

Corporate Response Form 'Ofgem Licence Modification Appeals'
Consultation
URN 10D/807 Open: 01/10/2010 Close: 29/10/2010

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General remarks

We have reservations regarding DECC's proposals to change the collective licence modification process, and are unconvinced that the scale of the change proposed is required in order to comply with the Third Package.

DECC's proposals represent a significant increase in the ability of the regulator to impose decisions on licensees, by placing the responsibility for making appeals on the licensee and by reducing the scope of the appeal process compared to the current public interest approach under the 1989 Electricity Act. This may increase the uncertainty faced by existing investors and potential new entrants to the British energy industry. This seems to us inconsistent with the approach being taken by the Department to electricity market reform which is focussed, amongst other things, on reducing risk and the cost of capital to investors.

We believe that the existing arrangements encourage debate and discussion between Ofgem, companies and other stakeholders, provide proper checks and balances within the regulatory framework and are more likely to result in the timely implementation of properly considered solutions which are in the interests of current and future consumers.

The existing process has also been effective in limiting the number of appeals. DECC's proposals could result in an increase in the proportion of proposed licence changes appealed, which will slow implementation, or of weaknesses in the detail.

We do, however, recognise that there are shortcomings in the current arrangements. We agree that the 20% rule means that appeal is not available equally to all licensees, and would support removing this threshold so that smaller players have the same right to challenge regulatory decisions. In addition, a review of the cost of appealing and of their allocation to the parties involved is needed. The risk of incurring very high costs if an appeal is lost may discourage licensees from appealing, and this is particularly likely to be a barrier to smaller players.

We also have concerns about the timing of this proposed change, and the fact that it is being considered separately from DECC's wider review of Ofgem. We understand the desire to implement the third package by March 2011, but believe that such fundamental change to the regulator's powers and the rights of licensees should not be undertaken hastily, and that the licence modification appeals process should be considered as part of the wider and more thorough review of the British regulatory framework.

Consultation Questions

What should be the scope of the appeal mechanism?

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| 1 | Does the fundamental nature of price controls require they be subject to different treatment from other licence modifications? Please explain what changes you consider are required, why you consider they are required and how they would be compatible with the Third Package. |
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Yes.

Price controls are a fundamental part of a licensee's business, and they set the economic framework within which the network business will operate for the duration of the control. It is therefore appropriate that this type of licence modification be subject to a more detailed assessment which will require more time. We would expect the licensee to be able to make his appeal on individual concerns about the proposed settlement but that the CC would consider the wider impact on the package as a whole. We think this different approach can be justified as expeditious in relation to the fundamental nature of the decision.

What should be the structure of the appeal?

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| 2 | Do you agree that a rehearing approach to appeals for modifications other than price controls strikes the right balance between appropriate economic scrutiny of the regulator's decisions and a timely appeals process that controls potential costs for the parties? |
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We agree that in most circumstances a rehearing is appropriate, in that the CC should be reconsidering the substance of a decision that the regulator has made.

However, whilst we would anticipate that all significant arguments would be made during the consultation process, we believe that it should be possible to introduce new information at the appeal in support of arguments opposing the regulator's proposals. A company would of course want to make its response to Ofgem's consultation as strong as possible, so we do not think it likely that arguments would be deliberately held back to be raised at appeal. Rather, allowing new information to be presented would allow the CC to consider information that was not available at the time of the original consultation as well as more detailed analysis or formal legal advice which could not be prepared in the timescales of the original consultation.

If it is not possible to introduce any new or expanded information, this will tend to increase the onus on companies to ensure that all the information they submit during the consultation phase is legally robust. This would make dealing with consultations a much more onerous, legalistic and costly process for both companies and the regulator, as Ofgem's own internal processes would have to deal with more substantial documents in response to each consultation.

3	Do you agree there should be a full investigative hearing for price controls?
<p>Yes.</p> <p>The complexity of price control licence modifications and their fundamental importance to the licensee's business means that they merit a more extensive, thorough process.</p>	
<p>Grounds for appeal</p>	
4	Do you agree with our proposal for an appeal on the merits?
<p>It is essential that an appeal should be allowed on the merits of the regulator's decision. However we are concerned that the proposed basis of the appeal is too narrow and will be over-focussed on whether the process followed by the regulator was correct and the Authority had reasonably interpreted its duties. The Competition Commission should be able to carry out a full assessment of whether the proposed licence modification was the best approach in light of the regulator's statutory duties. Whether an appeal should be allowed or not should be entirely a matter for the CC. There should be no replication of the Energy Act 2004 code process where an appeal can be excluded on security of supply grounds.</p>	
5	Would our proposed grounds allow for consideration of legitimate legal, factual and economic issues, without undermining regulator independence? If not, please state why.
<p>We do not see any issues with demonstrating the independence of the regulator under either the current or proposed arrangements.</p>	
<p>What who are the affected parties who should have right of appeal?</p>	
6	Do you see any case for extending the right of appeal in relation to an Ofgem decision to any licensees or other materially affected parties beyond directly affected licensees? Please explain which and why.
<p>In normal circumstances, we would expect any appeal to come from affected licence holders who are actively trading under those licences. However, licence modifications, including some elements of price control settlements, can in some cases have a material impact on other parties. It is possible for changes to transmission licences to have a significant impact on the business of network users, for example, and we think that in such circumstances users (i.e. those who pay charges directly) or signatories to the relevant network code should be able to ask the CC to reconsider Ofgem's decision.</p>	

Consumers may be affected by any licence change, but we suggest that the right of appeal on their behalf is limited to modifications to supply licences and to the customer service elements of distribution licences. We suggest that Citizens Advice and Consumer Focus (or its successor organisation) have a right of appeal, but other consumer groups could provide support and evidence.

We think that this right of appeal should be considered very carefully, however, as there is the potential for an increase in the number of vexatious or frivolous appeals if the scope is widened too far. We believe DECC should give careful consideration to a definition of 'materially affected', and would expect the CC to be able reject 'nuisance' appeals.

The appeal body

7	Do you agree the CC is the most appropriate appeal body? Why/ why not?
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Yes.

The CC is well placed to carry out the necessary in depth review of regulatory decisions, and to take proper account of the detailed economic, technical and legal information that will be presented to it.

Outcome

8	The Government would welcome views on whether the appeal body should have the power to vary Ofgem's decisions on matters, other than price controls, or whether such cases would be better handled by remitting decisions back to Ofgem to re-take, with any necessary binding recommendations.
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We think that the CC should have the ability to confirm or quash regulatory decisions; we do not think that it is appropriate for the CC to be drafting licence modifications. The CC should also be able to revise the implementation timescale for a regulatory decision it confirms.

In the event of a successful appeal, we would expect the CC to refer the matter back to Ofgem, with a series of binding recommendations setting out the CC's findings. Ofgem would then produced revised licence modifications in line with the CC's views, and the CC would have a final right of approval before the licence changes were implemented.

Time Limits for the process

9	Do you think the Government's suggested timescales of 4 weeks to lodge an appeal, and a period of 4 months for the hearing of most appeals will ensure appropriate scrutiny and efficient
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	decision making?
<p>It would depend on exactly what was expected during the initial four week period.</p> <p>If a company had simply to register its intention to appeal within that period, and outline the grounds on which it was appealing, then that would probably be achievable. However, it is unlikely that a company could both make the decision to appeal and develop a fully fledged case within four weeks. This is likely to be particularly problematic for smaller players who may not have their own regulatory experts or lawyers.</p> <p>We would expect four months to be enough time for most appeals to be heard. However, there should be sufficient flexibility in the process to allow more time for complex or problematic cases.</p>	
10	Do you see any circumstances in which an appeal may need to be subject to a faster timeline. If so can you provide examples?
<p>We would not anticipate appeals needing to be dealt with faster than timescales we describe in our response to question 9. In any case if the parties to the appeal believe there is a case for a more rapid resolution they can make this argument to the CC.</p>	
Can Ofgem's decisions be suspended?	
11	Do you agree the appeal body should be given the discretion to suspend Ofgem's decisions on application if they could lead to significant and potentially unnecessary expense and/or disclosure of confidential information?
<p>Yes.</p> <p>We would expect an appealed licence modification to be suspended automatically until the CC has reached its decision. This is particularly important in those cases where significant investment in new systems and processes is needed to comply with the licence modification, either for the individual licensee or for the industry as a whole.</p> <p>However, the CC must also balance the consumer interest against the desire of industry participants to avoid expense which may be wasted if an appeal is quashed or substantially altered. We accept that an implementation date which is after the expected date of resolution of the appeal might not necessarily be changed (if the appeal is unsuccessful), but the CC should have the power to set a new implementation date</p>	
How will the costs be recovered?	

12	What will be the likely costs and benefits of these changes on your organisation?
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The cost of appealing a regulatory decision is a major consideration for any business. E.ON has direct experience of an appeal to the CC, and even though we were successful, the costs we incurred were substantial. We believe that this is a real issue that needs careful consideration if the appeals process is to be accessible to all licensees, particularly smaller players for whom picking up Ofgem's costs could be potentially crippling.

We suggest that the CC should be able to award costs after an appeal, but that limits should be set on the scope of activities that the losing party would be expected to pay for. This would mean that if one side or the other wanted to take expensive external legal advice (for example, from a QC), they could, but that the other party would not have to accept a potentially open ended risk if they were to lose the appeal.

13	How do you recommend potential costs could be reduced? How could we maximise the potential benefits to the regulatory regime as a whole?
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We have described how we think the proposals could be improved to ensure better decisions by the CC which could have a lasting impact on the regulatory framework. In general we think that DECC should be looking to encourage a process which is not too legalistic and which allows arguments to be considered on their merits. We would not favour approaches designed simply to shorten the process where this results in poorer decisions whose impact may far outweigh the costs associated with extending an appeal. However, if the appeal is to be based on particular statutory grounds as proposed, as opposed to the wider public interest approach currently applying, some legal involvement seems unavoidable.