The Gas Bill [Bill 60 1994/95]

Research Paper 95/30

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The new Gas Bill lays down the legislative framework for a move to complete competition in domestic gas supply in 1998, a radical innovation to coincide with similar moves in the electricity industry. This paper describes the background, in a series of regulatory changes since gas privatisation in 1987. Another Library Paper will concentrate upon statistical estimates of likely changes in gas prices.

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I. The regulatory framework in the Gas Act 1986

The Act provided for the privatisation of British Gas and established the regulatory regime. In many ways it followed the pattern of the Telecommunications Act 1984 which did the same for British Telecom. The post of Director General of Gas Supply was established and he was allowed staff (OFGAS) to support him in his duties. A licence (irritatingly called an authorisation) would be issued and the Director General would have job of ensuring that British Gas complied with its conditions. The handling of individual consumer issues was given to the Gas Consumers Council, however, whereas in telecommunications it was merged with the regulatory function to form OFTEL. Although it did not directly feature in the legislation, the system of price control (RPI-x) was basically the same one, with the difference that for gas the formula takes account of movements in the cost of gas from the North Sea (RPI-x+y).

Competition was seen as an issue in these privatisations, but not a crucial one. In the case of British Telecom, the main initial measure to secure competition was the establishment and licensing of Mercury. In the case of British Gas, it was at that time believed that the best way to produce some competition was to allow companies other than British Gas to acquire a share of the North Sea gas and to have the right to use British Gas pipelines to supply industrial users.

British Gas was therefore given a monopoly of supply to users of less than 25,000 therms (later reduced to 2,500 therms) a year but competition was to be encouraged for larger users. The Director, or Regulator, was therefore to see fair play for consumers of less than 25,000 a year and to encourage competition for larger consumers. Section 4 described the general duties of the Secretary of State and the Director.

> **(1)** The Secretary of State and the Director shall each have a duty to exercise the functions assigned to him by this Part in the manner which he considers is best calculated-
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> > **(a)** to secure that persons authorised by or under this Part to supply gas through pipes satisfy, so far as it is economical to do so, all reasonable demands for gas in Great Britain; and
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> > **(b)** without prejudice to the generality of paragraph (a) above, to secure that such persons are able to finance the provision of gas supply services.

(2) Subject to subsection (1) above, the Secretary of State and the Director shall each have a duty to exercise the functions assigned to him by this Part in the manner which he considers is best calculated -

(a) to protect the interests of consumers of gas supplied through pipes in respect of the prices charged and the other terms of supply, the continuity of supply and the quality of the gas supply services provided;

(b) to promote efficiency and economy on the part of persons authorised by or under this Part to supply gas through pipes and the efficient use of gas supplied through pipes;

(c) to protect the public from dangers arising from the transmission or distribution of gas through pipes or from the use of gas supplied through pipes;

(d) to enable persons to compete effectively in the supply of gas through pipes at rates which, in relation to any premises, exceed 25,000 therms a year.

(3) In performing his duty under subsection (2) above to exercise functions assigned to him in the manner which he considers is best calculated to protect the interests of consumers of gas supplied through pipes in respect of the quality of the gas supply services provided, the Secretary of State or, as the case may be, the Director shall take into account, in particular, the interests of those who are disabled or of pensionable age.

II Regulatory Problems after the Act

In the event, relations between the Director (Sir James McKinnon) and British Gas deteriorated and a serious of rather acrimonious public disagreements took place. The main problem was that Sir James felt himself required by the legislation to press for greater competition while the company felt that it was being prevented from acting in a normal commercial way to make profits for its shareholders. Sir James saw the company as

obstructive while the company saw Sir James as continually trying to rewrite the rules so as to ensure that British Gas lost out in competition with other suppliers. Some people complained that shareholders had bought British Gas shares on one set of rules, but were losing out because the rules had been changed through steadily increased regulation. Sir James defended himself against charges of "creeping regulation" in the OFGAS Annual Report for 1991 (p.6), arguing instead that until 1990 the planned competitive regime had simply not operated. He pointed out that the prospectus explained the competitive regime.

> What was perhaps less clear to investors was the fact that no gas was available to competitors in the period from 1986 to 1990 and that was why no competition took place during that time...The provisions of the Gas Act 1986 on third party access have not been changed. Can it be described as "creeping regulation" when it took four years till 1990 before the first competitive gas flowed through the British Gas pipelines? Indeed, this was over eight years after third party access had first been made available by the Oil and Gas (Enterprise) Act 1982.

Although Sir James had a tiny staff, he was always willing to refer British Gas to other bodies to report on whether its behaviour was anti-competitive. Already in 1988, only two years after the privatising legislation, British Gas was referred to the monopolies and Mergers Commission. The Report[1] was critical.

> **8.99** We have concluded that a monopoly situation exists in favour of British Gas plc by virtue of section 6(1)(a) of the Fair Trading Act 1973, in relation to the supply in Great Britain of gas through pipes to persons other than tariff customers within the meaning of Part I of the Gas Act 1986. We have also concluded :
>
> > **(a)** that BG's extensive discrimination in the prices of firm gas, and its refusal to supply interruptible gas to most current users of firm gas are steps being taken for the purpose of exploiting that monopoly situation;
> >
> > **(b)** that the following actions or omissions on the part of BG are attributable to the existence of the monopoly situation; its extensive discrimination in its prices of firm gas; its refusal to supply interruptible gas to premium users; its imposition of

[1] *Gas* Cm 500 1988

> particular contract terms; and its failure to provide adequate information on the charges to be made for common carriage.

The Commission ruled that many of these operated against the public interest. British Gas gave various undertakings to the Commission, but just three years later, in 1991, it was referred to the Office of Fair Trading, who were also critical, although showing some sympathy [2].

> **97.** The conclusion of this review of the contract gas market is that the remedies introduced following the 1988 MMC Report have been ineffective in encouraging self-sustaining competition to BG. Since BG has complied fully with the undertakings it gave, it follows that further remedies are required if competition is to develop more strongly.

The OFT did not recommend an immediate referral to the MMC but felt that further action was required, perhaps at Ministerial level. OFGAS increasingly considered whether there might be no satisfactory solution short of splitting up BG, probably with the transportation part separate from the distribution part.

To be fair to BG, its position was not easy. A company's normal duty is to maximise the profits to its shareholders. The MMC normally intervenes to prevent a takeover bid, so as to prevent a monopoly arising. It is very unusual for a company to be permanently in the position of being told to give up market share - rather than simply to divest itself of assets - in order to help its competitors.

During this continual skirmishing over the contract market, a separate development raised the stakes. The 1986 Act defined the contract market as being over 25,000 therms a year, which covers most industrial use but not necessarily commercial use. In 1992 this limit was reduced, by Order[3], to 2,500 therms a year, thereby bringing a much greater portion of the gas market under normal competition law, and away from the remaining BG monopoly.

Eventually Sir James McKinnon despaired of encouraging a satisfactory level of competition under the legislative framework, and BG was once again referred to the Monopolies and Mergers Commission, which reported in September 1993[4]. These four volumes are

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[2] *The Gas Review*, Summary Version, OFT 1991
[3] *The Gas [Modification of Therm Limits] Order 1992* /SI 1751
[4] Cm 2314, 2315, 2316, 2317

recommended reading for anybody who finds Proust too short, or sometimes wishes that Wagner had added an extra act.

Sir James's view that British Gas needed to be broken up, probably with a separation between its transportation and distribution businesses, was accepted by the MMC which recommended that British Gas should be split up, with transportation and storage in a separate company, but that it should retain a monopoly of supply of small customers (basically the millions of domestic customers) for three to five years thereafter.

The Government quickly rejected the report and said that British Gas did not need to be split up, provided that it separated its activities within the one company, an option which the report had explicitly rejected. On the other hand, the Government went further in a commitment to reduce the British Gas monopoly. The President of the Board of Trade[5] stated:

> I propose that competition should be introduced in a phased and orderly way. This is primarily to give British Gas's transportation business time to prepare itself, through new computer systems and operating procedures, for the considerable task of handling the potential switch of millions of domestic customers to new suppliers. The proposal is that from April 1996 the whole of the non-domestic market should be open to competition; and all aspiring gas suppliers who have been granted the necessary gas supply licence will be free to serve any domestic customer. But at the start there will be a volume limit on the aggregate share of the domestic gas supply market which new suppliers will be permitted to supply. The limit will be fixed by the Director General of Gas Supplies in the light of her assessment of logistical feasibility: in the 12 months to April 1997 it would be of me order of five per cent of the domestic market - equivalent to nearly one million customers - with a further five per cent in the second 12 month period - making nearly two million customers in all. Provided that the DGGS is satisfied, on the basis of these introductory phases, that the necessary administrative systems are in place and operating satisfactorily, she will remove the volume limits altogether in April 1998.

This statement is the origin of the current Bill.

IV The Big Bang for energy industries in 1998

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[5] *DTI Press Notice* 21 December 1993

The introduction of competition for domestic gas consumers needs to be seen in the context of other dramatic changes in energy policy due in 1998. Domestic competition will also be introduced into the electricity market in that year. In addition, two separate developments will bring further changes in the electricity market. First, the contracts between the electricity generators and the coal industry will end and need to be renegotiated. The extent of coal demand after that time is unclear. Second, the arrangements by which the nuclear industry is subsidised will also terminate. The fossil fuel levy, introduced at the time of electricity privatisation, had to be approved by the European Commission to prevent a challenge in the European Court of Justice under EC Competition Law. There was an agreement that the levy could be operated for 10 years, which expire in 1998. There are no particular signs of an extension, although there will probably be an arrangement by which modest assistance can be given to alternative sources of energy such as wind-power and wave-power.

The interaction with electricity has been particularly important for the gas industry since privatisation. It was the freeing up of the electricity industry which increased the demand for gas-fired power stations. British Gas was reluctant to supply so much gas in this way, but Sir James required them to post their prices and them supply to anyone who could pay them. The so-called "dash for gas" has continued apace and is the main growth area for gas sales. The link will be particularly important in 20 years or so, when the nuclear power stations other than Sizewell B will have ceased operating and it is quite possible that no more will be built to accompany it. In addition, coal may have been marginalised, with perhaps no new coal stations to accompany Drax. Gas, therefore, will have a nearly captive market for a very large share of UK electricity generating capacity.

V Why the new legislation matters

It might seem that competition in gas distribution would automatically be beneficial and that the details of the legislation would not be too important. Several major issues, however, are raised.

First, it is generally agreed that the 1986 Gas Act did not provide a satisfactory framework in which competition could develop, It cannot be desirable for a company as important as British Gas to be involved in continual disputes with a regulator and to be referred twice to the MMC and once to the OFT within 6 years of privatisation. The consequence of legislation failing to address the various concerns would probably be increased action by the Regulator, perhaps raising issues of accountability. Since domestic energy competition is almost unknown elsewhere in the world, there are bound, in any case, to be issues arising

which will require some regulatory decisions, but ineffective legislation would increase this area.

Second, from a consumer point of view, it is the legislation - combined with the licences - which will determine whether all consumers are offered the same service - or whether poor consumers are forced to pay higher prices. In view of the similarity of the position of the various privatised utilities, the question of whether poor people have equal access to utilities is of great potential importance in determining their welfare.

Third, from an industrial point of view, it would be unfair if the regulatory system offered unfair advantages to either BG or its competitors. The company is ready to point out that these potential competitors are not tiny home-grown entrepreneurs, needing a little help to take on a giant, but vast US-based companies well able to look after themselves and invest heavily to acquire the market. The issue resembles that in telecommunications, where BT claims that the restrictions placed upon its operations in the cable television market mean that US-based companies are being allowed to dominate the market without BT being allowed to compete.

Fourth, energy is a key component in the economy, partly because consumers spend so much on it and partly because it is a vital input for industry. If British industry is having to pay more for its energy than its foreign competitors, then that will be another factor encouraging firms to locate elsewhere.

VI What British Gas wanted from the legislation

British Gas very much wanted the introduction of primary legislation, rather than the introduction of competition via a further reduction to zero of the limit below which the company retained a monopoly of gas supply. That would have left the company carrying the social obligations but competing against other suppliers without such obligations. In a Memorandum to the Trade & Industry Select Committee[6] the company laid down a number of specific requirements, after stressing the need for a level playing field.

> Gas supply licences must be defined so as to cover a mix of income groups and customer types, in order to ensure that the full benefits of competition are made available to all gas consumers.

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[6] 1993/94 HC 681 - ii p.57

During the 1996-98 transitional period and possibly for some time thereafter, all gas suppliers should be required to publish pricing schedules; this will greatly assist the development of a competitive market by providing a transparent basis for informed choices by consumers.

All suppliers should be required by their licences to offer a range of payment methods such that all types of customers and all income groups are able to benefit from the introduction of competition.

All domestic gas suppliers must have an obligation to supply all prospective customers, provided they are connected to the network within the area covered by their licence. All potential customers within the supplier's licence area should have a right to obtain a supply on the published terms, subject to any exclusion arising from the operation of a common debt/disconnection code. There must also be similar obligations to maintain supplies to existing customer premises, until another competing supplier has decided to take on the customer.

All suppliers should be required under the terms of their licences to abide by common codes of practice defining minimum standards relating to : debt and disconnection practices; services to older and disabled customers; and energy efficiency advice.

Security deposits required from customers under the terms of the debt and disconnection code should be reasonable, with powers for the DGGS to ensure fair treatment for consumers.

All suppliers should have an obligation to provide insurance cover against an inability to fulfil their supply obligations (eg, in the event of financial failure). The objective here would be to guarantee funding for continued gas deliveries and, where appropriate, to compensate customers for the difference between normal supply costs and the higher price of any gas obtained at short notice by a replacement supplier to maintain the service.

For a transitional period, British Gas recognizes that it may be appropriate for it (and any other suppliers with more than a predetermined share of the domestic market) to bear a limited number of special obligations or conditions.

Any obligations imposed in respect of special services should be fully remunerated on commercially acceptable terms. Such suppliers should also have the right to apply to OFGAS (or, failing agreement, to the MMC) for the lifting of any special obligations or conditions (including price controls) if they are no longer appropriate.

Where certain obligations (eg, special services for older and disabled customers, or special provisions for dealing with those in debt arrears) cannot otherwise be shared equally among all domestic suppliers, there should be provision for a levy mechanism to support the continued provision of high service standards in an equitable manner.

British Gas should not be subject to any special restrictions on its commercial freedom to restructure the gas trading business in the best interest of its shareholders, other than the conditions which apply to any company wishing to hold a domestic gas supply licence.

British Gas TransCo should have responsibility for :

> operating a national gas fault reporting service dealing with safety arrangements on its own supply network and meters;
>
> investigating and making safe gas leaks downstream of the meter on premises connected to the TransCo system, including minor appliance repairs which can be completed within half an hour.

Operators of non-British Gas TransCo pipelines and networks should have the primary legal obligation for safety management of their own networks.

There must be appropriate obligations to comply with the terms of the Network Code.

VII What the Gas Consumers Council wanted from the legislation

In its evidence to the Committee[7], the Gas Consumers Council opened with a general statement that it :

> Supports the principles of competition and choice and of their progressive introduction between 1996 and 1998.
>
> Is concerned that the removal of cross-subsidies, before monopoly abolition, will cause some people to pay more for their gas than they do now.
>
> Is not yet convinced that a network code and procedures for customer transfer will be sufficiently developed, by 1996, to ensure orderly transition.
>
> Advises that the consequences of changes should be carefully assessed and made public, especially an assessment of whether some consumers will suffer permanent price disadvantage.
>
> Urges continuation of a statutory body, representing gas consumers, whose independence will differentiate partisan consumer advocacy from impartial regulation.

VIII What the Trade & Industry Select Committee wanted from the legislation

The Committee (p.xxix) made several recommendations, but not all relate specifically to the legislation, although the following might do so.

> **6** We regard the principle of equal obligations on all suppliers as an essential feature of the new competitive market.
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> **8** We consider it essential that customers who at present benefit from special services for the elderly and disabled are not disadvantaged by the introduction of competition.

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[7] 1993/94 HC 681 -i

9 The Government, not the regulator, should take responsibility for any decision to impose an energy efficiency levy on gas consumers, and provision should be made in the Gas Bill for the Government to impose such a levy if it should prove necessary to achieve the Government's targets for reducing carbon dioxide emissions. The Government should also seek to ensure that the prospects for increased use of combined heat and power are not damaged in the transition to a competitive market.

10 The Gas Consumers Council should be retained as an independent consumer body.

16 The process of removing regulatory powers which are no longer necessary should be made subject to parliamentary approval, possibly making use of the Deregulation Committee.

In addition, there were other recommendations relating to the process of increasing competition in the gas industry. The Committee (p.xxix) was concerned at the possibility of some manipulation of the transportation site charge at a later stage. In order to prevent "cherry-picking" the Committee argued that licensees should not be permitted to discriminate unfairly between domestic customers using less than 1500 therms per year on the basis of the customers' level of consumption. The DTI and OFGAS should set out how the distribution of the less profitable categories of customer will be monitored, and what criteria they will use in determining whether a levy is necessary.

IX What should go in the Act and what in the Licence ?

The idea of licences policed by regulators came in with the Telecommunications Act 1984. At the time it was believed that regulation was required because of the lack of competition and, therefore, that in an industry where competition was increasing, the extent of regulation could correspondingly be reduced. The problem with this is that it is extremely hard to move from a monopoly to an industry with enough competitors for the market to exert enough pressure for regulation to be unnecessary or even for it to be sufficient to argue that the Director General of Fair Trading could intervene if necessary.

Indeed, experience is tending to suggest that an extension of competition complicates and increases the regulatory task. It becomes important to see fair play between the competitors. Many people would argue that the former-monopolist has so many advantages that any newcomers have to be helped disproportionately in order to get any serious competition going.

Privatised companies, on the other hand, often see it as simply unfair if the playing field is not level. Regulators often have to take many decisions fixing the terms on which the competition can take place.

At one extreme, it would be possible to put everything in the legislation. The problem is that the details are very complex and many of the privatised industries are changing rapidly. The legislation would have to be very detailed, and frequently updated. In practice, this would mean inserting enabling clauses into an Act, and making a series of statutory instruments to implement the details. Unfortunately, it is notoriously difficult to establish democratic control over statutory instruments, partly because of shortage of Parliamentary time to oversee so many items, and partly because they cannot be amended.

The other extreme would be a very short Bill, merely laying down the rules under which the regulator operates. This would allow maximum flexibility for dealing with new situations or technologies. It would also allow negotiation between the regulator and regulated companies, combined with the possibility of assurances of various kinds from the companies. Yet, at least in its extreme version, such a model would have serious problems. The lack of democratic accountability would not simply mean the absence of Parliamentary sanction over Governmental activity. The regulator is largely unanswerable to the Secretary of State, because the legislation has always been framed so as to prevent political interference in control of these industries. Such freedom makes sense in the context of a role limited to policing a licence, or deciding whether to refer a company to the MMC, but would present considerable problems in a more free-ranging role.

Even within the current system there have been problems of interpretation. The most important came in the gas industry in 1994, when the new regulator Clare Spottiswoode overturned a decision by the previous regulator to allow the cost of energy-saving projects to be passed through in terms of higher prices, accusing Sir James of having acted illegally. Although she backed down on the latter claim, the policy reversal remains clear (see section??). The point in this context is not who was correct as the problems of companies operating in a regulatory environment when so much depends upon the personal interpretation of the regulator and can change when one regulator is replaced by another.

There is no real system of appeal against a regulatory decision, except sometimes the possibility of forcing a referral to the MMC. That is, of course, a very double-edged weapon, not least because MMC recommendations go to the President of the Board of Trade who can always reject them, as he did for gas in 1993.

X Other Concerns in the move to domestic gas supply competition

(a) Price discrimination according to location

One major concern about costs is that some areas might have higher gas prices because of being a long way from gas supplies. Although that would be a consequence of increasing competition, the change is taking place in any case. In May 1994 the DTI and OFGAS produced a joint consultation document, *Competition and Choice in the Gas market*, which refers to the issue.

> 5.6 It is intended to move towards more cost-reflective pricing of transportation tariffs. A start will be made in autumn 1994, when it is proposed to align charges for use of the National Transmission System entry and exit points with the long-run marginal costs of using them. This could lead to variations in final prices to customers of the order of ≐ 2-4%.
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> 5.7 Further work is in hand to analyse the relative costs of transporting gas to customers within regions, with a view to introducing progressively from 1995/96 a more cost-related tariff system for use of regional transmission and distribution systems. It is important to introduce economic pricing of the National Transmission System at an early stage in order to give more accurate signals to shippers and producers on, for example, where the gas from new fields should be landed. But there is less urgency about adjusting the price distortions within individual regions. It is hoped to complete the process by 2002. The charges to shippers need to evolve in an orderly way if they are to have the confidence to enter into long-term contracts.

In other words, price variations between customers according to location are likely to take place in any case and are not dependent upon new legislation. On the other hand, increased competition would inevitably mean the end of cross-subsidisation, since competitors could concentrate upon the consumers who were paying higher prices to finance the subsidies.

(b) Price discrimination against poor people

More serious problems may arise with customers whose accounts are less profitable. Small users who pay in cash are costlier for BG than larger users who pay by direct debit.

Competitors would therefore target the latter and offer lower prices. British Gas is currently not allowed to discriminate between different classes of users and might have problems in reacting to this competition. However, BG can offer discounts reflecting the cost of handling an account, and did so with its direct debit discount scheme in the autumn of 1994. There is a fairly thin line in practice between offering incentives to attract the more desirable customers and offering discounts to those who pay in a way that is cheaper to handle.

BG has been very concerned that it might end up with the costlier accounts, but missing out on the accounts which would be most profitable. Therefore better-off people would actually be paying less per unit of gas consumed than poorer people. Some of this problem would be alleviated by the introduction of legislation placing all the companies on a level footing. One possibility would be to make all companies have to agree to accept any customer in an area in which they operated, so as to avoid all the small accounts being left to BG. The question of price discrimination would have to be addressed directly and that would probably mean allowing BG to charge lower rates for large domestic users. The alternative would be to force all companies to offer gas at a uniform rate per therm up to the 2,500 therm limit. The problem with that is that there would still be a competitive advantage for the new entrants because they could choose a different profile of users and therefore offer lower prices.

(c) Combined Utilities

There are also concerns about what would happen if different utilities in an area - gas, electricity and water - were to be operated by the same company. This is not simply a question of imagining what salary the chairman of a combined utility would have. There could potentially be considerable advantages in mergers of local utilities through centralised billing, combined retail outlets and perhaps a centralised civil engineering unit. Therefore if regulators were too insistent upon financial separation they might lose the advantages of the merger.

A recent News Release from OFWAT (*14 February 1995*) shows a very strong line being taken in that industry, perhaps because there are no plans to extend competition to the domestic supplies of water. The Regulator, Ian Byatt, stated that it was his duty to protect customers from any potential losses through diversification. Although he had no statutory powers to involve himself in company activities beyond the core businesses, companies had a duty to ring fence the water and sewerage businesses. In addition, OFWAT stressed the importance of proper transfer pricing, pointing out that the *Competition and Service (Utilities) Act 1992* placed a duty on the director general to ensure that companies carried out their functions at arms length.

Some concern has been expressed about the power that combined utilities might have. Would they be allowed to disconnect customers from all utilities for a default on one of them ? Could they use the customer information available to them to "cherry-pick" the more desirable customers and discard potential bad payers ? Perhaps such issues could be sorted out by direct requirements in the licences.

A more general problem might be that regulators would be drawn ever deeper into the businesses trying to decide whether the allocation of costs was correct and the benefits working through to the right customers. That would be a difficult job for them with their limited resources. It might also, potentially, reduce the economies of scale and involve a diversion of management time in the utilities.

At the moment, it appears that the differences in prices charged to customers according to their size of account and method of paying might potentially be greater than the differences in charges because of differences in transport costs due to location. however, it has to be stressed that there is a great deal of uncertainty as to how the increased competition will develop. Competition for domestic customers on this scale is virtually unique throughout the world and it is much too soon to know how it will operate in all details.

(d) Who will benefit from the changes ?

There has been considerable discussion as to the beneficiaries, reflecting a basic uncertainty. British Gas has always argued that the consumer benefited from the existence of the large company whose economies of scale enabled it to keep down costs. They see many of these benefits being lost already by the requirement to separate their transportation from the distribution business. On the other hand, critics of the company argue that it enjoys an easy life, free from competition, which allows it to operate inefficiently. Unfortunately, economic theory is little guide as to what will actually happen. Apart from anything else, economic theory does not say whether three or four companies constitute a satisfactory level of competition, or whether a much greater number is required.

XI The Gas Bill

The main function of the Bill is to amend the regulatory framework of the gas industry to provide for a competitive environment with many suppliers, all licensed on the same terms.

Some parts will become clearer when the draft licences are published, probably near the start of the Committee Stage. In a comment on the Bill, the British Gas Chief Executive, Cedric Brown, described it as a reasonable basis for competition in the domestic market below 2500 therms, but said this would depend on the key provisions contained in the licences for gas suppliers, shippers and transporters yet to be published[8].

Clause 1 replaces section 4 of the 1986 Act. Much of it is left virtually unchanged but two new pieces are added. Amongst the duties of the Secretary of State and the Director (ie the Regulator) is included (1) (c) to secure effective competition among the licensed companies. A more detailed subclause (2) (c) repeats this objective in more detail.

One unchanged part deserves comment. The Secretary of State and Director are still required (2) (b) "To promote efficiency and economy on the part of persons authorised by or under this Part to carry on any activities, and the efficient use of gas conveyed through pipes." This wording is taken from the 1986 Act but there has been considerable controversy as to what it implies. The first Regulator, Sir James McKinnon took it as the basis of the E-factor, by which companies would be allowed to pass through costs incurred in particular energy-saving projects. The second Regulator, Clare Spottiswoode, argued that extensive use of the E-factor amounted to tax gathering and was beyond her powers. Although she has dropped her original claim, she has only approved one tiny project and rejected four others. The Chairman of the Energy Saving Trust (Lord Moore) recently called for the law to be changed to allow the energy saving planned at the time of the Rio Summit, rather than only 10% of it as under current arrangements[9]. The Bill contains no such provision.

Clause 2 makes more explicit the duties of the Secretary of State and the Director with respect to safety. Safety is, of course, an important issue in a competitive framework but most of the safety obligations will probably be imposed upon TransCo, the transmission part of BG.

Clause 3 prohibits the transmission or supply of gas without a licence. The licence terms are the key to regulatory control and no amount of support for competition can allow a firm to operate without one.

Clause 4 gives an expanded list of exemptions from prohibition. Basically, the Secretary of State has a free hand to exempt a person or a class of people, provided that they comply with any direction from the Secretary of State or Director.

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[8] *British Gas Media Information* 2 March 1995
[9] *Daily Telegraph* 16 February 1995

Clause 5 provides for the licensing of public gas transporters. Although BG has not been required to divest itself of either its transportation or its supply businesses, they are seen from a regulatory point of view as totally distinct. Gas transportation will in practice remain a monopoly of TransCo (part of BG) and the licence will presumably look very different from the competitive licences for gas suppliers.

Clause 6 deals with the licensing of public gas suppliers. This is much more controversial, partly because consumers will be directly affected and partly because this is the sector in which competition is expected to operate. The idea is that there will be overlap between the areas licensed to different suppliers. Thus, by 1998, individuals living in the same street will be able to choose different gas suppliers.

Subclause (3) requires that a supply licence shall not be granted to a person who has a transportation licence. At first sight that might seem to be drafted to exclude BG from one side of the industry, but that is not so. The requirement is only that the transportation side and the supply sides are distinct legal persons, not that they are separate companies, therefore one can be a subsidiary of the other. The requirement is spelled out in Schedule 5 Article 2.

Sub-Clause (4) offers a procedure for the Director, with the consent of the licence holder, to vary the area covered by the licence.

Sub-clause (6) is concerned with trying to avoid so-called "cherry picking", the practice by which one supplier chooses to supply the most profitable part of the market, thereby offering lower prices and leaving the higher-cost accounts to other operators. BG has been particularly concerned not to be left with the residual accounts.

The sub-clause requires that the Director shall not grant licences which artificially exclude particular areas so as to exclude "an undue proportion of premises likely to be owned or occupied by persons who are disabled or of pensionable age, or who are likely to default in the payment of charges". Thus a licence holder could not specify an area excluding, for example, a poor housing estate. Whether this removes the possibility of cherry picking, however, depends upon one's definition. We do not know what size of areas will be chosen. The smaller the size, the greater the competition. If we consider city-sized areas, then some cities would be more profitable than others, partly because of including a lower proportion of late payers. It is difficult to see how the licensing system could operate if all such choices were excluded. The key to the sub-clause, then, is apparently the word "artificially". The choice of a prosperous city would be "natural" whereas the choice of an area excluding a poor estate would be artificial and therefore be ruled out. Clearly there could be a great many cases in between where the decision would not be clear-cut.

Clause 7 lays down some general guidance for licences. Although this gives some idea of what is likely to be involved, most of the requirements are permissive rather than mandatory. Thus, for example, subclause (4) (b), a licence may include conditions relating to the provision of services for the disabled or pensioners.

Clause 8 provides for some standard conditions for licences. The Secretary of State may make standard conditions to cover all transporters, or those supplying consumers, or those supplying gas into the system. In each case, the conditions will apply to all licences in that group.

The Director may modify such conditions with the consent of the Secretary of State, sub-clause (1) "to meet the circumstances of each particular case". He shall not modify the conditions, sub-clause (6) "unless he is of the opinion that the modifications are such that no other holder of such a licence would be unduly disadvantaged in competing with other holders of such licences".

Clearly this condition is included to prevent licence modifications helping one competitor at the expense of another. However, it would appear to be worded so as to make recourse to judicial review as difficult as possible, since the Director would not have to demonstrate objectively that no competitor was disadvantaged, merely to state that such was his opinion at the time.

Clause 9 inserts a revised version of the Gas Code

Clauses 10 and 11 provide for a series of miscellaneous amendments to the 1986 Act, largely to come into line with a competitive framework for the industry.

Clause 12 provides that the Secretary of State may grant applicants the right to make use of gas processing facilities other than those owned by a public gas transporter. The Secretary of State may determine the terms on which this right is to be granted.

Clauses 13 to 17 deal with other miscellaneous and general matters.