

**EXPLANATORY MEMORANDUM TO  
THE GAS (EXEMPTIONS) ORDER 2011**

**2011 No. 232**

**1.** This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

**2. Purpose of the instrument**

2.1 The instrument extends 19 gas licence exemptions that will otherwise expire on 1st March 2011. The exemptions apply to those companies in the gas market that perform the licensable activities of conveying, shipping or supplying gas, but for whom the requirement to hold a gas licence would be disproportionate. Without the exemptions a number of companies would find themselves operating outside of the law after 1st March 2011 or would have to be brought within the gas licensing system.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

**4. Legislative Context**

4.1 The instrument is being made in order to extend 19 gas licence exemptions that will expire on 1st March 2011. Those exemptions were contained in a number of orders made between 1996 and 2000, namely the Gas Act 1986 (Exemptions) (No 1) Order 1996 (1996/449); the Gas Act 1986 (Exemptions) (No 2) Order 1996 (1996/471); the Gas Act 1986 (Exemptions) (No 4) Order 1996 (1996/2765); the Gas Act 1986 (Exemption) Order 1997 (1997/2427); the Gas Act 1986 (Exemptions) Order 1999 (1999/2639); and the Gas Act 1986 (Exemptions) (No 2) Order 1999 (1999/3089). Those orders included provision providing for their self expiry on 1<sup>st</sup> March 2011.

**5. Territorial Extent and Application**

5.1 This instrument applies to Great Britain.

**6. European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## 7. Policy background

- What is being done and why

7.1 The Gas Act 1986 provides the Secretary of State (for the Department of Energy and Climate Change) with the power to grant an exemption from the requirement to hold a licence for the conveyance, shipping or supply of gas, or participation in the operation of a gas interconnector. The purpose of the exemptions is to reduce the regulatory burden for those people for whom holding a licence would be excessive, or onerous. This includes people whose business requirements involve the operation of a pipeline that is not truly part of the gas network, for instance a terminal operator operating a pipeline that connects the terminal with the National Transmission System (NTS). Some licence exemptions only apply during a specific situation, such as an emergency, and allow the usual separation of market roles to temporarily break down in the interests of security of supply, for example, allowing a transporter to supply gas for a limited period in the event of the shipper going bankrupt. DECC estimates that the number of businesses that could currently operate under the exemptions that will expire to be just over 3,500, of which some 3,500 are exempt from holding a gas transporter licence, while some 31 businesses are exempt from holding a supply licence. The exemptions meet the policy objectives of minimising the regulatory burden; avoiding unnecessary restructuring by gas market participants to avoid holding two gas licences; maintaining a legislative regime which supports secure gas supplies; and allowing gas market participants to continue to operate legally. The exemptions are a deregulatory measure; without them companies would have to apply to Ofgem for a licence or chose not to operate in the market.

7.2 DECC examined all of the exemptions which are being extended to ascertain whether they were still required. Accordingly not all exemptions that were due to expire on 1<sup>st</sup> March 2011 are being extended.

- Consolidation

7.3 This order extends and consolidates the Gas Act 1986 (Exemptions) (No 1) Order 1996 (1996/449); the Gas Act 1986 (Exemptions) (No 2) Order 1996 (1996/471); the Gas Act 1986 (Exemptions) (No 4) Order 1996 (1996/2765); the Gas Act 1986 (Exemption) Order 1997 (1997/2427); the Gas Act 1986 (Exemptions) Order 1999 (1999/2639); and the Gas Act 1986 (Exemptions) (No 2) Order 1999 (1999/3089).

## **8. Consultation outcome**

8.1 The Secretary of State issued a notice under Section 6A of the Gas Act 1986” on 29 September 2010 for a period of 28 days until 26 October 2010. The consultation period was in line with the requirement in the Gas Act 1986 (S.6A(1A)(c)). The 15 companies covered by the named exemptions were consulted directly and included the operators of 12 gas terminals; for the gas storage class exemption, the Notice was sent to the Gas Storage Operators Group representing 17 gas storage operators; and for the exemptions covering gas transporters, shippers and suppliers the Notice was sent to the relevant trade associations: the Gas Forum, the Joint Office of Gas Transporters and the Energy Networks Association. The Notice was also sent to Ofgem, Consumer Focus and the Health and Safety Executive. The Notice was made publicly available on the DECC website. Twelve responses were received to the Notice all of which supported the approach being taken to extend the exemptions and bring them up to date. Receiving particular support were the proposals to standardise the information requirements in the named and class exemptions and to grant the new exemptions indefinitely.

## **9. Guidance**

9.1 We will provide an explanation about the new order on the DECC website, as well as a link to the instrument, but as the instrument extends what is already in place formal guidance is not necessary.

## **10. Impact**

10.1 The impact on business is that the estimated net present benefit is £41million which relates to reducing the potential costs to business from operating in the gas market if they were to be licensed instead of operating under an exemption. Applying for a gas licence requires an application fee as well as the costs associated with making the application and ensuring that a business is able to meet the conditions of the licence. Some respondents to DECC’s Notice estimated that the administrative costs of applying for a gas transporter licence could be £20,000, regulatory, legal, commercial and other costs. DECC judges this might be close to the upper limit that ought to be applied because if there were large scale applications for transporter licences efficiencies might be found that reduced the cost of the process and the licence application might be simplified and thus less costly than for other transporter licences.

10.2 The impact on the public sector is negligible as the exemptions are being extended. However, if they were to expire Ofgem, the industry regulator, would incur the upfront cost of issuing additional licences (to gas market participants who previously operated under an exemption and who decided to apply for a licence) although

Ofgem would effectively recover these costs through the application fee it charges for each licence.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on [www.legislation.gov.uk](http://www.legislation.gov.uk).

## **11. Regulating small business**

11.1 The legislation applies to small business.

11.2 This is a deregulatory measure and small firms will also benefit from extending the licence exemptions. If we did not take this action companies (regardless of size) would have to apply to Ofgem for a licence and be required to meet the conditions of that licence, or chose not to participate in the market.

## **12. Monitoring & review**

12.1 The success criteria for this instrument is that companies continue to operate legally under the exemptions. A number of anticipated changes to the regulatory environment in the next couple of years could impact on the relevance of some of the exemptions. Therefore we will review the exemptions in 2013 to identify whether any have become redundant and assess whether they could be removed. More information is available in the Post Implementation Review Plan in annex A of the Impact Assessment.

## **13. Contact**

Nicola Robinson at the Department of Energy and Climate Change, tel: 0300 068 6095 or email: [nicola.robinson@decc.gsi.gov.uk](mailto:nicola.robinson@decc.gsi.gov.uk) can answer any queries regarding the instrument.

<b>Title:</b> <b>Gas Licence Exemptions</b> <b>Lead department or agency:</b> DECC <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>
	<b>IA No:</b> DECC0049
	<b>Date:</b> 04/01/2011
	<b>Stage:</b> Final
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Secondary legislation
	<b>Contact for enquiries:</b> Alex Whitmarsh 0300 068 5195 Nicola Robinson 0300 068 6095

## Summary: Intervention and Options

### What is the problem under consideration? Why is government intervention necessary?

The Gas Act 1986 sets out the regulatory regime for the operation of the gas market. The Gas Act enables the conveyance, shipping and supply of gas to occur without the need for a licence in some specific circumstances where the requirement to hold a licence would be excessive or onerous. Exemption orders have been made under the Gas Act seven of which will expire on 1 March 2011. If the exemptions are not renewed gas market operators would face an additional administrative burden, some gas market operators could find themselves operating outside the law or ceasing the activity for which they were previously exempt.

### What are the policy objectives and the intended effects?

The objectives are to:

- i) minimise the regulatory burden; ii) avoid unnecessary restructuring by gas market participants to avoid holding two gas licences; iii) maintain a legislative regime which supports secure gas supplies; and iv) allow gas market participants to continue to operate legally.

### What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The following options have been considered:

- i) 'Do nothing'; and
- ii) Extend the exemptions which are due to expire making the minimum changes necessary to bring them up to date.

DECC intends to extend the licence exemption orders indefinitely as described above. Responses to the notification indicated unanimous support for this option and it should be noted that even the low-end estimate for benefits significantly outweighs the small administrative burden to DECC in extending these licence exemptions.

**Will the policy be reviewed?** It will be reviewed. **If applicable, set review date:** 12/2013

**What is the basis for this review?** Not applicable. **If applicable, set sunset clause date:** Month/Year

**Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?**

Yes

**SELECT SIGNATORY Sign-off** For final proposal stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible Lord Marland: .....

Date: 7<sup>th</sup> February 2011

# Summary: Analysis and Evidence

# Policy Option 1

## Description:

Extension of Gas Licence Exemptions

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 7.1	High: 75.2	

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			
High			
Best Estimate	0.08	0	0.08

### Description and scale of key monetised costs by 'main affected groups'

There is a small administrative cost to DECC of around £80,000. This includes the costs of policy, legal and economic advice and includes a mark-up for overheads.

### Other key non-monetised costs by 'main affected groups'

It is possible that some 'option value' could be lost, since replacing the exemption regime with a licence regime would allow Ofgem to impose different conditions than currently apply in the exemptions. However, it is assumed for the purposes of this IA that Ofgem would not add any substantive duties on new licensees since Ofgem is already able to issue licences with many of the standard conditions 'switched off'.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	7.4		7.2
High	77.8	1	75.3
Best Estimate	42.6		41.2

### Description and scale of key monetised benefits by 'main affected groups'

The key benefits will be to reduce the administrative burden on gas market participants by avoiding the need to apply for (and ensure compliance with) a new licence. As such, all of these benefits are direct benefits to business.

### Other key non-monetised benefits by 'main affected groups'

i) ensuring some market participants who might not be aware that the sunset clauses will expire do not act in a way that becomes unlawful; ii) ensure that economies of scope and efficient organisation structures are not adversely affected iii) enhancing security of supply

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

Whilst the application costs for a new licence are readily accessible, only limited evidence regarding the costs to business in terms of the resource required to apply for a licence is available. It is judged that the range of benefits captures the degree of uncertainty involved.

It is also assumed that Ofgem would not add any substantive new duties to operators that are currently exempt if they were to require a licence.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?		Great Britain			
From what date will the policy be implemented?		01/03/2011			
Which organisation(s) will enforce the policy?		n/a			
What is the annual change in enforcement cost (£m)?		0			
Does enforcement comply with Hampton principles?		Yes			
Does implementation go beyond minimum EU requirements?		N/A			
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)		Traded: 0		Non-traded: 0	
Does the proposal have an impact on competition?		Yes			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?		Costs: 0		Benefits: 0	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro 0	< 20 0	Small 0	Medium 0	Large 0
Are any of these organisations exempt?	No	No	No	No	No

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties</b> <sup>1</sup> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	Yes	11
Small firms <a href="#">Small Firms Impact Test guidance</a>	No	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	No	
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	
Justice system <a href="#">Justice Impact Test guidance</a>	No	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	

<sup>1</sup> Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

## Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	<b>Notice under section 6A of the Gas Act 1986; DECC, September 2010</b> <a href="http://www.decc.gov.uk/assets/decc/Consultations/notice-section-6a-gas-act/571-notice-6a-gas-act.pdf">http://www.decc.gov.uk/assets/decc/Consultations/notice-section-6a-gas-act/571-notice-6a-gas-act.pdf</a>
2	<b>Gas and Electricity Licence Applications – Guidance; Ofgem, September 2010</b> <a href="http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasnd0electricityapplications.pdf">http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasnd0electricityapplications.pdf</a>
3	
4	

+ Add another row

### Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

#### Annual profile of monetised costs and benefits\* - (£m) constant prices

	Y <sub>0</sub>	Y <sub>1</sub>	Y <sub>2</sub>	Y <sub>3</sub>	Y <sub>4</sub>	Y <sub>5</sub>	Y <sub>6</sub>	Y <sub>7</sub>	Y <sub>8</sub>	Y <sub>9</sub>
<b>Transition costs</b>	0.08	0	0	0	0	0	0	0	0	0
<b>Annual recurring cost</b>	0	0	0	0	0	0	0	0	0	0
<b>Total annual costs</b>	0.08	0	0	0	0	0	0	0	0	0
<b>Transition benefits</b>	0	42.6	0	0	0	0	0	0	0	0
<b>Annual recurring benefits</b>	0	0	0	0	0	0	0	0	0	0
<b>Total annual benefits</b>	0	42.6	0	0	0	0	0	0	0	0

\* For non-monetised benefits please see summary pages and main evidence base section

## Evidence Base (for summary sheets)

### Issue

1. Licence exemptions under the Gas Act 1986 enable the conveyance, supply and shipping of gas to occur without the need for a licence. Whilst the licensing of gas market participants is important to ensure security of supply, safety and the protection of consumers, there are some circumstances where the requirement to hold a licence will be excessive and onerous. These include situations such as the operation of short pipelines connecting gas import terminals with the pipeline of a licensed gas transporter. They also include the operation of very small networks such as in caravan sites. Some licence exemptions only apply during a specific situation, such as an emergency, in order to safeguard supply.
2. The activities that must be authorised by a licence are set out in section 5 of the Gas Act. These include:
  - the conveyance of gas through pipes to any premises, or to a pipeline system operated by a gas transporter, other than by the means of a gas interconnector;
  - participation in the operation of a gas interconnector;
  - the supply to any premises of gas which has been conveyed to those premises through pipes; and
  - the arrangement with a gas transporter for gas to be introduced into, conveyed by means of, or taken out of, a pipeline system operated by that transporter.
3. Nevertheless, the Gas Act does provide the Secretary of State (for the Department of Energy and Climate Change) with the power to grant an exemption for the activities listed above. The purpose of the exemptions is to reduce the regulatory burden for those people for whom holding a licence would be excessive, or onerous. This includes people whose business requirements involve the operation of a pipeline that is not truly part of the gas network, for instance a terminal operator operating a pipeline that connects the terminal with the National Transmission System (NTS). Some licence exemptions only apply during a specific situation, such as an emergency, and allow the usual separation of market roles to temporarily break down in the interests of security of supply, for example, allowing a transporter to supply gas for a limited period in the event of the shipper going bankrupt.
4. Seven out of ten extant exemption orders contain sunset clauses that will expire in March 2011, the others do not contain an expiry date and are not considered here. The policy question at hand is whether to extend those exemption orders that will expire in order to maintain the current arrangements.

### Background

5. On 29 September 2010 DECC published a notice under section 6A of the Gas Act 1986. Representations regarding the notice were invited to be sent to DECC until 26 October 2010.
6. There are two broad classes of exemptions: 'Class' and 'Named' exemptions. Tables 1 and 2 summarise the types of exemptions. Most of the exemptions can currently apply, that is, they do not require a particular set of circumstances to arise in order for them to potentially become effective. Some class exemptions can potentially apply but only under certain circumstances; for example, the emergency shipper's exemption can only apply when the exemption would help to prevent or remedy a gas supply emergency.
7. DECC estimates that the number of businesses that could currently operate under the exemptions that will expire to be over 3,500, of which around 3,500 are exempt from holding a gas transporter licence, while some 31 businesses are exempt from holding a supply licence.

8. Neither Class nor Named exemptions are free from obligations. However, these obligations are generally not onerous, for example, there are obligations in some cases to provide information regarding changes to capacity levels and the flows of gas.

**Table 1: Summary of Class Exemptions**

Class Exemption	Number of Undertakings likely to be affected	Licences they would need to hold	they otherwise hold	Licence they currently hold
<b>EXEMPTIONS THAT CAN CURRENTLY APPLY</b>				
<b>Gas storage sites (other than storage in natural porous strata)</b>	5 <sup>1</sup>	Transporter & Supply		
<b>Transportation of gas created as a by-product of some other process (for example, manufacturing or agriculture)</b>	2 – 10 <sup>2</sup>	Transporter		
<b>Conveying gas beyond a secondary meter</b>	3300 <sup>3</sup>	Transporter		
<b>Conveyance of gas previously supplied</b>	192 <sup>4</sup>	Transporter	Supply	
<b>Supplying bottled gas</b>	23 <sup>5</sup>	Supply		
<b>EXEMPTIONS THAT REQUIRE CERTAIN CIRCUMSTANCES IN ORDER TO APPLY</b>				
<b>The supply of gas by a gas transporter in the case of a failure of a shipper</b>	Potentially 36 <sup>6</sup>	Supply		Transporter
<b>Consumer's shipping exemption</b>	Potentially 324,300 <sup>7</sup>	Shipper		
<b>Supplier's shipping exemption</b>	Potentially 192 <sup>8</sup>	Shipper		Supply
<b>The shipping of gas in an emergency situation</b>	Potentially producers, storage operators, or others	Shipper		

<sup>1</sup> These are the salt caverns in existence or under construction.

<sup>2</sup> There is one biogas plant at the moment and at least one plant linked to a power station. There are likely to be others.

<sup>3</sup> Source: Ofgem. This figure represents the number of UNC sub-deduct supply meter points where gas is received at secondary meters

<sup>4</sup> Number of companies holding a gas supply licence. Source: Ofgem website

<sup>5</sup> The number of LPG cylinder suppliers taken from [http://www.uklpg.org/supplier\\_member.php](http://www.uklpg.org/supplier_member.php) as of 27th October 2010.

<sup>6</sup> The number of licensed gas transporters.

<sup>7</sup> Number of customers using more than 73,200 kwh per year in 2008. Source: DECC.

<sup>8</sup> Number of companies holding a gas supply licence. Source: Ofgem website

**Table 2: Summary of Named Exemptions (all of these can currently apply)**

Named Exemption	Number of Undertakings affected	Licences they would otherwise need to hold
Lindholme compressor site	1	Transporter
Connah's Quay Power Station	1	Transporter and Supply
Premier Transmission Ltd.	1	Transporter
<b>Gas Terminals</b> (SI 1996/471; Schedule 1)	12	Transporter
<b>Gas Facilities</b> (SI 1996/471; Schedule 2)	1	Transporter
<b>Benenden School (and one of its trading companies)</b> (SI 1996/471; Schedule 3)	2	Supply

### Overview of Options

**Option 1:** The licence exemptions are allowed to expire.

**Option 2:** The licence exemptions are renewed with no changes to primary legislation.

#### Option 1: Licence exemptions are allowed to expire

9. This option is the 'baseline option' and all the costs and benefits of the other options are considered relative to this. In this scenario the following exemption orders made under the Gas Act 1986 will expire:

- The Gas Act 1986 (Exemptions) (No 1) Order 1996 (1996/449);
- The Gas Act 1986 (Exemptions) (No 2) Order 1996 (1996/471);
- The Gas Act 1986 (Exemptions) (No 4) Order 1996 (1996/2765);
- The Gas Act 1986 (Exemption) Order 1997 (1997/2427);
- The Gas Act 1986 (Exemption) Order 1998 (1998/1779);
- The Gas Act 1986 (Exemptions) Order 1999 (1999/2639); and
- The Gas Act 1986 (Exemptions) (No 2) Order 1999 (1999/3089)

10. For the gas market participants operating under the exemption orders that will expire in March 2011 this would mean that they would need to apply to Ofgem for the appropriate licence and ensure they were able to comply with the licence conditions, or if they already held a licence under the 1986 Gas Act they would have to consider setting-up a new legal entity as one company is prohibited from holding a gas transporter licence as well as a supply, shipper or interconnector licence. Companies would risk acting outside the law if they do not undertake these actions or will have to cease the action that was previously exempt.

11. In the case of both supply and transporter licences, subject to consultation and compelling grounds for doing so, Ofgem can, and do, issue licences without many of the standard conditions ‘switched-on’. These ‘cut down’ licences are generally not onerous and many of the conditions are likely to be adhered to anyway by a supplier. Annex 2 shows examples of such licences and the conditions that apply.
12. Although such a decision would be a matter for Ofgem, it is assumed for the purposes of this scenario that undertakings which are currently exempt would be issued a ‘cut down’ licence by Ofgem.

### Option 2: The licence exemptions are extended

13. In this scenario, the exemption orders would be extended with no end date.

#### Monetised Benefits

i) Reduced administrative costs to business regarding licensing

14. When an exemption order expires it is assumed that market participants would require the relevant licence instead. The issuance of additional licences would add to the costs to Ofgem in issuing the licence although Ofgem effectively recovers these costs (and passes them on to applicants) through the application fee it charges for such a licence. Table 3 shows the application fees charged by Ofgem.

15. In addition to the application fee charges, applicants also face costs in making an application. Some respondents to DECC’s notice pointed to one estimate for administrative costs in applying for a transporter licence of around £20,000 which reflects the regulatory, legal, commercial and other inputs required in making the application. It is understood that this reflects around 10 to 20 days of professional advice although the exact basis for this estimate is not clear. DECC judges this might be close to an upper limit that ought to be applied as if large scale applications for transporter licences were required (as assumed in the baseline scenario) then:

- a. efficiencies might be found in the application process<sup>9</sup> and
- b. the licence application process for ‘cut down’ licences may be more straightforward than for other transporter licences.

16. For the purposes of this IA, DECC has therefore made the assumption that the administrative costs are likely to be between the same costs as the licence fee itself to around twenty times the application fee<sup>10</sup>. Table 3 shows applications fees, the range of administrative burdens and the number of exemptions that currently apply by each licence type.

**Table 3: Administrative Costs of Applying for a Licence, 2010 prices**

Licence Type	Admin Fee <sup>11</sup>	Burden in Applying for a licence (assumed)	Number of Exemptions that currently apply
Transporter	£1,050	£1,050 to £21,000	3515 to 3523
Supply	£450	£450 to £9,000	31
Shipper	£350	n/a	0

<sup>9</sup> For example, a market for a third-party to offer specialist support in making an application might be created which might help to reduce the administrative burdens.

<sup>10</sup> This would give an upper limit for a GT licence or £21,000 which slightly exceeds the estimate that respondents offered.

<sup>11</sup> <http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasand0electricityapplications.pdf>

17. The licence fee and administrative burden costs together with the number of gas market participants currently requiring a class and named exemption (see table 3) are used to calculate the monetised cost savings that could be made from extending the licence exemptions. The ranges are used to produce a low, central and high set of benefits as shown in table 4 (the central estimate takes the centre of the range of the number of licence exemptions and the burden in applying for a licence).

**Table 4: Monetised Benefits Estimates (Rounded, £m, undiscounted, 2010 prices)<sup>12</sup>**

		Low	Central	High
<b>Licensing Savings</b>	<b>Cost</b>	7.4	42.6	77.9

18. Whilst it may be that even a cut-down licence may lead to additional conditions being placed on a market participant, compared to the conditions required under an exemption, it is assumed for this impact assessment that the cost implications of these additional conditions is *de minimis*. This is because 'cut down' licences (see Annex 2) need not have onerous conditions.

### Non-monetised benefits

#### ii) Avoidance of Separation Costs

19. Both in current legislation and in the forthcoming EU 'Third Energy Package', a separation between certain roles in the gas market must be maintained. Removing the licence exemptions could, in some cases, bring market participants' business structures into conflict with these separation requirements.

20. If they wished to continue their functions companies would be required to separate their businesses with consequent costs in terms of reductions in economics of scope and compliance costs.

21. Alternatively, the affected market participants might choose to sell some of their assets in order to comply, although this itself might cause problems. For example, value might be lost if potential purchasers found it difficult to value these assets and therefore were cautious in their valuation (for example the condition of pipelines might be hard to establish accurately by a third-party).<sup>13</sup>

22. The benefits from avoiding these costs could be potentially significant and outweigh the estimated benefits in terms of administrative cost savings.

#### iii) Enhanced Security of Supply

23. Some licence exemptions only apply when there is a risk that consumers' supply of gas might be curtailed. These exemptions were designed to allow certain market participants to temporarily undertake new roles in the gas market in the interests of security of supply. For example, one exemption allows some market participants to enter gas into the network under certain conditions where this would help to prevent or remedy a gas supply emergency.

24. Whilst these exemptions were primarily designed to enhance security of supply the exemptions may become increasingly redundant over time as the regulatory regime develops. For example:

<sup>12</sup> These benefits would be felt in 2011 whilst most of the costs to DECC in extending the licences were borne in 2010. For the NPV calculations these benefits are therefore discounted by one year.

<sup>13</sup> NB This particular cost would be a transfer (from the seller to the buyer) and not a resource cost. However, economies of scope might still be lost.

- a. DECC is proposing changes to supplement the current arrangements that allow Ofgem to appoint a supplier of last resort in the event of supplier insolvency with a special administration regime. In the unlikely event that a major supplier became insolvent, a trade-sale was possible and Ofgem was unable to appoint a supplier of last resort, then the Secretary of State could apply to the court for a special administration order. This would allow the company to continue to supply customers until it was either rescued, sold or its customers transferred to other suppliers. As suppliers are ultimately responsible for the shipping of gas in the event of a shipper's bankruptcy this measure should further enhance resilience.

However, an exemption may still be needed to cater for the situation where a Gas Shipper and/or Supplier cannot fulfil the shipping arrangements. Standard Condition 18 of the Gas Suppliers licence now gives 25 working days for a supplier to arrange for new shipping arrangements to a premise. An exemption would be needed to cover the interim period between being appointed as a supplier last resort, or making alternative shipping arrangements in the event of a shipper unexpectedly leaving the market.

- b. Ofgem's technical survey of sub-deduct systems is being considered within the current review of gas distribution price controls to determine the most appropriate way forward which might have implications for a couple of the exemptions in The Gas Act (Exemptions) (No.1) Order 1996.

25. DECC is therefore proposing to extend the licence exemptions but will review those that might no longer be necessary, before the end of 2013 with a view to considering whether any that are redundant ought to be removed.

26. Other licence conditions that help to reduce the costs of operating in the gas market, and therefore help to make these activities economic, make a significant contribution to energy security. One respondent, E.ON, specifically stated that if the Connah's Quay pipeline exemption was not extended it would no longer be able legally to convey gas without a gas transporter licence from the gas treatment plant at Connah's Quay to the NTS at Burton Point and would have to cease doing so; if this were indeed to happen then the impact would be a loss of the gas input capability at Burton Point.

iv) Other Benefits to Business

27. Reducing mistake costs: Some licensees may not be aware they need to apply for a licence. This might cause them to act outside of the law inadvertently. This risk could be mitigated by DECC publicising any forthcoming changes, but it may be difficult and costly to ensure all those under class exemptions are made aware of the changes. Extending the licence exemption orders, with which operators are already familiar, would remove this risk entirely.

28. Reducing regulatory uncertainty: If gas market participants *perceive* that a licence with conditions that can be 'switched-on' or added more easily than the conditions set out in secondary legislation it could add to regulatory uncertainty with consequent impacts on the incentive to invest in the gas market. For example, responses to DECC's consultation on the implementation of the gas market aspects of the EU Third Package indicated that a majority of respondents thought that legislation, rather than introducing a licence regime, gave more regulatory certainty.

## Costs

29. If market participants did not require a licence, as at present, then Ofgem would be unable to determine licence conditions i.e. potentially there is a loss of option value. However, as noted earlier, it is assumed for the purposes of this IA that Ofgem would issued cut-down licences and therefore the costs are assumed to be *de minimis*.
30. There is also an administrative cost in extending the licence exemption orders which includes policy, legal and economic advice. This is estimated to be around cost £80,000 based on DECC 2010 London payscales and including the recommended 30% mark-up to account for overheads.

## Competition: Specific Impacts Assessment

Table 5 summarises the response to the four key competition questions.<sup>14</sup> The measures help to promote a competitive market but the removal of unnecessary administrative costs, and allowing flexibility in organisation form for a number of companies that might otherwise be affected. The impact is therefore to support competition in the gas market.

**Table 5: Competition Assessment Key Questions**

Do the measures directly limit the Number of Suppliers?	No
Do the measures indirectly limit the number of suppliers?	No. The measures reduce the costs of market participation and therefore increase number of players than can profitably exist in the market.
Do the measures limit the ability of suppliers to compete?	No. By allowing a number of participants to select their own organisation structure to helps these participants to compete in the market in an efficient way.
Do the measures reduce the incentive on suppliers to compete vigorously?	No

## Risks and Assumptions

31. Whilst the application costs for a new licence are readily accessible, there is limited evidence on the costs to business in terms of the resource required to apply for a licence. A range, drawing on the application costs and evidence provide by stakeholders, is applied to capture the degree of uncertainty involved.
32. Ofgem would be responsible for issuing licences. It has been assumed for the purposes of this IA that Ofgem would issue 'cut down' licences which would not add significantly to the administrative burden in complying with exemption requirements. However, if Ofgem deemed that additional licence conditions were appropriate then the impact of not extending the licence exemptions would be greater.

## Appraisal Period

33. The start of the period used for this Impact Assessment is 2010 when the administrative cost to DECC was experienced. The monetised benefits are estimated for 2011 when the licence exemptions would cease if they were not extended. No costs or benefits for subsequent years have

<sup>14</sup> [http://www.ofg.gov.uk/shared\\_ofg/reports/comp\\_policy/oft876con.pdf](http://www.ofg.gov.uk/shared_ofg/reports/comp_policy/oft876con.pdf)

been estimated and therefore the net present value is not sensitive to the length of the appraisal period beyond the second year.

34. Arguably, the appraisal period could have been set at four years as the intention is for a review to be held before the end of 2013. However, the review is likely to focus on a small number of the exemptions that would only be used in specific circumstances. These particular exemptions do not drive the monetised costs and benefits. Therefore, the standard appraisal period of ten years was used.

#### **Response to notice under section 6A of the Gas Act 1986**

35. DECC invited representations to its notice and received 12 responses in total. There was support for DECC's approach in extending the exemption orders, agreement that all new exemptions should be made indefinitely, and support for minimum changes being made, such as standardising the information requirements for named and class exemptions.
36. Some respondents also supported similar arrangements to be made in future for on-shore gas production which would include the injection of bio-methane into the gas grid. DECC is considering these suggestions.

#### **Summary and preferred option**

37. DECC intends to extend the licence exemption orders as described above. Responses to the notification indicated unanimous support for this option and it should be noted that even the low-end estimate for benefits significantly outweighs the small administrative burden to DECC in extending these licence exemptions.
38. Therefore, the assessment that the benefits will outweigh the costs is considered robust.

# Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

## Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p><b>Basis of the review:</b> [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review , or there could be a political commitment to review (PIR)];</p> <p>A number of changes to the regulatory environment in the next couple of years are foreseen that might make some of the licence exemptions redundant.</p>
<p><b>Review objective:</b> [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p> <p>To reconsider whether all the licence exemptions will still be required in future.</p>
<p><b>Review approach and rationale:</b> [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p> <p>The review is likely to involve a significant amount of ex ante desktop research that would examine how the exemptions fit with forthcoming changes in the legal and regulatory environment. It may be appropriate to seek stakeholders’ views if it were judged that this could have an impact on them.</p>
<p><b>Baseline:</b> [The current (baseline) position against which the change introduced by the legislation can be measured]</p> <p>n/a. The review is likely to focus on how the exemptions fit with any changes in the regulatory environment.</p>
<p><b>Success criteria:</b> [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p> <p>n/a</p>
<p><b>Monitoring information arrangements:</b> [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]</p> <p>Processes to document changes to the UK, EU legal and regulatory environment are already in place and easily accessible.</p>

**Reasons for not planning a review:** [If there is no plan to do a PIR please provide reasons here]

n/a

## Annex 2

### **Example 1: A supply 'light' licence: Blaenau Gwent Country Borough Council**

The majority of standard licence conditions (SLCs) do not apply to this licence. The conditions that remain can be summarised as:

- i) that the facilities need to be built in order to supply the gas;
- ii) the facilities must not change significantly;
- iii) the licensee must observe the proper principals of safe distribution of gas and have regard to HSE guidance;
- iv) the licensee must have the power to access the premises being supplied under certain conditions
- v) the provision of a (shared) telephone service; and
- vi) the licensee must be able to gain access to the premises within 24 hours under certain conditions.

### **Example 2: A 'cut down' transporter licence: Caythorpe Gas Storage Limited**

In this licence, many of the conditions have been "switched-off". The conditions that remain can be summarised as:

- i) rules to enforce competition (such as non-discrimination of access and the need for separate regulatory accounts);
- ii) the provision of a (shared) telephone service;
- iii) the provision of certain information; and
- iv) rules relating to the development, expansion and disposal of assets.