EXPLANATORY MEMORANDUM TO THE

ELECTRICITY ACT 1989 (UNIFORM PRICES IN THE NORTH OF SCOTLAND) ORDER 2005

2005 No.490

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 The Order will ensure that comparable customers in the North of Scotland will not be subject to price discrimination by local electricity suppliers solely on the basis of their location within the area. The aim of the Order is therefore to protect customers in the North of Scotland from the relatively high costs of supplying electricity.

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

3.1 None

4. Legislative Background

4.1 The Order was originally set out in section 3(2)(a) of the Electricity Act 1989 (c.29), which imposed a duty on the Secretary of State and the sectoral regulator to ensure that public electricity suppliers maintained common tariffs within a given area in Scotland (which was to be specified by the Secretary of State). In 1990, the Secretary of State for Scotland laid an Order under the Electricity Act 1989 which specified the precise area of the North of Scotland to which the Order should apply.

4.2 The Utilities Act 2000 (c.27) repealed section 3(2)(a) of the Electricity Act 1989 and inserted a new section 7B into the Electricity Act 1989. Section 7B enables the Secretary of State to make an Order requiring the holders of transmission, distribution, and suppliers' licensees to charge prices, and in the case of suppliers, to offer contract terms, which do not distinguish between users in different parts of a specified area in Scotland. However, contrary to the policy intent at the time, no Order was made under section 7B to update the legislative framework, following the passing of the Utilities Act.

5. Extent

5.1 This instrument extends to Great Britain.

6. European Convention on Human Rights

Not applicable

7. Policy background

7.1 Since the passing of the Utilities Act 2000, suppliers in the North of Scotland have assumed that the necessary order under section 7B of the Electricity Act had been passed. There has not been any evidence of widespread locational charging within the North of Scotland, however, it is conceivable that this might change in the future, without the necessary legal framework being in place. On 4th August 2004 the Government announced its intention to correct what could be perceived as a legal anomaly with the launch of a public consultation. on the laying of an Order to ensure that suppliers do not charge different prices to comparable domestic customers in the North of Scotland simply on the basis of their geographical location within the area. Following that public consultation, DTI now plans to lay the Order.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

Renata Williams at the Department of Trade and Industry, Tel: 020 7215 0442 or e-mail: Renata.Williams@dti.gsi.gov.uk, can answer any questions regarding the instrument.

ELECTRICITY ACT 1989 (UNIFORM PRICES IN THE NORTH OF SCOTLAND) ORDER 2005:

FINAL REGULATORY IMPACT ASSESSMENT

Purpose and Intended Effect of Measure

Objective

1.1 This final RIA is designed to accompany the Order that will ensure that the existing Government policy of the Common Tariff Obligation (CTO) continues.

1.2 The CTO is designed to ensure that electricity suppliers in the North of Scotland do not price discriminate between comparable domestic electricity customers in terms of geographical location within the region. In other words, customers in one part of the North of Scotland will be charged the same prices for each unit of electricity as similar customers in another part. Although, there is currently no price discrimination, the future possibility exists, which could have a negative social impact on remote rural areas in particular.

Background

1.3 A new order should have been laid to update the legislative framework following the passing of the Utilities Act 2000, but was not. The CTO was originally derived from Section 3(2)(a) of the Electricity Act 1989 (c.29), which imposed a duty upon the Secretary of State and Ofgem ("the Director General of Electricity Supply") to ensure that public electricity suppliers maintained common tariffs within a given area of Scotland specified by the Secretary of State as the North of Scotland.

1.4 The Utilities Act 2000 (c.27) repealed section 3(2)(a) of the Electricity Act 1989 and inserted a new Section 7B into the Electricity Act 1989. Section 7B enables the Secretary of State to make an order requiring the holders of transmission, distribution and supply licenses to charge prices and, in the case of suppliers, to offer contract terms which do not distinguish between users in different parts of a specified area in Scotland. However, no order was made under section 7B.

1.5 Paragraph 6 of Standard Licence Condition 42 for electricity suppliers[1] gives effect to the CTO as if an order was in effect under Section 3(2)(a) of the Electricity Act 1989, but these particular provisions in the primary legislation no longer exist because they were repealed by the Utilities Act 2000. The Government therefore believes that it is necessary to rectify this by laying a new order under section 7B of the Electricity Act 1989, which will essentially give a secure legal foundation to the CTO regime.

[1] Standard Licence Condition 42, para.6: "Where the Secretary of State has specified an area of Scotland by an order made pursuant to section 3A of the Act, a domestic supply contract for the supply of electricity to premises within that area shall be on terms as to price which are the same as those for an equivalent supply to any other premises within that area."

1.6 Suppliers in the North of Scotland are currently CTO compliant, as they continue to behave as if the CTO still exists. This behaviour by suppliers has been facilitated by the fact that, over the same period, Scottish and Southern Energy has set demand transmission and distribution charges at common levels for the whole area, again notwithstanding the absence of an order under section 7B requiring them to do so. Nevertheless, this does not rule out the possibility that suppliers may, in future, charge different prices for comparable domestic customers in different areas of the North of Scotland.

1.7 The Order will prevent suppliers from charging different prices to comparable domestic customers on the basis of geographical location and also ensure that the North of Scotland is treated as one single demand transmission and distribution charging zone.

Risk assessment

1.8 The aim of laying this Order is to provide policy certainty for the CTO. Thus the Order will prevent electricity suppliers in the North of Scotland from charging similar domestic customers different prices on the basis of geographical location as well as ensure that the North of Scotland is treated as one single demand transmission and distribution charging zone. The risks associated with not doing so are that suppliers may charge comparable domestic customers different prices in different areas, particularly if demand distribution or transmission charges vary in future by area. Furthermore, the risks associated with any possible future variation in the demand transmission or distribution charges within the area is that this would seriously undermine suppliers' ability to be able to charge common prices within the area. If this were to occur, it would be likely to adversely affect those customers in remote rural areas. In short, laying the Order is an example of the precautionary principle, i.e., to take action now so as to avoid an undesirable future event, even though the likelihood of that event is unknown.

1.9 There does exist a potential future risk, which arises from the possibility of more independent Distribution Network Operators (DNO's) moving into the area, since they could conceivably "cherry pick" within the North of Scotland. This means that they would tend to concentrate on small areas consisting of a lot of customers, such as urban areas (e.g. Aberdeen). This could result in different demand distribution charges applying for different areas within the North of Scotland. The DTI recognises this could be a potential problem for the operation of the CTO if this were to occur in the future. However, this is unlikely to happen within the next three years. When the CTO is reviewed in three years' time, the current market conditions would naturally need to be considered and assessed in determining how the CTO might be applied in the future.

Options

2.1 There are two options open to the Government:

i) To do nothing, which means not laying the Order. There are two possible outcomes from this. Firstly, suppliers will not price discriminate on the basis of a customers' geographical location within the North of Scotland, even given the opportunity to do so. Secondly, that the suppliers do vary

their prices by geographical location. Furthermore, suppliers could face different transmission and distribution charging zones within the North of Scotland.

ii) To lay the proposed Order, which would ensure that suppliers could not price discriminate on the basis of geographical location. The outcome of this would be a continuation of the status quo, but with a secure legal foundation, which is presently lacking. Furthermore, this would ensure that the North of Scotland is treated as one single demand transmission and distribution charging zone.

Costs and Benefits

Business sectors affected

3.1 The proposed changes would impact on every electricity supplier that serves domestic customers in the North of Scotland. Currently the Order would mainly affect Scottish & Southern Energy, as it is the dominant supplier in this area.

Benefits

3.2 The benefit of option i) is dependent on which of the two possible outcomes would take effect. The first outcome would be that suppliers would not vary prices in any event. This is based on the assumption that suppliers will charge common prices across the area regardless of whether there is an obligation to do so or not. Given this outcome, the benefit would be avoiding what could be perceived to be unnecessary regulation. However, if the second outcome would take effect, then suppliers would price discriminate between domestic customers, with a likely adverse impact on customers in the remote rural areas in particular.

3.3 The benefit of option ii) is that it prevents suppliers from charging domestic customers different prices solely on the basis of geographical location within the CTO area. This will prevent customers in remote rural areas of the North of Scotland from potentially facing much higher bills.

3.4 According to the most recent regional household income survey from the Office for National Statistics, there are parts of the North of Scotland, which are significantly disadvantaged in terms of income. This can also be seen in indexes for Gross Disposable Household Income per capita, where UK equals 100. The North Eastern Scotland (e.g. Aberdeen, Aberdeenshire and North East Moray) has an index of 102, Eastern Scotland (e.g. Edinburgh, Angus and Dundee City, Clackmannanshire and Fife) 99, South Western Scotland (Glasgow, Ayrshire, Lanarkshire) 92, and finally, the Highlands and Islands (Eilean Siar, Orkney Island and Shetland Islands) has just 90. The figures roughly show that the Highlands and Islands is the poorest area of Scotland, as well as being poor compared to Great Britain.[2] The Highlands and Islands is 10% lower than the national average in terms of gross disposable household

[2] Source: "Regional, sub-regional and local area household income", Office for National Statistics. Published in the series: 'Economic Trends' No. 582 May 2002. Here is a link to the publication: http://www.statistics.gov.uk/CCI/article.asp?ID=128 More recent data available later in 2005.

income per capita.. There are only 5 of the 36 regions of Great Britain (NUTS2) that are lower than Highlands and Islands.[3]

Costs

3.5 The cost of option i) concern the risks associated with the suppliers deciding not to charge common prices in the future. One way in which this might occur is if demand distribution or transmission charges were varied within the North of Scotland at some point in the future. If locational charges existed in the North of Scotland, there is the potential for suppliers to distinguish price differentiation on the basis of geographical location. This would potentially lead to higher costs to customers in the more remote areas in the North of Scotland (especially in the Highlands and Islands).

3.6 Furthermore, there are no anticipated costs with this option to lay the Order. Indeed, as suppliers in the North of Scotland are effectively already implementing the CTO, these costs are likely to be negligible.

Equity and Fairness

4.1 It is envisaged that option i) could have a disproportionately high impact on customers in remote rural areas, since it would lead to higher electricity prices especially in these areas. As mentioned above, this would be likely to have a negative impact on the Highlands and Islands. Option ii) is not seen to have an impact since it is simply securing the status quo.

Small Firms' Impact Test

5.1 The Small Business Service was content that a Small Firms' Impact Test was not required, on the basis that the costs to SMEs are not changed from the original policy.

Competition Assessment

6.1 The difference between the two options is that, under option i) suppliers are likely to charge different prices in different areas if they envisaged that they could win new customers by doing so. Equally, however, it is possible that suppliers would be less enthusiastic about competing in areas with fewer customers, resulting in a decrease in competition.

6.2 Option ii) has no adverse impact upon the status quo with regard to competition. Thus, it is believed that the consequences of laying the Order will be minimal since it only covers domestic customers. The Government did seek views from industry on the likely impact of the inclusion of large business. In light of the responses received and issues raised, the Government agrees with the respondents that the order should only cover domestic customers.

[3] There are certain issues concerning this data, such as they are quite old, are averages over the period 1997-99, and do not entirely divide the region North of Scotland. However, even if the levels would have changed since the late 1990's, it is highly unlikely that the proportion would have varied significantly. Although these indexes are not considered to be an ideal measure, they do however highlight the income distribution in the North of Scotland.

6.3 Furthermore, suppliers should still be able to negotiate and offer discounts to customers, provided they do not treat location within the CTO area as a factor. Thus suppliers can still offer discounts just as long as these are not dependent solely upon domestic customers' geographical location within an area. Similarly, the use of geography in determining pricing across Great Britain is not prejudiced, as the Order will simply require suppliers selling such products to treat the North of Scotland as a single area.

6.4 Laying the Order could lead to a theoretical loss of marketing efforts by suppliers competition in option ii) with regard to option i). However, this should not be significant for domestic customers, since there are a variety of ways of informing customers of their choices, e.g. Energywatch's customer awareness campaigns of the benefits of switching supplier.

Enforcement and Sanctions

7.1 Failure to comply with the Order would result in a breach of statutory duty, which would be enforceable by legal proceedings.

Consultation

8.1 The DTI conducted a public consultation on 4th August 2004 seeking views from industry on the laying of the Order for the CTO. The consultation closed on 4th November 2004; and the DTI's conclusions document was published on 8th March 2005. The respondents of the consultation were broadly content with the proposal to lay the CTO Order although specific concerns were raised over proposed provisions (in the draft Order) to extend the CTO to the business market. DTI have made adjustments in the light of the responses and have provided in the final Order for the CTO to apply only to the domestic market.

Monitoring and Review

9.1 The DTI intends to carry out a full review of the provisions of the CTO at the same time as the Hydro Benefit Replacement Scheme. Under the Section 184 of the Energy Act 2004, the review will take place within three years following the implementation of the Hydro Benefit replacement Scheme.[4] At that stage it will be examined whether the CTO remains an appropriate tool for preventing geographic price discrimination between electricity customers in the North of Scotland.

Summary and Recommendation

10.1The DTI intends to provide legal certainty for the Common Tariff Obligation by laying an Order under Section 7B of the Electricity Act 1989.

10.2Because this Order will simply give legal effect to the status quo, it is not envisaged to have any costs associated with it, and will prevent suppliers from charging comparable domestic customers different prices in the North of Scotland in the future. In short, laying the Order is an example of the precautionary principle.

[4] See Section 184 of the Energy Act 2004 "Assistance for areas with high distribution costs"

Since the areas subject to higher prices under such circumstances would be the less advantaged remote rural area (especially the Highlands and the Islands) laying the Order would prevent a socially undesirable situation.

Ministerial Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the Minister responsible

Mike O'Brien

Date ***5th March 2005***

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