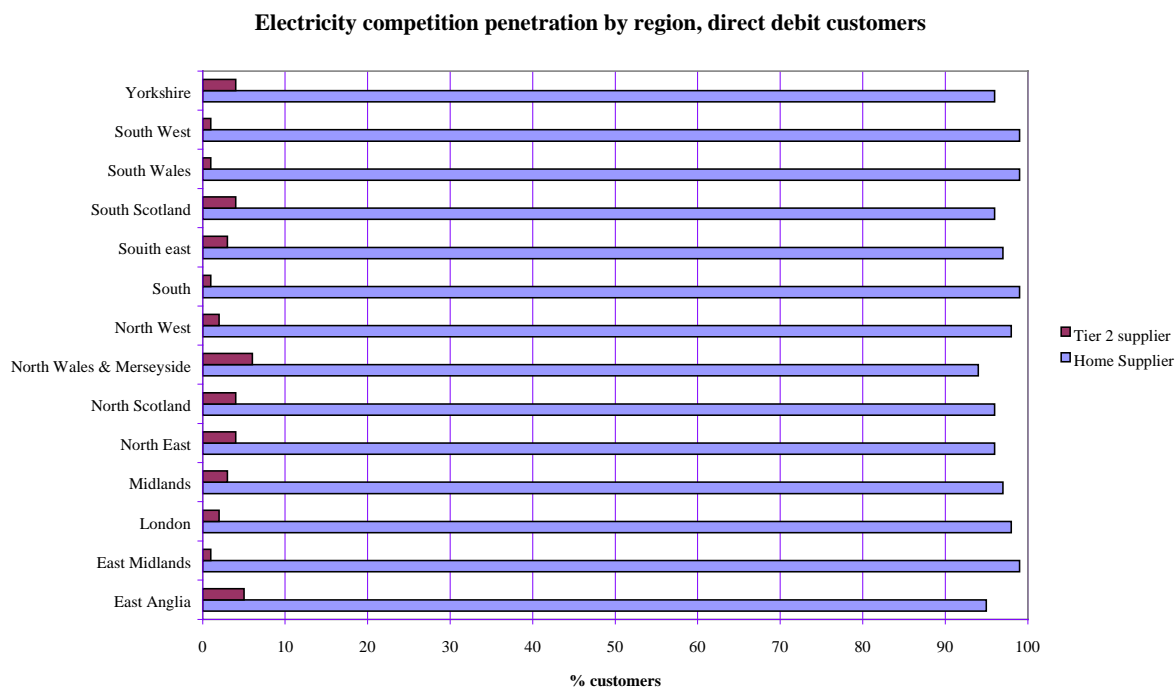
¹²² DTI, *Energy Report*, 1999

F. Customer choice and diversity of supply

Up to April 1996 all domestic customers received gas from British Gas and electricity from their local regional electricity company (REC). By May 1999 the situation had changed completely when competition in the domestic gas and electricity markets was fully rolled out.

The domestic gas competition roll-out was completed in May 1998 offering a choice of supplier to 20 million households. By September 1999 almost five million gas customers had switched supplier and 25 new suppliers were competing with British Gas Trading.¹²³ The switch is less pronounced for pre-payment customers; by Q1 1999 British Gas had lost around a fifth of the credit and direct debit markets but only 10% of pre-payment customers.

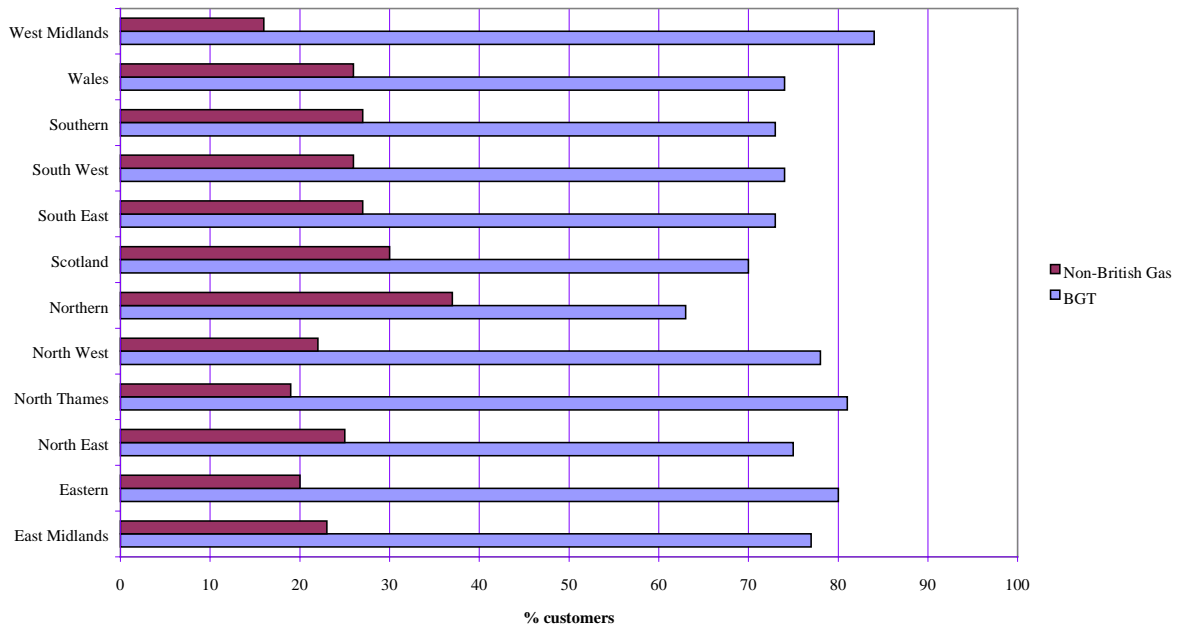
By May 1999 all customers in Great Britain connected to the public electricity network were free to switch supplier and by October 1999 3.3 million customers had registered to do so. During summer 1999 75-100,000 customers were switching each week. In the industrial market, 'incumbent' RECs have started to lose market share to 'second tier' RECs, and other suppliers including the nuclear generators, independent suppliers and British Gas. Home suppliers have also begun to lose their share of the domestic market. The graphs show that so far, as might be expected, domestic competition is more advanced for gas than electricity,¹²⁴



¹²³ DTI, *Energy Report*, 1999

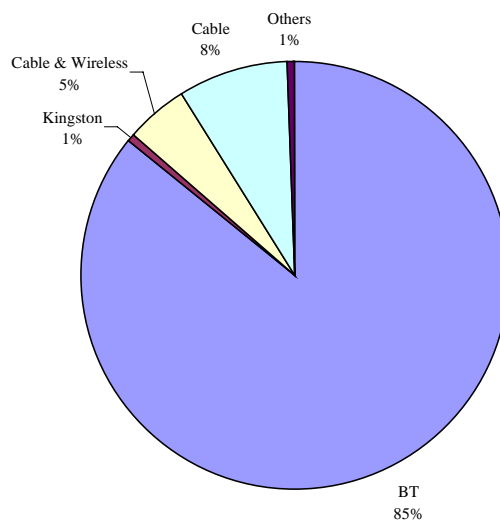
¹²⁴ *ibid* table A4.5

Gas competition penetration by region, direct debit customers



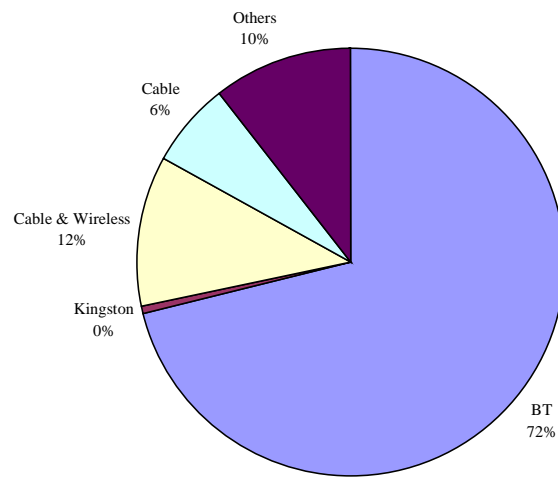
For telecoms, the extent of competition depends on whether you look at the domestic fixed line or the cellular/mobile market. So far as fixed line connections are concerned, BT retains the bulk of domestic connections, although it now earns only 72% of revenues. In the cellular market of course competition is far more advanced, with BT Cellnet claiming around a third of call minutes, and under a third of subscribers, fewer than Vodaphone.¹²⁵

Share of fixed link telephone connections Q3 1998/99 (per cent)

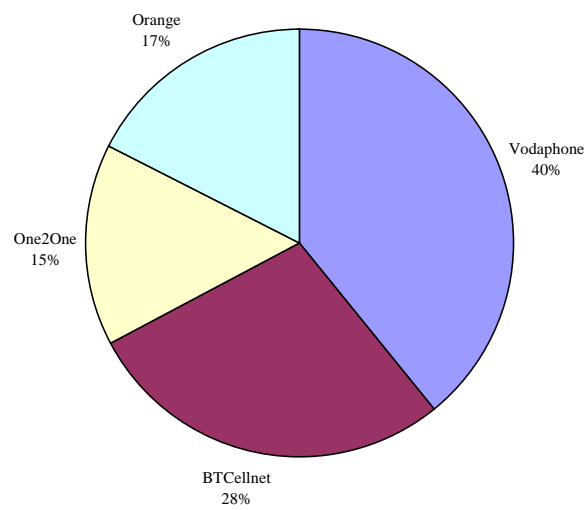


¹²⁵ Oftel Market Information Update August 1999

Share of fixed link telephone call revenues Q3 1998/99 (per cent)



Cellular phone subscribers by company Q3 1998/99 (per cent)



STATISTICAL APPENDIX

The statistical appendix is provided to support the previous section, Section IX "Statistical Information on utilities". It provides more detailed background information in tabular form for the gas, electricity, water and telecommunications industries on the following subjects:

Number of complaints received by utility regulatory bodies since privatisation.

The table shows the annual number of complaints received by each of the regulatory bodies since privatisation and the change in the number of complaints received from 1997 to 1998.

Number of utility customers having their service disconnected since privatisation

The table shows the annual number of domestic customers that have had their supply disconnected, due to non-payment or debt, by utility, since privatisation. It also contains information on the percentage change in the number of disconnections since privatisation.

Average or typical bills in the privatised utilities

The table shows the average or typical real annual company bills for British Gas, British Telecom, each of the Water & Sewerage companies and all of the Regional Electricity Companies since privatisation. The table also provides information on the percentage change for each company since they were privatised.

Profits of utilities since privatisation

The table shows the real pre tax profits of British Gas, British Telecom and the regional water companies. It also provides information on the real operating profits of the Regional Electricity Companies and the change in each company's profits, all since privatisation.

Chairmen's Remuneration in the Privatised Utilities

The real remuneration of the company Chairmen in each of the privatised industries has been included for general reference only and no analysis is provided in the previous section. This is due to the difficulties involved in tracking the salaries of individual company Chairman after their companies have merged, demerged or have been taken over.

Number of complaints received by utility regulatory bodies since privatisation

Regulator	Market	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	Change on previous year (a)
Ofgas	Gas	..	6	287	302	451	397	968	1,827	1,842	2,318	3,389	9,287	27,274	61,887	127%
Oftel	Telecommunications	8,765	13,660	24,186	23,782	31,644	38,530	41,393	41,026	23,413	30,831	29,900	29,750	35,100	42,050	20%
Ofwat	Water & Sewerage	..	..	..	..	..	4,613	10,635	14,795	14,290	13,326	13,192	10,070	11,123	na	10%
Offer	Electricity	..	..	..	..	..	..	14,173	15,054	10,219	8,932	7,436	6,394	5,703	5,053	-11%

na not available

.. years preceeding privatisation

(a) Change in number of compaints 1997 to 1998 except for Oftel which is 1996 to 1997.

Sources: Ofgas, Oftel, Ofwat, Offer *Annual Reports* various years

Number of utility customers having their service disconnected since privatisation

Regulator	Market	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	(c) Change since privatisation
Ofgas	Gas	..	39,933	51,952	65,980	42,105	20,465	19,261	16,022	16,285	16,523	14,946	8,820	29,771	29,486	-26%
Oftel	Telecommunications (a)	na	na	na	na	na	na	na	na	na	na	330,353	449,603	608,775	702,000	na
Ofwat	Water & Sewerage (b)	..	..	..	..	8,426	7,673	21,282	18,636	12,452	10,047	5,826	3,148	1,907	1,280	-85%
Offer	Electricity	..	..	..	..	..	..	47,913	18,080	3,769	1,228	840	477	349	377	-99%

na not available

.. years preceeding privatisation

(a) Net disconnections (Phones are reconnected once bill has been paaid)

(b) Water supply disconnections for non payment of charges households

(c) Estimated

Sources: Ofgas, Oftel, Ofwat, Offer *Annual Reports* various years

Average or typical bills in the privatised utilities

Real (1998/99 prices)£

Utility	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	change since privatisation
Gas Companies:															
British Gas (a)	..	472	427	425	410	409	410	384	366	361	361	350	na	na	-26%
British Telecom (b)	132	125	117	112	109	108	107	105	103	101	na	-24%
Water & Sewerage companies: (c)															
Anglian	204	216	227	248	265	280	297	311	312	293	288	41%
North West	148	154	160	173	182	194	205	214	222	291	294	99%
Northumbrian	141	149	157	173	183	195	211	218	224	228	234	66%
Severn Trent	145	148	156	168	179	188	202	205	204	223	228	57%
South West	191	203	211	233	268	304	343	353	355	215	222	16%
Southern	145	173	178	197	204	214	227	233	242	354	354	144%
Thames	138	139	146	157	165	173	182	190	191	250	257	86%
Welsh	200	204	216	237	255	271	289	289	291	302	301	50%
Wessex	190	191	198	214	224	239	251	259	260	261	266	40%
Yorkshire	157	170	175	188	194	203	217	227	232	227	226	44%
Regional Electricity Companies: (d)															
East Midlands Electricity	347	357	371	371	362	347	323	283	262	244	-30%
Eastern Group	314	317	331	330	322	317	299	296	267	239	-24%
London Electricity	336	341	358	348	332	319	303	300	281	246	-27%
Manweb	351	353	368	363	353	342	327	321	285	267	-24%
Midlands Electricity	330	332	347	339	317	307	298	289	265	241	-27%
Northern Electric	333	344	362	360	340	335	309	299	280	273	-18%
Norweb	325	326	341	333	325	294	280	284	257	246	-24%
Seeboard	328	332	347	341	332	317	291	282	259	240	-27%
South Western Electricity	346	362	377	372	356	351	341	313	283	261	-25%
Southern Electric	324	327	342	339	322	317	302	293	312	243	-25%
Swalec	346	362	377	372	356	351	341	331	252	284	-18%
Yorkshire Electricity	336	337	346	341	319	314	295	278	252	233	-31%

na Figures are not available due to mergers or other reasons

.. years preceding privatisation

Notes:-

(a) Typical annual bill domestic customer on standard tariffs, annual consumption of 19,200 kWh.

(b) Median residential bill.

(c) Annual average company bill for unmeasured water and sewerage services.

(d) Typical annual bill domestic customer on standard tariffs, annual consumption of 3,300 kWh.

Sources: Ofgas Annual Reports various years
 BT www.oftel.org/pricing/medi299.htm
 CRI The UK Electricity Industry Charges for Electricity Services various years
 CRI The UK Water Industry Charges for Water Services various years
 GDP treasury deflator as at 4.1.2000

Profits of utilities

Real (1998/99 prices) £millions

Utility		1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	Real change since privatisation
British Gas (a)	(b)	..	..	1,602	1,569	1,460	2,004	1,782	1,051	(650)	1,035	..	..	..	na
British Gas (a)	(b)	..	..	..	..	..	..	..	..	..	..	638	265	1,251	na
British Telecom	(b)	3,164	3,460	3,642	3,627	3,197	3,961	3,727	2,315	3,152	3,001	3,308	3,308	3,219	2%
Water Companies:-	(b)														
Anglian		..	..	..	..	109	197	208	218	151	244	261	215	274	152%
Dwr Cymru (Welsh Water)		..	..	..	..	48	165	168	183	165	136	124	215	209	339%
North West		..	..	..	..	54	276	279	290	308	320	299	396	394	628%
Northumbrian		..	..	..	..	14	61	74	81	72	102	101	99	114	719%
Severn Trent		..	..	..	..	180	321	322	317	322	302	409	378	362	101%
South West		..	..	..	..	83	113	109	109	106	71	120	118	106	27%
Southern		..	..	..	..	63	125	140	140	146	161	181	137	na	na
Thames		..	..	..	..	224	273	286	295	276	342	251	384	419	87%
Wessex		..	..	..	..	32	85	93	101	118	132	147	150	139	339%
Yorkshire		..	..	..	..	141	147	150	163	164	160	178	223	206	46%
Electricity Companies:-	(c)														
East Midlands Electricity		..	..	..	..	..	..	130	167	188	194	161	104	88	-32%
Eastern Group		..	..	..	..	..	..	129	155	168	197	142	135	na	5%
London Electricity		..	..	..	..	..	..	122	130	130	118	112	92	115	-6%
Manweb		..	..	..	..	..	..	82	91	104	107	66	293	95	16%
Midlands Electricity		..	..	..	..	..	..	121	151	161	183	165	152	117	-3%
Northern Electric		..	..	..	..	..	..	70	89	88	108	75	75	70	-1%
Norweb		..	..	..	..	..	..	103	130	140	165	22	119	125	21%
Seeboard		..	..	..	..	..	..	61	80	92	113	77	149	137	127%
South Western Electricity		..	..	..	..	..	..	70	81	85	83	69	87	103	46%
Southern Electric		..	..	..	..	..	..	139	158	166	202	220	195	205	48%
Swalec		..	..	..	..	..	..	54	52	64	83	84	83	75	40%
Yorkshire Electricity Group		..	..	..	..	..	..	110	113	123	176	174	(53)	115	4%
National Power	(c)	..	..	..	..	..	..	406	370	549	483	568	521	453	11%
Power Gen	(c)	..	..	..	..	..	..	270	333	412	253	407	465	(243)	-190%

na not available

.. years preceding privatisation

(a) 1991/92 figure is for the year ending 31 December 1991; subsequent figures are calendar year results, thus the 1992 figure is not directly comparable with 1991.

Further changes in accounting policy were implemented during 1994 affecting comparisons between this year and prior years.

During 1997, the accounting convention was changed from current cost to modified historical cost. Prior year comparative information has been given for 1995 and 1996.

(b) Pre tax profits

(c) Operating profit

Sources: Ofgas, Ofel, Ofwat, Offer *Annual Reports* various years

Chairmen's Remuneration in the Privatised Utilities

Real (1998/1999 prices) £Thousands

Utility	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1995/96 (c)	1996/97	1997/98	1998/99
Gas Companies:															
British Gas (a)	292	310	310	..	528	445	457	532	517	..	499	399 (d)	410
British Telecom	297	228	207	417	519	690	654	723	866	675	721	721	742	518 (e)	275 (e)
Water & Sewerage companies:															
Anglian	96	119	156 (b)	76	182 (b)	134	141	145	145
North West	185	201	313	413 (b)	407	405 (b)	na	na	na	na
Northumbrian	66	93	120 (b)	62	89 (b)	90	na	na	na	na
Severn Trent	193	175	210	263	113 (b)	121	121	119	147	86
South West	115	131	131	174 (b)	185 (b)	137	137	7	na	na
Southern	183	205	200	246	263	283 (b)	na	na	na	na
Thames	206	176	298 (b)	128 (b)	183 (b)	185 (b)	158	160	256	255
Welsh	184	171	183	113 (b)	103 (b)	136	na	na	na	na
Wessex	165	194	244 (b)	256 (b)	260 (b)	256 (b)	201	195	209	206
Yorkshire	153	173	183	206	214 (b)	216 (b)	179	180	143	135
Regional Electricity Companies:															
East Midlands Electricity	280	298 (b)	286 (b)	78 (b)	82 (b)	na	na	na	na
Eastern Group	295	279	277	159 (b)	na	na	na	na	na
London Electricity	215	284 (b)	244 (b)	113 (b)	110 (b)	na	na	na	na
Manweb	260	196	96	64 (b)	na	na	na	na	na
Midlands Electricity	268	270	286 (b)	198 (b)	119	na	na	na	na
Northern Electric	199	224	347 (b)	374	324 (b)	na	na	na	na
Norweb	224	244	271 (b)	290	na	na	na	na	na
Seeboard	223	183	80	79 (b)	na	na	na	na	na
South Western Electricity	264	279	183	126 (b)	na	na	na	na	na
Southern Electric	312	359 (b)	94	120 (b)	122 (b)	22	91	127	na
Swalec	234	263 (b)	260 (b)	170 (b)	na	na	na	na	na
Yorkshire Electricity	247	231	143	80 (b)	146 (b)	na	na	na	na
National Power	228	222	217	214 (b)	213 (b)	213	207	202	197
PowerGen	133	129	98	169 (b)	164 (b)	na	495	475	na

na Figures are not available due to mergers or other reasons

.. years preceeding privatisation

Notes:-

Remuneration includes basic salary, benefits and bonus payments.

(a) 1991/92 figure is for the year ending 31 December 1991; subsequent figures are calendar year results, thus the 1992 figure is not directly comparable with 1991.

Further changes in accounting policy were implemented during 1994 affecting comparisons between this year and prior years.

(b) Remuneration includes contributions to a pension fund.

(c) figures are restated to comply with the Company Accounts (Disclosure of Directors' Emoluments) Regulations 1997

(d) British Gas demerged into BG plc and Centrica plc

(e) Remunerations include those as Deputy Chairman up to 30 June 1997 and as Chairman thereafter.

Source: Annual Reports

X Further reading

House of Commons Library Research Paper 98/19, *Regulating Energy Utilities*, 2 February 1998

House of Commons Library Research Paper 98/117, *Water Industry Bill*, 10 December 1998

House of Commons Library Research Paper 98/53, *Competition Bill [HL]*, 28 April 1998

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DTI, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation: Regulatory, Environmental and Equal Treatment Appraisals*, January 2000

House of Commons Trade and Industry Committee, *Developments in the Liberalisation of the Domestic Electricity Market*, HC 871 1997/98

House of Commons Trade and Industry Committee, *Progress in the Liberalisation of the Gas Market*, HC 338 1997/98

House of Commons Trade and Industry Committee, *Telecommunications Regulation*, HC 254 1996/97

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