

Title: Proposals for implementation of licence modification appeals under the EU Third Package Lead department or agency: DECC Other departments or agencies:	Impact Assessment (IA)
	IA No: DECC0030
	Date: 22/06/2011
	Stage: Final
	Source of intervention: EU
	Type of measure: Secondary legislation
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Summary: Intervention and Options

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

The EU Third Package of measures concerning the internal market in gas and electricity (the Third Package) gives the National Regulatory Authority numerous regulatory tasks and stipulates that it must have powers to, amongst other matters: take autonomous decisions; implement binding decisions by the European Commission and the Agency for the Cooperation of European Regulators (ACER); and carry out its regulatory tasks in an efficient and expeditious manner. It also requires that Member States ensure that suitable mechanisms are in place under which a party affected by the decision has a right of appeal. Taken together, the Government considers that these requirements mean that the current process for licence modifications must be amended to enable the regulator to carry out its duties. The Government intends to introduce a revised appeals process to ensure compliance with EU law consistent with the domestic regulatory process.

What are the policy objectives and the intended effects?

The policy objective is to introduce an appeals process for licence modification decisions in order to implement requirements of the Third Package, and deliver a coherent and effective regulatory framework that enables the Regulator to take independent decisions and comply with EU obligations, whilst including appropriate safeguards for affected parties to challenge the Regulator's decisions. The proposed framework should result in robust regulation that benefits consumers and industry.

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

Option 1 - To introduce a right of appeal in relation to licence modification decisions to the Competition Commission (CC) for all directly affected licensees (those holding the licence to which the modification decision relates).
 Option 2 – To introduce a right of appeal in relation to licence modification decisions for directly affected licensees, materially affected licensees and Consumer Focus, where consumers are materially affected.
 Option 3 (strict implementation) – To introduce a right of appeal as Option 1, but limited to licence modification decisions related to Ofgem's regulatory tasks under the Third Package.
 Option 1 is the minimum cost option, and should deliver benefits including improved quality and efficiency of decision making, increased fairness and competition and potentially reduced costs of capital. Option 2 may result in additional appeal costs. However, it is our preferred option, since we believe extending the right of appeal would improve the regulator's decision making process by giving a voice to all those materially affected by a decision, thereby contributing further to cost-effective regulation in GB and potential resulting benefits to business. We believe Option 3 would be extremely difficult (if not impossible) to operate in practice. If implemented, it may still entail some risk of non-compliance with Third Package requirements. Resulting costs could be uncertain, but we believe that risks are to the downside, i.e. that costs under Option 3 could be higher than estimated. Some of the anticipated benefits of the new process could be lost, as it would not cover all Ofgem licence modifications.

Will the policy be reviewed? Please see overarching IA. **If applicable, set review date:** Month / Year

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?

No

Ministerial Sign-off For SELECT STAGE stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options

Signed by the responsible Minister:



Date: 13/07/2011

Summary: Analysis and Evidence Policy Option 2

Preferred Option: Introduce a right of appeal for directly affected licensees, materially affected licensees, and Consumer Focus, where consumers are materially affected, to the Competition Commission for licence modification decisions.

Price Base Year 2010	PV Base Year 2010	Time Period Years 21	Net Benefit (Present Value (PV)) (£m)			
			Low: -106.6	High: 2.8	Best Estimate: -13.7	
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)	
Low	0.01	1			10.8	
High	0.01				106.6	
Best Estimate	0.01		1.5		21.3	
Description and scale of key monetised costs by 'main affected groups'						
Monetised costs include the one-off set up cost to the CC, and ongoing costs associated with appeals borne by the CC, Ofgem and business. Ongoing costs depend on the number of appeals per year. Costs associated with third parties giving evidence at each appeal.						
Other key non-monetised costs by 'main affected groups'						
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)	
Low	0	N/A			0.0	
High	0				13.6	
Best Estimate	0		0.5		7.7	
Description and scale of key monetised benefits by 'main affected groups'						
Monetised benefits include ongoing cost-savings from avoided licence modification references, to the CC, Ofgem business and third parties.						
Other key non-monetised benefits by 'main affected groups'						
Improved quality of decision making; improved efficiency of decision-making; increased fairness and competition; increased transparency and accountability; and potentially reduced costs of capital.						
Key assumptions/sensitivities/risks					Discount rate (%)	3.5%
The cost analysis is extremely dependent on the assumptions made regarding the average number of contested decisions made per year. We have sought to illustrate this sensitivity by using a range of values. Costs and benefits are estimated relative to a baseline of maintenance of the current process.						
Direct impact on business (Equivalent Annual) (£m):			In scope of OIOO	Measure Qualifies as		
Costs: N/A	Benefits: N/A	Net: 0.02	Yes	IN		

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?		Great Britain			
From what date will the policy be implemented?		03/03/2011			
Which organisation(s) will enforce the policy?		N/A			
What is the annual change in enforcement cost (£m)?		N/A			
Does enforcement comply with Hampton principles?		Yes			
Does implementation go beyond minimum EU requirements?		Yes			
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)		Traded: N/A		Non-traded: N/A	
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: N/A		Benefits: N/A	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
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
Statutory equality duties ¹ Statutory Equality Duties Impact Test guidance	Yes	24
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	14
Small firms Small Firms Impact Test guidance	Yes	24
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	N/A
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	N/A
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	N/A
Human rights Human Rights Impact Test guidance	Yes	24
Justice system Justice Impact Test guidance	Yes	24
Rural proofing Rural Proofing Impact Test guidance	No	N/A
Sustainable development Sustainable Development Impact Test guidance	No	N/A

¹ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB 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 assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
	RIA for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005
	<u>Impact Assessment for the Market Power Licence Condition</u>
	<u>Implementation of the EU Third Package: Consultation on licence modification appeals</u>
	<u>Consultation on the Implementation of the EU Third Internal Energy Package</u>
	<u>Final Impact Assessments: Implementation of the EU Third Package</u>

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 2010 prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	-	0.01	-	-	-	-	-	-	-	-
Annual recurring cost	-	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Total annual costs	-	1.51	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Transition benefits	-	-	-	-	-	-	-	-	-	-
Annual recurring benefits	-	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Total annual benefits	-	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5

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

Evidence Base (for summary sheets)

Background and Problem under Consideration

The EU Third Package of measures concerning the internal market in gas and electricity (the “Third Package”) provides that the National Regulatory Authority (NRA) must be capable of, among other matters:

- taking autonomous decisions;
- implementing binding decisions by the European Commission and the Agency for the Cooperation of European Regulators (ACER); and
- carrying out its regulatory tasks in an efficient and expeditious manner.

In addition, it requires Member States to ensure that sufficient mechanisms exist at national level to afford a right of appeal to persons affected by the Regulator’s decision.

Taken together, the Government considers that these requirements mean that the current process for licence modifications needs amending to enable the regulator to carry out its duties and effectively implement the requirements of the Third Package. The Government intends to introduce a revised appeals process to ensure compliance with EU law consistent with the domestic regulatory process.

Gas and electricity markets are competitive, but regulated markets. Market participants are required to hold a licence from Ofgem to carry out specific activities in relation to gas and electricity (or an exemption from the Secretary of State, for example, in relation to small operators such as microgeneration). One of Ofgem’s main tools for regulating the gas and electricity market is through licences. The licence sets out the conditions under which the licensee must operate. For some, the licence conditions also set the prices which the licence holder can charge other market participants, e.g. the price that National Grid as a transmission owner can charge supply companies for transmitting electricity and gas to their customers. A brief explanation of licensed activities can be found at Annex A.

Under the current system, Ofgem’s proposed change or introduction of a standard licence condition can be blocked by 20% of the relevant licensees (measured by number of licence holders **or** market share). If Ofgem does not secure this agreement it can either re-consult on a modified proposal or refer the proposal to the Competition Commission (CC) for a decision. For conditions specific to one licensee, the licensee must agree to the proposal. Failure to reach agreement with that licensee means that if Ofgem wants to impose the change, it must refer its proposal to the CC for a decision. In considering a reference made to it, the CC, investigates whether the licence modification operates or may operate against the public interest.

The current process risks falling short of Third Package requirements because it is capable of preventing the Regulator from taking autonomous decisions in relation to regulatory tasks and effectively implementing binding decisions of the European Commission and ACER, given that proposed changes to licences must either be supported by licence holders before they are introduced or be referred to CC for a decision.

In addition, the Government is concerned that all licence holders do not have an equal ability to challenge amendments to standard licence conditions. In some circumstances a single company may be large enough to meet the required 20% of market share to raise a blocking objection alone. This means there are circumstance where a single licensee can require Ofgem to either reconsider or to refer the proposal to the CC for a decision before any amendment can be made. Smaller companies are therefore particularly disadvantaged under this process.

Rationale for intervention

Our proposal is designed to ensure compliance with the EU Third Package and provide an opportunity for all licence holders to challenge the Regulator’s licence modification decisions. The proposal should also lead to an increase in competition in the electricity and gas markets by giving market participants a right to appeal which would be fair to all licensees, removing the current disadvantage that applies to small companies. It will create a more transparent and efficient decision making process, enabling the Regulator to issue binding decisions autonomously and expeditiously. It will increase the accountability of the Regulator’s decisions, as it could be subject to appeal from all licensees and materially affected consumers. In addition over time an appeals system is likely to lead to a build up of case law, which may increase regulatory stability. These benefits would be in addition to those already afforded by the

existence of judicial review, as judicial review is less likely to consider the technical merits of the Regulator's decisions.

Policy Objectives

The policy objectives are to introduce an appeals process for licence modification decisions in order to implement the requirements of the Third Package so that they deliver a coherent and effective regulatory framework that includes appropriate safeguards for licensees to challenge the Regulator's decisions. The intention is that the proposed framework will result in robust regulation that benefits consumers and industry.

Options under consideration

We considered three main options:

Option 1 is to introduce a right of appeal on all licence modification decisions to the CC for all directly affected licensees (i.e. those holding the licence to which the modification decision relates).

Option 2 is to introduce a right of appeal as Option 1 above, for all directly affected licensees, other materially affected licensees and also Consumer Focus², where consumers are materially affected.

Option 3 is to introduce the same right of appeal as Option 1 above, but limited to licence modification decisions in relation to the regulatory tasks arising from the Third Package. Option 3 represents strict implementation of the EU Third Package requirements.

In addition, we have considered several different design options associated with each option. Option 2 is our preferred option.

Option 1 (appeals process for all licence modification decisions, right of appeal for directly affected licensees)

Option 1 is the introduction of a process that will enable all directly affected licensees to appeal all licence decisions to the CC provided they have sufficient grounds. The CC will have an adjudicatory function (rather than a full investigatory function), but will have the right to review all relevant aspects of the decision under appeal. Under Option 1, Ofgem will make a licence modification (after the current statutory consultation period). Having considered the consultation responses, Ofgem will make a decision. If that decision is to modify a licence condition, a directly affected licence holder (i.e. those holding the class of licence to which the modification decision relates) with sufficient grounds can appeal that decision to the CC within 4 weeks.

The grounds for appeal will be similar to those for code appeals as set out in the Energy Act 2004. In determining the appeal the CC considers matters of law and fact, whether Ofgem has acted in accordance with its statutory duties and the weight attributed to individual statutory duties in reaching the decision, and whether the decision achieves its intended effect. The CC would have the right to review all relevant aspects of the decision being appealed and would have powers to require parties to supply documents and attend hearings. For modification appeals that do not relate to a price control, the timescale for the CC to reach its decision will be 4 months (with the possibility of a one month extension). The CC will have the power to quash the decision, uphold the decision and issue binding directions. For price control decision appeals the process will be more in depth. This process may last up to 6 months (with the possibility of a one month extension). The CC will have the power to substitute a new price control determination in addition to the remedies available for determining other licence modification decisions.

Option 2 (appeals system for all licence modification decisions, right of appeal for directly affected licensees, materially affected licensees and Consumer Focus)

Option 2 would introduce an appeals system (as described for "Option 1" above), but extend the right of appeal to Consumer Focus (where consumers are materially affected) and other materially affected licensees.

² The Government intends to consult next year on the future of consumer bodies. Should the role or status of Consumer Focus change as a result of the consultation, the right to appeal will apply to a successor body.

Option 3 (strict implementation)

Option 3 would introduce an appeals system (as described for “Option 1” above) limited to decisions relating to the regulatory tasks arising from the Third Package and maintaining the current collective licence modification process for other licence modification decisions. This option represents strict implementation of the EU Third Package requirements. However, as discussed in more detail below, this would be very difficult (if not impossible) to implement in practice, and may carry some risk of non-compliance with Third Package requirements.

Design options for an appeal process

As part of the assessment of options we have considered several different design features for the appeals process including:

- the structure of the appeals mechanism and whether price control decisions should be subject to a more in depth appeals process;
- the grounds for appeal;
- the appropriate appeal body;
- the time limits for the process;
- the possible outcomes of an appeal, including whether the appeal body should be able to remit the decision to the regulator with recommendations or substitute the regulator’s decision; and
- whether the regulator’s decisions should be suspended on appeal.

Cost-benefit analysis

Table 1 below summarises the best estimates of monetised costs and benefits to society of the three main options, relative to maintenance of the current licence modification process.

Table 1 Monetised costs and benefits to society of the main options (best estimates)

£ million (PV)	Option 1	Option 2	Option 3
(Costs)	(17.1)	21.3	N/A*
Benefits	7.7	7.7	N/A*
Net benefit	-9.4	-13.6	-9.5

Source: Table 2, Table 13, Table 16. *Costs and benefits for Option 3 are not estimated separately.

Monetised cost and benefit estimates are uncertain, and are sensitive in particular to differences in assumptions around projected number of appeals given the different options. Hence, qualitative considerations are key in interpreting the quantitative analysis and judging which option is preferred. Option 2 is our preferred option.

Option 1 is the minimum cost option, and improves on the status quo by delivering some potentially significant non-monetised benefits, including: improved quality and efficiency of decision making; increased fairness and competition; increased transparency and accountability; and potentially reduced costs of capital.

While Option 2 may result in increased appeals (and therefore increased costs), it is our preferred option. We believe it would better contribute to furthering Ofgem’s statutory objectives and to decisions that better reflect the perspectives of different market participants, by giving Consumer Focus (where consumers are materially affected) and other materially affected licensees a right of appeal, thereby contributing further to cost-effective regulation in GB and potential resulting benefits to business. Given the scale of the electricity and gas industry³, even fractional benefits in this regard could offset the additional costs of Option 2.

As explained below, we believe that Option 3 (strict implementation) would be extremely difficult (if not impossible) to operate in practice. Even if possible to implement, developing different elements of a single package of measures using two different processes would give rise to a confused, inconsistent

³ For example, Ofgem estimates that companies will need to invest £32 billion by 2020 to deliver the networks required for the low carbon economy and to maintain secure, reliable supplies. See <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>.

and incoherent regulatory process. It is difficult to quantify the potential costs, although monetised costs are higher than Option 1. Cost estimates are based on the assumption that it is possible to implement. In addition, Option 3 entails the following risks:

the analysis may underestimate costs relative to other options (due to non-monetisation of some costs not incurred under other options);

non-compliance with the requirements of the Third Package (e.g. due to delays and inefficiencies in implementing decisions arising from EU obligations); and

by not applying the new appeals process to all Ofgem licence modifications, some of the benefits of the new process (summarised above, and discussed in more detail below) would be lost.

Below, we consider in more detail the monetised and non-monetised costs and benefits to society of Options 1, 2 and 3 relative to a baseline of maintenance of the current collective licence modification process (“business-as-usual”, or “status quo”). We choose this baseline, as it allows for a better comparison of the relative costs and benefits of Options 1, 2 and 3. We also consider the costs and benefits associated with the different design options associated with the type of appeal.

Monetised costs and benefits relate primarily to the costs associated with appeals incurred by the appeal body, Ofgem and business. Estimates are based on a 21 year appraisal period, from 2010 to 2030, with costs and benefits starting in 2011, and are stated in 2010 prices. We consider other impacts qualitatively. We consider distributional and specific impacts, including net costs to business, in a subsequent section.

We first consider the costs and benefits of Option 1. We then use Option 1 as a reference case for considering the costs and benefits of Options 2 and 3.

Option 1 (appeals system for all licence modification decisions, right of appeal for directly affected licence holders)

Option 1 includes the introduction of an appeals process which would enable directly affected licensees to appeal any licence condition change to the CC provided they have sufficient grounds. The costs and benefits, relative to business-as-usual associated with Option 1 are summarised in Table 2 below.

Table 2 Monetised costs and benefits associated with Option 1

£ million (PV)	Low	Best estimate	High
(Costs)	(106.6)	(17.1)	(10.8)
Benefits	0.0	7.7	13.6
Net benefit	-106.6	-9.4	2.8

Sources: Table 3, Table 8. Note: Figures may not sum exactly due to rounding.

In addition, there are some potentially significant non-monetised benefits, including:

improved quality of decision making;

improved efficiency of decision-making

increased fairness and competition;

increased transparency and accountability; and

reduced cost of capital for licensees.

We explore these in more detail below.

Costs

Table 3 below summarises the monetised costs associated with Option 1. Costs primarily relate to ongoing costs associated with appeals, which will depend on both the number of appeals and costs per appeal. Below we outline our reasoning behind the costs presented, including the assumptions we make on the number and costs of appeals.

Table 3 Monetised costs associated with Option 1

£ million (PV)	Low	Best estimate	High
CC set-up costs	0.011	0.011	0.011
CC ongoing costs	3.1	5.7	35.5
Ofgem ongoing costs	5.1	6.8	42.6
Business ongoing costs (appellants)	2.0	3.4	21.3
Third Party costs	0.6	1.1	7.1
Total	10.8	17.1	106.6

Sources: Table 4, Table 5, Table 6, Table 7. “Low” and “High” estimates for each header of cost are the lowest and highest costs respectively from the source tables.

Appeal body set-up costs

Based on a previous impact assessment⁴ for introducing an appeals process for code modifications, we estimate the CC could face one-off set-up costs of up to £11k⁵.

Number of appeals

In order to estimate the ongoing costs, we need to establish how many appeals we can expect under the new regime. For this impact assessment, we assume that there are between 0.6 and 5 appeals per year on average, with a central estimate of 0.8 appeals per year. In the central case, we thus assume that a greater number of modification decisions are appealed under Option 1 as have been blocked on average under the current system (0.6 per year, see below).

Our central assumption on the average number of appeals (0.8 per year) also differs from that made in the consultation-stage version of the IA, in which we made a central assumption of 0.6 appeals per year. Though we cannot be certain of the impact, we now consider it is possible that giving directly affected licensees an equal right to contest a licence modification could lead to an increase in the average number of contested licence modifications. There is uncertainty over the range of the number of appeals, but experience from the code modification appeals procedure and other considerations, outlined below, suggest that we should expect the number of appeals to be towards the lower end of the spectrum.

Since 2003, Ofgem has made 97 changes to standard licences (approximately 12 per year on average) and has had a licence change blocked 4 times (approximately 0.6 times per year). However, the number of appeals under the proposed process may differ from this number, depending on:

- the Competition Commission’s ability to filter and join appeals;
- effort spent by Ofgem on “appeal-proofing” their decisions;
- the expected costs to the appellant of appealing; and
- the grounds for appeal.

Relative to business-as-usual, our proposals could increase the number of appeals by giving all directly affected licensees an equal right to appeal. It is worth noting that parties wishing to appeal a licence modification decision for different reasons would have to do so separately. In addition, the Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This will help to prevent smaller companies being denied access to the appeals process because of the potential cost. However, the following factors will tend to reduce the number of appeals:

We are proposing to give the CC discretion to dismiss trivial and vexatious appeals where there is no real prospect of success.

⁴ Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

⁵ The previous impact assessment estimates set-up costs to the CC of up to £10k. We have assumed that this figure is stated in 2005 prices, and have converted to 2010 prices.

In order to keep costs down, the CC would consider whether it could amalgamate appeals, so that those appealing the same point are heard together.

The increase could be limited by the fact that we could also expect Ofgem to make additional efforts to 'appeal-proof' their decisions (though we discuss this in more detail below). This may be through extended consultation or other methods. It should also be noted that Ofgem carry out impact assessments for licence modifications where there is a major and important change. The extent to which Ofgem make additional efforts will, in turn, depend on the credibility of the threat of appeal.

Appellants may have to bear some costs, whereas previously it was possible for licence holders to block a modification without incurring any cost (though if Ofgem referred the decision to the CC, costs would be then incurred by licence holders). This will tend to deter appeals with little chance of success.

The impact of the grounds for appeal on the number of appeals is more complex. For those licence holders with greater power to block a decision under the current system, the setting of any required grounds for appeal might be expected to reduce the number of appeals, relative to business-as-usual. However, for those licence holders that do not currently have the power to block a decision, introducing wide grounds for appeal would tend to increase the number of appeals.

A previous impact assessment⁶ for introducing an appeals process for code modifications assumed that there were between 5 and 10 code modification appeals per year. However, since the appeals process was introduced six years ago there have in fact been only two code appeals.

Table 4 below illustrates the impact on ongoing costs (under central cost of appeal assumptions, discussed in the following sub-sections) of varying the number of appeals.

Table 4 Sensitivity of ongoing costs to number of appeals under Option 1 (Present value, £ million)

Number of appeals per year	0.6	0.8	5
CC ongoing costs	4.3	5.7	35.5
Ofgem ongoing costs	5.1	6.8	42.6
Business ongoing costs (appellants)	2.6	3.4	21.3
Third Party costs	0.9	1.1	7.1

Competition Commission – ongoing costs

As well as initial set-up costs, the CC will incur costs of dealing with each appeal. Costs to the CC will depend on a number of factors, including the scope of the appeal, the amount of technical expertise required and the time allotted for investigation, hearings and considerations of the issues.

Based on advice from the CC, we assume that the CC could incur costs in dealing with a 6-month price control decision appeal in the range of £400k to £800k, and costs for a 4-month adjudicative hearing for other licence modification appeals in the range of £270k to about £600k. This gives an overall range of costs to the CC of dealing with appeals of £270k to £800k. As a central estimate, we assume costs to the CC of £500k, as we believe there are likely to be fewer appeals on price control decisions than on other licence modifications, as price control decisions will be taken only every 8 years.

Table 5 below shows the present value of ongoing costs to the CC, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 5 Sensitivity analysis of CC cost of appeal

Cost per appeal (£k)	270	500	800
CC ongoing costs (£ million, PV)	3.1	5.7	9.1

Note that these assumptions differ from the assumptions made in the consultation-stage Impact Assessment, where we assumed CC costs (presumed to be in 2005 prices) per appeal of £150k, or

⁶ Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

approximately £170k per appeal in 2010 prices⁷. These costs were based on a 2005 impact assessment for introducing an appeals process for code modifications. The CC advised that code modification appeals, though resource-intensive, are shorter and likely to cost less than the proposed licence modification decision appeals.

Ofgem – ongoing costs

We would expect there to be a direct cost on Ofgem for each appeal. These costs would vary depending on the length and intensity of the appeal. For example we expect a price control decision appeal to take up to 6 months and to be more in depth than appeals on other licence modification decisions. These costs would include initial, and any further, submission of evidence to the CC.

We estimate that each appeal will cost Ofgem £600k. This is based on experience of Ofgem's costs in relation to a recent code modification appeal which used external legal resource. As this is just one example we are unsure whether this is representative of the costs Ofgem would face should appeals become more common. However, this estimate would appear to be consistent with appeal costs estimated in the recent Impact Assessment of the Market Power Licence Condition⁸, for appeals to the Competition Appeals Tribunal (CAT):

Ofgem states that whilst the appeal costs to the competition appeals tribunal (CAT) will also vary on a case-by- basis, they consider that a reasonable benchmark would be £250k to £600k where no external law firm is instructed and £500k to £1.2m where an external law firm is engaged.

Under central estimates of the number of appeals, the present value of Ofgem's costs of appeals is £6.8 million.

Ofgem could also incur costs associated with “appeal proofing” licence modification decisions, but these costs may not be additional to any costs that might be incurred under the current system. Ofgem might incur costs currently (under business-as-usual) in designing licence modifications to avoid being blocked. It is also likely that Ofgem currently incurs costs in designing licence modifications to reduce the risk of judicial review. To the extent that Ofgem incurs additional costs associated with “appeal proofing”, we might expect a lower number of appeals, and hence offsetting lower costs associated with appeals.

The Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This could act as an incentive for parties to keep appeal costs to a minimum.

Business costs – appellants – ongoing

There would also be a cost to businesses that decided to appeal. These costs would include initial, and any further, submission of evidence to the CC. Costs may vary by case, depending on the number and nature of issues raised.

E.ON UK have advised us that their external legal costs for their appeal to the CC under Section 173 of the Energy Act 2004 in 2007 were £257k. As this relates to a code modification appeal, these costs may be lower than costs to business of our proposed licence modification appeals, as code modification appeals are shorter in duration. Other evidence provided in confidence suggests that companies may spend around £175k per appeal. These cost estimates may, however, not include internal costs of time. SSE, responding to the main consultation on GB implementation of the EU Third Package, suggested that costs could be in the range of £0.5m to £1m, although it is not clear from the response what this figure includes. Evidence from telecoms appeals suggests that £315k may be representative of industry spending on an appeal to the CAT. We believe that CAT adjudicative hearings for telecoms cases are similar to the type of hearings we are proposing, and cover similar types of regulatory decisions.

Taking the evidence above, we thus assume a central cost to business of £300k per appeal. We assume a lower and upper bound of costs of £175k and £750k respectively. Note that this differs from the assumption made in the consultation-stage impact assessment, due to the evidence we have received during the consultation period (see above).

⁷ Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

⁸ Published as part of the Energy Bill 2009 Impact Assessment, available at http://www.decc.gov.uk/en/content/cms/legislation/energy_act_10/energy_act_10.aspx

The Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This could act as an incentive for parties to keep costs to a minimum.

Table 6 below shows the present value of ongoing costs to business who appeal, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 6 Sensitivity analysis of business cost of appeal

Cost per appeal (£k)	175	300	750
Business ongoing costs (£ million, PV)	2.0	3.4	8.5

There could also be initial upfront legal costs associated with deciding whether or not to appeal. We have not monetised these costs. We are unsure how much these would be and how often they would apply, although it is likely that these would not be significant, compared to the appeal costs themselves. We did not receive any additional information on this.

Third party costs – ongoing

There may also be some third party costs associated with each appeal. These may include the provision of evidence to the CC by parties other than the appellant(s), should the CC require them to do so. The process envisaged is that the CC will invite submissions. It will have powers to require other parties to provide evidence, but has found that in other appeals processes that it rarely needs to exercise this power. Interested parties will be able to voluntarily submit evidence to support either the case of Ofgem or the appellant. Evidence received in confidence shows that the costs to an “intervener” in a code modification appeal were approximately £160k. While code modification appeals are shorter than our proposed licence modification decision appeals, the proposals for the licence modification appeals process do not allow for “intervention” in the same formal sense as the code modification appeal process.

Under the Code Modification Appeals process those that are materially affected by a licence modification decision may apply to the CC to intervene. In the application they will need to demonstrate that they are materially affected by the decision. They must also include in a statement whether it supports or opposes the appeal and identify the grounds of appeal in relation to which the intervention is made, together with the facts and reasons relied on, or if the intervention opposes the appeal, identifying the facts and reasons why it believes the appeal should not succeed. If the CC gives leave to intervene the intervener effectively becomes a party to the appeal, with all the attendant expense that entails, including the possibility that it may have to pay a proportion of the CC’s costs.

We believe that the costs of submitting evidence to the CC should be substantially less for the licence modification appeals process, as there is no requirement to apply to intervene (and those that submit evidence will not be liable for the CC’s costs).

Taking the evidence above, we thus assume a central cost to third parties of £100k per appeal. We assume a lower and upper bound of costs of £50k and £200k respectively. Table 7 below shows the present value of ongoing costs to business who appeal, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 7 Sensitivity analysis of third party cost of appeal

Cost per appeal (£k)	50	100	200
Third party ongoing costs (£ million, PV)	0.6	1.1	2.3

Benefits

Table 8 below summarises the monetised benefits associated with Option 1. Benefits primarily relate to avoidance of costs associated with blocked licence changes under the current collective licence modification process. These cost savings will depend on both the number of blocked licence changes and the costs associated with them. Below we outline our reasoning behind the benefits presented, including the assumptions we make on the number and costs of blocked licence changes.

Note that the consultation-stage Impact Assessment did not include any monetised benefits. We now consider it is reasonable to assume that, in moving from the current licence modification process, costs

associated with blocking a proposed licence change may be avoided. These would include the cost of a referral to the CC and subsequent investigation and/or the cost of Ofgem modifying its decision and re-consulting.

Table 8 Monetised benefits associated with Option 1

£ million (PV)	Low	Best estimate	High
CC ongoing savings	0.0	3.4	5.5
Ofgem ongoing savings	0.0	2.6	4.2
Business ongoing savings (objecting licensee)	0.0	1.3	3.2
Third Party cost savings	0.0	0.4	0.9
Total	0.0	7.7	13.6

Sources: Table 9, Table 10, Table 11. “Low” and “High” estimates for each header of benefit are the lowest and highest benefits respectively from the source tables.

In addition, there are some potentially significant non-monetised benefits, including:

- improved quality of decision making;
- improved efficiency of decision-making
- increased fairness and competition;
- increased transparency and accountability; and
- reduced costs of capital for licensees.

We explore these in more detail below.

Possible outcomes of a blocked licence change under business-as-usual

Under the current system, Ofgem’s proposed change or introduction of a standard licence condition can be blocked by 20% of the relevant licensees (measured by number of licence holders or market share). If a standard licence modification is blocked, it can either modify the proposal and re-consult or refer it to the CC for a decision. For conditions specific to one licensee, the licensee must agree to the proposal. Failure to reach agreement with the licensee means that if Ofgem wants to implement the decision it must refer its proposal to the CC for a decision. In considering a reference, the CC investigates whether the licence modification operates or may operate against the public interest.

Number of blocked licence changes and references to the Competition Commission

We assume that, on average, 0.6 licence modifications are blocked per year. Since 2003, Ofgem has made 97 changes to standard licences (approximately 12 per year on average) and has had a licence change blocked 4 times (approximately 0.6 times per year).

One might expect that Ofgem would be likely to make a reference to the CC in most cases, if it has strong reason to believe that a proposed modification would contribute to achieving its statutory duties. Exceptions to this might be that when a decision is blocked, industry is able to suggest the possibility of a further option not considered at consultation stage. In practice, however, Ofgem has not made any licence modification references to the CC since 2003.

For the purposes of this impact assessment, we have taken as a central assumption that, in those cases where licence modification decisions are blocked, Ofgem decides to make a licence modification reference to the CC in 50 percent of those cases (i.e. 0.3 references per year). As lower and upper bounds, we assume that Ofgem makes references in zero and 80 percent of cases (zero and 0.5 references per year) respectively.

Table 9 below illustrates the impact on ongoing cost savings (under central licence modification reference cost assumptions) of varying the number of licence modification references.

Table 9 Sensitivity of ongoing cost savings to number of licence modification references under Option 1 (Present value, £ million)

Number of references per year	Zero	0.3	0.48
CC ongoing cost savings	0.0	3.4	5.5

Ofgem ongoing cost savings	0.0	2.6	4.1
Business ongoing cost savings (objecting licensee)	0.0	1.3	2.0
Third party cost savings	0.0	0.4	0.7

Competition Commission –ongoing cost savings

Implementation of Option 1 will lead to the avoidance of costs to the CC associated with licence modification references under business-as-usual. Modification references are longer than most of our proposed appeals – generally 6-12 months, rather than 4-6 months. Modification references also require an investigative approach that under the new appeals process we are proposing only for price controls. Generally, one would expect the cost of an inquiry will increase if it takes longer. We have assumed that costs associated with licence modification references are in the range of £600k to £1m, with a central estimate of £800k.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 10 below.

Table 10 Sensitivity analysis of CC cost savings from reduced CC references under Option 1

Cost per reference (£k)	600	800	1000
CC ongoing cost savings (£ million, PV)	2.6	3.4	4.3

Ofgem – ongoing cost savings

Implementation of Option 1 could lead to the avoidance of Ofgem costs associated with licence modification references. We have assumed that these costs are £600k per licence modification reference, the same as the costs we assume Ofgem incurs in relation to our proposed licence modification appeals (see above), although Ofgem’s costs could be higher under the current licence modification process, as references take longer than they would under our proposed appeals process.

Under central estimates (see section above) of the number of references under business-as-usual, the present value of Ofgem’s cost savings from avoided licence modification references is £2.6 million.

In those situations where contested licence modification decisions do not result in a reference to the CC, Ofgem could incur costs associated with altering proposals for licence modifications. We have not monetised these cost savings. However, it is possible that Ofgem could still incur costs of altering proposals under Option 1, if the CC, in its judgement following an appeal, asks Ofgem to do so.

Business – objecting licensee – ongoing cost savings

Option 1 will result in cost savings to licensees where Ofgem would have referred a decision to the CC under business-as-usual. These costs would include initial, and any further, submission of evidence to the CC by the objecting licensee. We assume a central cost to business of £300k, and a lower and upper bound of costs of £175k and £750k respectively.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 11 below.

Table 11 Sensitivity analysis of business cost savings from reduced CC references under Option 1

Cost per reference (£k)	175	300	750
Business ongoing cost savings (£ million, PV)	0.7	1.3	3.2

An equal right of appeal means that some businesses will receive additional powers to contest licence modification. These parties may gain from the introduction of Option 1, as it decreases the likelihood that they will incur unreasonable costs arising from the licence modification (either because they appeal, or because their threat of appealing is credible).

Third party cost savings – ongoing

There may also be some third party cost savings associated with avoided licence modification references. These may include the provision of evidence to the CC by parties other than the objecting licensee. We assume a central cost saving of £100k, and a lower and upper bound of costs of £50k and £200k respectively.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 11 below.

Table 12 Sensitivity analysis of third party cost savings from reduced CC references under Option 1

Cost per reference (£k)	50	100	200
Third party ongoing cost savings (£ million, PV)	0.2	0.4	0.9

Quality of decision-making

An equal right of appeal, on the technical merits of Ofgem's decision in relation to the specified grounds, should help improve decision making and ensure that Ofgem is able to autonomously make licence modifications that further its statutory duties. Under business-as-usual, licence holders meeting the blocking threshold can block decisions, possibly even when Ofgem is acting in accordance with its statutory duties and which are in the overall economic and financial interests of the market. Ofgem may not automatically make a licence modification reference to the CC. Even if Ofgem makes a reference, the CC's current public interest test may not necessarily be aligned with Ofgem's statutory duties. In addition, though judicial review exists currently, judicial review would not always allow consideration of the technical merits of the Regulator's decision. No actual appeals need take place for this benefit to arise - this benefit could also arise from the credible threat of an appeal.

Efficiency of decision-making

The proposed process would enable Ofgem to issue binding decisions autonomously and independently, potentially resulting in more efficient decision making. This would enable more efficient economic regulation of the market.

To the extent that Ofgem takes more time to design licence modifications, the time taken to issue decisions may increase somewhat. However, it is also worth noting that the appeal mechanism will be governed by a set of time limits.

Fairness and competition

An equal right to appeal and challenge the regulator's decisions would be fairer to licensees. On balance, we believe it could improve competition. Taking in turn the four questions of the Office of Fair Trading (OFT) competition impact assessment guidance⁹:

Will the proposal directly limit the number or range of suppliers?

Our proposals would not limit directly the range of suppliers in either the wholesale or retail energy markets, and would not directly affect the number of licensees.

Will the proposal indirectly limit the number or range of suppliers?

There is no reason to believe that the proposals would increase costs of some market participants relative to others.

Increased average costs on all participants could be argued to represent a barrier to entry. However, the central estimate (present value) of costs to business under Option 1 is £1.6 million (see Table 16 below). When spread across market participants, we consider this is unlikely to represent a significant barrier to entry.

Will the proposal limit the ability of suppliers to compete?

By removing asymmetries in licence holders' ability to contest licence modification proposals, the proposals could potentially lead to licence modifications less likely to favour certain market participants over others. This would tend to increase the ability of participants to compete.

⁹ http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft876.pdf

Will the proposal reduce suppliers' incentives to compete vigorously?

The proposals are unlikely to affect firms' incentives to compete vigorously, as they are unlikely to facilitate collusion between firms, or affect the ability of consumers to switch between suppliers.

Transparency and accountability

The new process would be more transparent as major objections to licence modifications would be dealt with through a transparent appeals process.

If there is an increase in appeals under the new mechanism, we would expect to see an increase in the accountability of Ofgem's decisions, as the appeal body would provide an additional level of expert scrutiny.

Cost of capital

Building up case law under appeals, on the technical merits of Ofgem's decisions in relation to the specified grounds, going beyond what judicial review would usually consider, may increase regulatory stability and in turn may lower the cost of capital faced by market participants. However, the build up of case law will take time and will depend on the frequency of appeals.

Some respondents to the consultation felt that the proposals could increase regulatory uncertainty. It is possible that this risk may in part arise as the equal right of appeal may give increased power to contest Ofgem's licence modifications to some licensees. We believe that this is likely only to represent the position of certain market participants, rather than licensees as a whole – smaller licensees are likely to gain from their increased power to contest Ofgem licence modifications.

The risk may also arise from uncertainty over the decisions that Ofgem may introduce. In order to minimise this risk, we have designed the appeals mechanism so that Ofgem's decisions will come into force only once the timescale for submitting an appeal has expired. Appellants will be able to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal, in circumstances where implementation of the licence change would result in significant unrecoverable costs (see section on Option design below). This could help to mitigate any negative effect of the proposals on regulatory uncertainty.

Option 2 (appeals system for all licence modification decisions, right of appeal for all directly affected parties, and also Consumer Focus and other materially affected licensees)

Option 2 would introduce an appeals system (as described for "Option 1" above), but extending the right of appeal to materially affected licensees and Consumer Focus, where consumers are materially affected. The majority of respondents to the consultation were in favour of extending the right of appeal to materially affected licensees. Generators and supply companies argued that changes to network company licences in particular could have a significant impact on them.

The costs and benefits, relative to business-as-usual, associated with Option 2 are summarised in Table 13 below.

Table 13 Monetised costs and benefits associated with Option 2

£ million (PV)	Low	Best estimate	High
(Costs)	(106.6)	(21.3)	(10.8)
Benefits	0.0	7.7	13.6
Net benefit	-106.6	-13.7	2.8

Source: Table 14, Table 15

Costs

As Option 2 extends the right of appeal to additional parties, it is possible that there will be, on average, a greater number of appeals under Option 2, when compared to Option 1. We have attempted to capture this by assuming that there will be 1 appeal per year on average, in the central case (compared to 0.8 per year under Option 1). As lower and upper bounds, we assume that there are 0.6 and 5 appeals respectively per year (the same bounds as for Option 1). It is possible that extending the right of appeal to additional parties will not lead to an increase in the number of appeals, if these additional parties are less likely to contest licence modifications relative to "directly affected" parties. It is worth noting that in order to appeal, other licence holders and Consumer focus will have to demonstrate that they/consumers are materially affected by the decision.

Given that Ofgem’s principal objective is to protect the interests of customers, one might expect that the likelihood of a Consumer Focus appeal is low. However, other materially affected licensees may have an interest in appealing, where they are likely to face a commercial impact from a proposed Ofgem licence modification of a different class of licence.

The monetised costs associated with Option 2 are summarised in Table 14 below.

Table 14 Monetised costs associated with Option 2

£ million (PV)	Low	Best estimate	High
CC set-up costs	0.011	0.011	0.011
CC ongoing costs	3.1	7.1	35.5
Ofgem ongoing costs	5.1	8.5	42.6
Business ongoing costs (appellants)	2.0	4.3	21.3
Third Party costs	0.6	1.4	7.1
Total	10.8	21.3	106.6

Option 2 may bring additional non-monetised costs, relative to Option 1:

There may be potential additional costs to Ofgem, relative to Option 1, associated with “appeal proofing” licence modification decisions against appeal from Consumer Focus and other materially affected licensees. These may be additional to costs that Ofgem would incur in designing licence modifications to reduce the risk of judicial review from these parties. To the extent that additional costs are incurred, the number of appeals may be reduced.

Additional uncertainty over the potential origin of appeals may increase regulatory uncertainty for all parties. However, it should be noted that, under Option 1, Consumer Focus and other materially affected licence holders would still be able to seek a judicial review of Ofgem’s licence modification decisions. In addition, the requirement for a party to demonstrate a material impact (before an appeal could proceed) might mitigate this risk.

Benefits

The monetised benefits of Option 2, relative to business-as-usual, are the same as Option 1, and are summarised in Table 15 below.

Table 15 Monetised benefits associated with Option 2

£ million (PV)	Low	Best estimate	High
CC ongoing savings	0.0	3.4	5.5
Ofgem ongoing savings	0.0	2.6	4.2
Business ongoing savings (objecting licensee)	0.0	1.3	3.2
Third Party cost savings	0.0	0.4	0.9
Total	0.0	7.7	13.6

Source: Table 8

Option 2 may bring additional non-monetised benefits, relative to Option 1:

Additional scrutiny from additional parties (either through actual appeals, or because of the credible threat of appeal) of Ofgem’s decisions will ensure that Ofgem considers the impact of its proposals on these parties. Ofgem should face additional pressure to carry out its statutory duties at least cost from the view of all market participants, taken together, as it would be difficult for Ofgem to justify anything else to the CC. Given the grounds for appeal, we might also expect this to put additional pressure on Ofgem to ensure its decisions are made on the basis of correct factual information and have the intended effect. Ofgem’s decisions will be more accountable to Consumer Focus and other materially affected licensees.

Any increase in the number of appeals, relative to Option 1, may contribute to an increased build-up of case law, on the technical merits of Ofgem’s decisions. This could help to further reduce costs of capital.

Option 3 (strict implementation)

Option 3 would involve strictly implementing the EU Third Package requirements by introducing an appeals system (as described for “Option 1” above) for the implementation of decisions in relation to the regulatory tasks arising from the Third Package only, and maintaining the current licence modification process for domestic obligations. It should be noted that this would be extremely difficult (if not impossible) to operate in practice. This is because it would be impossible in many instances to determine with any certainty which process should be used, as the same licence modification could be deemed to be in relation to a regulatory task under the Third Package, or deemed to arise from Ofgem’s domestic duties depending on the context in which it is proposed.

For instance the Third Package provides that Ofgem has to help to ensure, together with other relevant authorities, that consumer protection measures are effective and enforced (Article 37 (1) (n) of the Directive). Ofgem is currently considering whether companies through licences should be obliged to give customers 30 calendar days’ warning before putting prices up. This proposal could in some contexts be said to be arising from an EU obligation or in others arising out of domestic responsibilities.

Further difficulties would arise in relation to packages of measures which make up a licence modification, where some elements could be considered to arise from EU obligations and others may not. Developing different elements of a single package of measures using two different processes would give rise to a confused, inconsistent and incoherent regulatory process.

Given the difficulties in determining whether a proposed licence modification arises from EU or domestic obligations, operating a dual process would also give rise to disputes, legal challenge and increased regulatory uncertainty. Even if Ofgem’s choice of process were not challenged, delays in implementing decisions arising from EU obligations could occur if they were interlinked with decisions arising from domestic duties risking non compliance with the requirements of the Third Package.

Costs and benefits

Below we examine the range of costs and benefits associated with strict implementation in more detail, with the use of some illustrative scenarios.

Table 16 Net monetised benefits associated with Option 3

Net benefits (£ million, PV)	
Scenario A	-9.0
Scenario B	-9.4
Scenario C	-10.0
Average	-9.5

As set out above, we believe that Option 3 would be impractical and breach the principles of good regulation. It would require the separation of the domestic and European elements of a particular decision. Assuming that it is possible to determine whether a decision arises from EU or domestic obligations, it would require the creation of two substantively different, regimes - one ex ante and one ex post - and would increase regulatory uncertainty. Experience of the appeals process in telecoms has shown that dual processes lead to delay and inefficiency as there can be differences of opinion about which process and timetable to follow. Given the considerable uncertainties around how or whether this option could be made to work in practice, it is difficult to quantify the potential costs. We have attempted to do so by considering three possible scenarios set out below. We assume that each of these scenarios is equally likely, in the absence of further evidence. Monetised net benefits under these scenarios average £-9.1 million, using the same central assumptions on the cost and number of appeals as Option 1, where appropriate.

In addition, under Option 3, there are the following undesirable impacts:

the possibility of delays in decision making, raising concerns over the ability of Ofgem to perform regulatory tasks in an efficient and expeditious manner, and to implement binding decisions of ACER and the Commission;

delays and/or uncertainty (described in detail above) over additional litigation/appeals could lead to additional regulatory uncertainty; relative to Option 1, Option 2 and business-as-usual;

reduced transparency and accountability of decision-making relative to Options 1 and 2, due to the maintenance of the current collective modification process for decisions arising from domestic obligations; and

reduced fairness and competition, relative to Options 1 and 2.

The impacts of the Option 3 scenarios on Ofgem's costs associated with "appeal proofing" and (where it is possible to ascertain that appeals process should be used) on costs to third parties that submit evidence in support of the appellant or Ofgem are uncertain. Due to the lack of evidence, we have not quantified these costs.

Scenario A

Scenario A assumes that Ofgem's decision on which process to use is not challenged. Net benefits (to society) under Scenario A comprise of the following elements:

net costs of introducing an appeals system (as described for "Option 1" above) for the implementation of decisions in relation to the regulatory tasks arising from the Third Package only;

the costs of the current licence modification process for domestic obligations;

additional costs to Ofgem of deciding which process to use; and

additional costs to Ofgem of consulting separately on different elements of the same proposal.

Under Scenario A, the number of appealable decisions in relation to regulatory tasks imposed by the Third Package Directives would be fewer under the minimum implementation option (Option 3) than under our preferred option (Option 2), where the appeals process would apply to all licence modification decisions. As an illustration, assuming that 75% of Ofgem licence modification decisions are in relation to regulatory tasks imposed by the Third Package Directives, we would expect these costs under Scenario A to be 75% of the net costs for Option 1, i.e. costs of £7.0 million (present value). This figure assumes the CC still incurs the full one-off setup costs of £11k assumed for Options 1 and 2.

The costs of maintaining the current licence modification process for decisions in relation to domestic obligations are assumed to be 25% of the cost savings estimated above for Option 1, i.e. costs of £1.9 million.

Under Option 3, Ofgem will incur increased costs in deciding which process to use. Given the risk of legal challenge we assume that Ofgem may need to seek legal advice before deciding which process to use and that these additional costs could therefore be substantial. We have not monetised these costs, due to lack of firm evidence. However, it should be noted that these costs are not incurred under the other options. Hence, not including these costs risks underestimating costs under Option 3, relative to the other options.

Under Option 3, the total number of Ofgem decisions would be greater, if decisions that related to both domestic and European obligations were disentangled, as Ofgem would be required to consult separately on different elements of the same proposal. In this scenario, we would expect increased costs to both Ofgem and licence holders from the increase in consultations. We have not monetised these costs, due to lack of firm evidence. However, it should be noted that these costs are not incurred under the other options. Hence, not including these costs risks underestimating costs, including costs to business, under Option 3, relative to the other options.

Total monetised net benefits under Scenario A are £-9.0 million.

Scenario B

Scenario B is as Scenario A, but assumes that a certain proportion of Ofgem's decisions on which process to use (i.e. appeals system or current system) are challenged by way of judicial review. In Scenario B, the outcome of this litigation is that the process to be applied for the licence modification decision is settled.

Costs are as above for Scenario A, but with additional costs of litigation and possible costs of additional Ofgem consultations.

The number of judicial reviews brought in this scenario is uncertain. In general, a party might have an interest in challenging Ofgem's decision on which process to use if they expect to secure a better

outcome for themselves under the alternative process. It is possible that a judicial review could go some way towards clarifying which process is more suitable in a given context. As an illustration, we assume 0.1 judicial reviews per year, on average (equivalent to 2 challenges over the 20-year appraisal period).

Ofgem have advised that the cost of judicial review to them could be in the range of £35k to £200k. We assume a central estimate of £100k in costs to each of Ofgem, the judicial body and the business bringing the judicial review. We assume that third parties face costs of approximately £30k, in line with the ratio of third party to business costs assumed for Option 1. This results in additional costs of £0.5 million (present value), above those in Scenario A.

Once the hearing is complete, Ofgem would have to re-consult on its proposals. We have not monetised any costs associated with this.

Total monetised net benefits under Scenario B are £-9.4 million (present value).

Scenario C

This scenario involves challenge to both the process and the decision itself. In the event that Ofgem's decision on which process to use is challenged under judicial review, it is conceivable that the decision itself would also be subject to challenge.

In these cases, it would seem likely that costs of judicial review to business, Ofgem and the hearing body are similar to central costs assumed for Option 1. The number of judicial reviews brought in this scenario is uncertain. In effect, the potential to bring a judicial review adds an additional avenue for appeal of the decision itself, i.e. rather than "displace" appeals, it is possible that judicial review could be additional to any appeals under Scenario A. As an illustration, we assume an average of 0.05 judicial reviews per year – fewer than in Scenario B, to reflect the increased expense of these reviews, and the fact that these reviews would be more conclusive in nature, because they would provide a ruling on the decision itself as well as the process used. The effect of assuming 0.05 judicial reviews per year under this scenario is to bring the total average number of contested decisions per year to 0.8, the same as the average number of appeals per year assumed for Option 1.

This results in additional costs of £1.1 million (present value), above those in Scenario A. Total monetised net benefits under Scenario C are £-10.0 million (present value).

Consideration of policy design options

Structure of the appeals mechanism

We consulted on two possible options regarding the structure of the appeals mechanism – an adjudicative approach and investigatory approach.

In practice, both types of appeal follow similar processes in so far as the appeal body would consider evidence submitted by the appellant, Ofgem, and potentially other parties, and weigh up the arguments and evidence to reach a decision. The appeal body would have the power to require the submission of information and to hold hearings. However, an investigative appeal would be more in-depth and longer. Therefore there may be a greater cost on business, Ofgem and the CC as they may require more time, legal resources and documentation. There may also be further duplication of Ofgem's work due to additional analysis and consultation. However, an investigative appeal would allow for greater scrutiny of the economic considerations that underpin the regulator's decision, which go to the heart of a business operation.

Price control arrangements are mainly contained in special licence conditions and apply to individual network companies. Due to the complex nature of these decisions and the significant impact they have on companies, the government has decided that they should be subject more in-depth scrutiny. This was also the view of the majority of respondents to the consultation. While taking an in-depth, investigative approach to price controls seems likely to make these appeals more expensive, it would ensure a thorough review of decisions very fundamental to monopoly companies' financial positions. Appeals against standard licence condition modification decisions will follow an adjudicative process.

The government will allow parties to appeal individual elements of a price control as this may reduce the cost of appealing. However, as price control decisions are essentially a package of balancing measures, there is the potential that the upholding of an appeal on a single element could have a knock-on effect on other elements of the package and upset the balance of the package. The CC would therefore have discretion to consider additional elements or the whole package of the price control decision if the evidence submitted shows that reviewing individual elements is likely to upset the balance of the whole package.

The grounds for appeal

There are two options available for the grounds for appeal: an appeal mirroring judicial review grounds only, or in addition enabling scrutiny of the technical merits of the case.

A merits-based approach will have different costs depending on how wide the grounds for appeal are and the analysis that follows refers to the difference in breadth of grounds for appeal, with a merits-based approach having broader grounds than a judicial review approach. The main difference between a merits based approach and a judicial review approach is that economic and market questions would be more likely to be considered in scrutinising the decision. Allowing appeals on the merits of the case in relation to the specified grounds is likely to mean that more appeals are allowed, as compared with stricter grounds for appeal. This would be expected to result in higher costs overall from an increase in the number of appeals.

However, appeals based on the merits of a case should also mean higher associated benefits, particularly around competition and consistency of economic regulation. In addition a merits-based appeal would provide a greater challenge function to decisions with costs to business. Respondents to the consultation document overwhelmingly supported an appeal on the merits of the decision.

A very widely defined merits appeal may have a much larger risk associated with a much increased number of appeals and correspondingly higher costs. If this in turn slowed decision-making, the benefits around stable, consistent framework may be reduced.

An appeal on judicial review grounds only would be restrictive compared to a merits based approach. This may mean that the cost per appeal is lower and fewer appeals are heard.

The government intends to introduce a carefully defined right of appeal on the merits, in relation to the specified grounds. We believe that this balances the costs and benefits of the different options best. This grounds would be broadly similar to those contained in the Energy Act 2004 which provides the procedure for reviewing amendments to industry codes.

The appeal body

The government put forward two options in its consultation document for an appropriate appeal body: the Competition Commission (CC) and the Competition Appeals Tribunal (CAT). Our preferred option was the CC and almost all respondents to the consultation were in favour of the CC as the appeal body

Outcomes of an appeal

There are a range of possible remedies available to the appeal body, including the ability to confirm, quash, remit, give directions, vary the decision and substitute its own decision. The possible outcomes of an appeal are linked to the type of appeal. For an adjudicative process the possible remedies would be the ability to uphold, quash, remit, issue binding directions. An investigative approach would allow the appeal body to substitute the regulator's decision with its own decision, in addition to the remedies outlined above. Remitting a decision with directions is potentially less costly to the appeal body than substituting the decision because the appeal body is not replacing the decision with its own, but rather enabling the original decision-maker, who has greater expertise, to revise the decision in line with the directions of the appeal body.

The government intends to give the appeal body the power to confirm, quash, remit the matter back to the regulator, and give binding directions for ordinary licence modification decision appeals. However, for price control decision appeals the government intends to give the appeal body an additional power to substitute the decision.

Time limits for the process

Time limits for an appeals process are dependent on the structure of the appeal and the appeal body.

A longer appeal is likely to be more costly to all involved (appeal body, Ofgem and business). It is also likely to create more uncertainty. However, longer time limits allow for greater scrutiny of decisions.

Respondents agreed with the government that price control decision appeals warrant greater scrutiny and may need longer to resolve. The government therefore intends to introduce a 6 month time limit for the CC to determine price control decision appeals and a 4 month time limit for it to determine other licence modification decision appeals.

Suspending decisions on appeal

The government considered in its consultation whether decisions subject to appeal should be suspended, particularly where the decision requires expenditure by companies.

In order to achieve the balance between the need to prevent unrecoverable costs to business and limit the effect of gaming by parties to delay licence modifications, the government has decided to allow appellants to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal. The appeal body will be given discretion to suspend decisions on application where those decisions would result in significant unrecoverable costs that would be unnecessary if the appeal succeeded.

In addition the government proposes that each licence modification decision should be accompanied by a coming into force date. The decision will come into force only once the timescale for submitting an application for appeal has expired.

Risks and assumptions

The cost analysis is extremely dependent on the assumptions made regarding the average number of appeals made per year. We have tried to illustrate this sensitivity by using a range of values.

Note that one might expect the average number of appeals (under Options 1, 2 and 3) and blocked licence modifications (under "business-as-usual") per year to depend on the number of licence modifications made per year. We have not attempted to forecast the number of licence modifications made per year. Instead, we have attempted to provide an estimate of the order of magnitude costs, based on historical data on the number of blocked licence changes per year, ignoring the ratio of blocked licence changes to total licence modifications. If there are significantly more or fewer licence modifications per year in the future, this method may result in an under- or over-estimate of both costs and benefits.

Distributional impacts and specific impact tests

Below we consider distributional and specific impacts of the proposals..

Net costs to business

Below we compare net costs to business under Options 1, 2 and 3. Table 3 and Table 8 above show the distribution of first-order monetised costs and benefits respectively between Ofgem, business and the CC under Option 1. Table 14 and Table 15 above show the distribution of first-order monetised costs and benefits respectively between Ofgem, business and the CC under Option 2.

A precise comparison of net costs to business is difficult, as:

it depends on assumptions on costs, numbers of contested licence modifications and distribution of costs; and

it ignores any difference in non-monetised costs and benefits between options.

With regards to the distribution of costs, for the purposes of this Impact Assessment, we have assumed that only costs borne by third parties constitute **direct** costs to business, for the purposes of One In, One Out ("OIOO"). We explain the reasoning in more detail below.

All options would result in costs and benefits to business, which are discussed in more detail in the main cost-benefit analysis section above. However, we do not consider that the bulk of these costs constitute **direct** costs to business as a result of the proposals, since companies can choose whether or not to appeal. More specifically:

We believe that it is reasonable to assume that companies would only appeal when it was in their interest. We would therefore expect that businesses would only appeal when they believed that, given the probability of them winning an appeal, the benefits would outweigh the costs of the appeal.

If a licensee appealed, and was successful in its appeal, it is likely that the CC would decide to award costs to the licensee, assuming the costs incurred were reasonable – i.e. there would be no direct cost to the business from appealing.

If a licensee appealed, and was unsuccessful in its appeal, then it chose to incur appeal costs, even though its case against the proposed Ofgem licence modification was not strong enough, i.e. it incurred costs unnecessarily.

Similarly, cost savings to business, in moving from the current licence modification process, from avoided CC references, would not constitute savings in **direct** costs. Under business-as-usual, businesses also have the choice of whether to block an Ofgem licence modification.

However, it is difficult to argue that costs borne by third parties are borne voluntarily, in the same sense. Indeed, the CC may even require some companies to submit evidence. Table 17 below compares net costs to business under Options 1, 2 and 3, relative to a baseline of business-as-usual, under central assumptions on numbers and costs of appeals.

Table 17 Comparison of net costs to business

	Option 1	Option 2	Option 3
Net present value (£ million, 2009 prices)	0.7	1.0	0.7
Equivalent annual costs (£'000s, 2009 prices)	45	64	43

Source: Table 3, Table 8, Table 14, Table 15, DECC calculations, BRE Equivalent Annual Net Cost to Business Calculator, HMT GDP deflator series

Table 18 below compares net costs to business under Options 1 and 2, relative to Option 3 (strict implementation)

Table 18 Difference in net costs to business, relative to Option 3 (strict implementation)

Net present value (£ million, 2009 prices)	0.03	0.31
Equivalent annual costs (£'000s, 2009 prices)	2	20

Source: Table 17

With regards to non-monetised costs, we believe it is unlikely that businesses would incur significant net direct costs associated with a licence modification, pending the outcome of an appeal:

The government proposes that each licence modification decision should be accompanied by a coming into force date. The decision will come into force only once the timescale for submitting an application for appeal has expired.

Appellants will be able to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal, in circumstances where implementation of the licence change would result in irreparable harm (see section on Option design above).

Businesses may incur costs in deciding whether or not to appeal. As discussed in the cost-benefit analysis section, we did not have any firm evidence on these, although it is likely that these would not be significant, compared to the appeal costs themselves. In addition, businesses would bear costs under the current system in deciding whether or not to contest a licence modification – these costs would not be borne under the proposed appeals process.

Impact on consumers

Any additional costs to licensees as a result of these proposals may be passed through to energy consumers. However, consumers may gain from these proposals, to the extent that they improve competition and help to further Ofgem's statutory duty to promote the interests of consumers. We have not quantified the impact on consumer bills arising from these proposals.

Administrative burden

These proposals should not have an administrative burden on business. Costs on business are associated with making an appeal only.

Wider impacts – competition impacts

The proposals are designed to improve competition, through ensuring more effective regulation and reducing a competitive disadvantage faced by smaller industry participants under the current arrangements. See the discussion of "fairness and competition" in the cost-benefit analysis of Option 1 above for more detail.

Small firms impact test

The proposals reduce a competitive disadvantage faced by smaller industry participants under the current arrangements, by giving all licensees an equal right of appeal. Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This will help to prevent smaller companies being denied access to the appeals process because of the potential cost.

Equality Impacts

We do not consider that the impact of our proposals is likely to differ by race, gender or disability.

Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

Annex A: Licensed Market Participants

The electricity market framework

Under the Electricity Act 1989, it is illegal to generate, transmit, distribute or supply electricity without a licence or an exemption.

System Operator: National Grid acts as System Operator. The System Operator has the responsibility of overseeing and managing the flow of electricity across the whole GB transmission network. It must hold a licence from Ofgem.

Transmission Owner: The high voltage transmission system transmits electricity over long distances. National Grid owns the England and Wales transmission system, with Scottish Power Transmission Ltd (SPT) and Scottish Hydro-Electric Transmission Ltd (SHETL part of SSE) each owning a part of the transmission system in Scotland. As transmission owners, these companies are responsible for building and maintaining safe and efficient networks and must hold a licence from Ofgem.

Distribution Network Operator: The lower voltage distribution network brings electricity to most business and domestic consumers. There are 14 licensed electricity distribution networks owned and operated by seven different companies.

Generators: Generators have to have a licence from Ofgem unless they are subject to an exemption.

Suppliers: are the commercial interface between generators and most consumers. Electricity is sold by generators in the wholesale market to suppliers who then supply domestic and business consumers. Suppliers must hold a supply licence from Ofgem unless they are subject an exemption.

The gas market framework

Under the Gas Act 1986, a licence is required to convey gas through pipes to premises or to a pipe-line system operated by a gas transporter, to supply gas which is conveyed to premises through pipes, or to arrange for gas to be put into, conveyed on or taken out of a pipe-line system. Exemptions from the requirement to hold a licence are contained in various exemptions orders made under s.6 Gas Act 1986.

System Operator: National Grid acts as System Operator. The System Operator has the responsibility of overseeing and managing the flow of gas across GB transmission network. It must hold a licence from Ofgem.

Gas Transporter: Transportation is the activity of “conveying” gas, carried out by network companies engaged in long-distance transportation and in regional distribution. Gas networks transport gas from the point where the gas is landed in GB (whether from offshore production or from an import route) or from a gas storage facility, to the point of use. Gas transporters, (unless exempt) must hold a licence from Ofgem.

Shipper: Shippers make arrangements with licensed Gas Transporters for the conveyance of gas. Shippers must hold a licence from Ofgem unless they are subject to an exemption.

Supplier: Suppliers are the contractual interface with consumers. They must hold a licence from Ofgem unless they are subject to an exemption.