DEPARTMENT OF ENERGY & CLIMATE CHANGE

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

What should be the scope of the appeal mechanism?

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.**

This naturally poses the question of whether applying a different appeals framework to different kinds of licence modifications would constitute due, or undue, discrimination. On balance, we think a case can be argued that it is due discrimination and could be justified.

The same statutory provisions govern both price control modifications and other licence modifications, which on face value may suggest a common appeals approach should be adopted for both. But in practice price control modifications differ from other modifications in their depth and breadth.

Although, in principle, any licence modification could alter a wide range of rules at the same time, in practice, most relate to discrete issues. So, for example, the current consultation on removing the right of suppliers to retrospectively notify consumers of price changes ('the 65 day rule') does not link modifications in supply licences in this area with modifications to other requirements on suppliers.

Price controls differ considerably from this norm in that they relate to a bundled settlement of requirements on (and targets for) the network, rather than an individual requirement or target. The settlement will affect all aspects of the networks business and affect its ability to finance itself, behaviours, targets and business decisions for many years to come.

It is this complexity that may justify the approach you suggest; of a four month rehearing for 'normal' licence modifications and a six month in-depth investigation of

price control modifications.

We think a case could be made that this is consistent with the 3rd package. This view is based on trying to find a balance between the competing drivers at work within the wording of the Directive. The requirement that the regulator must be able to carry out its duties expeditiously suggests that any appeal window should be as short as possible – i.e. the shorter it is, the more expeditiously the regulator will be able to enact its decision. However, if an appeal window is so short that it precludes a case being adequately heard, this rather defeats the whole point of actually having a right of appeal – because the appellate body may not be able to reach a decision or, worse still, may reach the wrong decision.

You may therefore be reasonably able to argue that the increased complexity of price control modifications necessitates the differential treatment you suggest, because a single-track approach would either fail to deliver expeditious regulatory decisions (six months appearing unnecessarily long for most licence modifications) or it would fail to deliver a credible appeals process (four months appearing unrealistically aggressive for a price control modification).

What should be the structure of the appeal?

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?**

Yes, it appears to find the right balance.

A rehearing should allow reasonable opportunity for any grievance to be heard and resolved. While a full investigative hearing would also achieve this aim it would necessitate considerably greater resources (and by extension, cost) and we suspect it would be difficult for the appeals body to turn round such an investigation in anything under six months.

3	**Do you agree there should be a full investigative hearing for price controls?**

Yes.

As highlighted in our answer to question 1, price controls are extremely complex bundled settlements that will cover a wide range of issues. In addition, they are likely to be extremely high materiality and with long lasting consequences - Ofgem estimates that approximately £32bn of network investment is required by 2020, and will be increasing the duration of price controls to eight years as a result of the introduction of its RIIO methodology[1].

This makes a full investigative hearing more appropriate for disputed price controls than a more limited rehearing would be, notwithstanding the higher cost and longer timescale before final determination.

In practice, we think that a sensible appellate body, provided it is not prohibited from doing so by the statutory framework set up for it, is likely to concentrate its time on those areas of the price control settlement that are in dispute and not expend significant effort on investigating those matters where both the regulator and the appellant are in agreement. Provided this flexibility exists, the six month process you envisage, though challenging, should be workable.

Grounds for appeal

4	**Do you agree with our proposal for an appeal on the merits?**

Yes, this seems entirely sensible. We prefer the merits based approach to an approach that simply looks at procedural propriety because it is more likely to deliver the right policy outcome for consumers.

5	**Would our proposed grounds allow for consideration of legitimate legal, factual and economic issues, without undermining regulator independence? If not, please state why.**

Yes, they would.

We do not think it can reasonably be argued that these proposals undermine regulatory independence. Provided the regulator has acted appropriately and reached sensible, evidence based decisions it should be entirely able to defend these in any appeal process.

[1] See Ofgem press release, 'Britain needs rewiring to the tune of £32 billion', 4 October 2010 (link).

What who are the affected parties who should have right of appeal?	
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.**

Yes we do see such a case – both for legal and moral reasons.

The 3rd package talks about the right of appeal existing for 'a party affected by a decision of a regulatory authority'. 'Party' is undefined, but reading this clause in the context of the surrounding clauses and the rest of the Directive it does not appear that there is any intention or provision that should narrow the interpretation of this clause to licensees alone. You would need to take your own legal advice on this matter, but we suspect that a disgruntled third party could bring forward a decent case that DECC had failed to transpose the Directive correctly if they found that they wanted to appeal a decision by the regulatory authority but could not.

More broadly, it seems inappropriate to us to restrain appeals rights to licensees. In practice, a steel plant, a trade association or a consumer group[2] may be 'a party affected by the decision of a regulatory authority' just as much as a licensee is. They may be put out of business, or see the interests they represent severely adversely affected. We think that the ability to seek remedy for perceived injustice should be available to all.

We suspect that the desire to restrict the appeals right is driven by an entirely reasonable desire not to see an avalanche of appeals, with all the costs and uncertainties that this would bring, but we think there are natural safeguards that would prevent this in other aspects of your proposed scheme design.

Firstly, as you highlight in paragraph 2.12, you could allow the appellate body discretion to dismiss trivial and vexatious appeals. We would expect that a sensible appellate body, if presented with an appeal submission by someone who cannot demonstrate that a decision has had a material adverse impact on their interests, may decide that the appeal is trivial and/or vexatious and refuse to progress it.

Secondly, you propose that the appellate body would have the right to award costs

[2] These are simply intended as indicative examples of potentially affected parties, not an exhaustive list.

(i.e. the loser may potentially end up paying for both sides plus the appellate body's administrative costs). This creates a significant disincentive to spurious appeals and is likely to naturally filter down appellants to only those who are very materially affected, although there may be a need to try to ensure that the cost of participation does not become a material barrier to the appeal regime being accessible (we touch on this in more depth in our answer to question 13).

We think a preferable alternative to an upfront prescription on who may appeal would be to rely on these safeguards. We note that these are essentially the same safeguards that are in place for the industry code modification appeals process and that this has not resulted in spurious appeals.

The appeal body

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

The Competition Commission (CC) is a credible appellate body with obvious expertise as an independent competition authority. It may lack expertise in hearing energy cases but we consider this is likely to be the case with any potential candidate for this role, given the historic absence of independent scrutiny of this sector.

On the single occasion[3] where a disputed energy code modification appeal has been heard the CC appeared to do a very capable job in getting up to speed on the subject matter and delivering a well argued finding despite limited time. This – admittedly very limited – experience suggests they could carry out a similar role for licence changes.

In addition, there are obvious synergies and logic in having a single appellate body dealing with both licence modifications and code modifications. This should reduce the overall cost of maintaining the appeals function (because much of the technical expertise in these areas should overlap). It should also ensure consistency in the approach taken to appeals in the two areas.

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.**

[3] E.ON UK plc v GEMA on Energy Code Modification UNC116, 2007.

It may be appropriate to allow the appeals body the flexibility to choose between these options, rather than making this choice for it upfront in the legislation.

We think there could be an extremely wide range of scenarios in which an appeals body reaches a decision that a regulatory decision was wrong and that the individual circumstances should drive how the appeals body responds.

For example, the following[4] kinds of factors may suggest that the appeals body should vary a decision rather than remitting it to the regulator for reconsideration:

- Cases where the regulator has acted inappropriately or otherwise created a reasonable doubt as to whether it can credibly reach a decision on the disputed matter
- Cases where an alternative option to the one proposed by the regulator is clearly optimal and has already been adequately consulted on with any affected third parties
- Cases where the costs and/or benefits of a proposal are highly time-dependent and where any further delay caused by remitting the decision may materially reduce the benefits and/or increase the costs of implementation

Conversely, the following kinds of factors may suggest that the appeals body should remit a decision to the regulator with further instructions rather than seeking to vary the decision itself:

- Cases where the regulator has acted appropriately but where its decision has simply been overtaken by events (for example, significant new evidence being presented during the appeal that was not available at the time of the initial decision, or material changes to underlying market conditions or legislation)
- Cases where the appellate body thinks the optimal licence modification is entirely different to any of the options that the regulator considered. In such cases it would appear inappropriate for the appeals body to substitute a modification that has never been subject to any meaningful public consultation
- Cases where the appellate body thinks that further investigative work is required before any modification should be made

Given the wide range of possible scenarios the appellate body could be faced with,

[4] These two bulleted lists are simply intended for illustration, we do not suggest that either is an exhaustive list of circumstances.

we think a sensible outcome may be to allow it the option of either varying or remitting back with instructions.

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 decision making?**

Both of these windows appear appropriate.

Licensees currently have four weeks in which to lodge an objection to a proposed licence modification. The window you propose for lodging an appeal is directly equivalent.

More generally, most – possibly all – proposed licence modifications are likely to have been through an iterative consultation and development process before the regulator formally proposes the amendment. While the exact final form of the licence modification may not be known until the end of this process, its broad shape will normally be known many months out. We think that in many cases any potential appellant may be in a position to start preparing their case for challenge before the regulator has even made its' decision[5].

The four month window for the hearing appears challenging, but we are mindful that a (slightly) shorter period is available for industry code modification appeals and has proven to be workable. We do not think licence modifications are likely to be materially more difficult to consider than industry code modifications.

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?**

[5] Indeed, there is some real-world evidence of market participants pre-empting controversial regulatory decisions by starting to mount legal challenges before the regulator has even made it to the decision-making stage. For example, in 2007 a number of generators successfully brought a judicial review preventing Ofgem from making a decision on a suite of proposals to introduce zonal charging for transmission losses (link).

We cannot think of any examples, although we do not discount the possibility that they may exist.

In principle, the model you propose provides some security for appeals with urgency issues through the inclusion of suspension powers. For example, the suspension powers may mitigate the need for accelerated consideration of any modification that might otherwise have severe short term consequences.

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?**

Yes, we do.

If an appellant is severely, and immediately, adversely affected by a decision it seems consistent with the principles of natural justice to give them a route to seek mitigation of that impact while the appeal is heard.

At the same time, we think that any suspension of a regulatory decision should be decided case-by-case on its merits rather than by default. There is a (high) risk that if appealed decisions were suspended by default that the appeal mechanism would essentially become game-able – i.e. that it could become in the interests of those on the 'losing side' of a licence modification decision to lodge 'blocking' appeals that are purely intended to slow down the implementation of the regulator's decision. A model that suspended implementation by default may fall foul of the requirement that the regulator has powers 'enabling them to carry out [their] duties in an efficient and expeditious manner' (Article 37(4)) (i.e. because it would not appear to be expeditious).

The approach you suggest seems to us to find an appropriate balance between protecting the interests of appellants and protecting the interests of other affected parties.

How will the costs be recovered?

12	**What will be the likely costs and benefits of these changes on your organisation?**

The implementation costs would be zero; we would not need to develop any working procedures or systems to respond to this kind of change.

The operating costs are very likely to also be zero as we would hope our working relationship with the regulator is sufficiently strong that we would always be able to resolve any policy concerns without resorting to legal challenge. We have no experience in invoking similar appeals mechanisms and therefore could not forecast what the costs of invoking an appeal of this type might be with any great accuracy.

For context, our total annual energy budget is approximately £5m, so in practical terms any appeal mechanism that exposed us to the risk of costs in excess of several hundred thousand pounds may be inaccessible to us regardless of the perceived merits of any case we may have (i.e. the downside risk of losing may be too great to countenance lodging an appeal, even if we thought we had a very good case). While we have a very different funding model to smaller market participants you should be aware that they may have essentially similar concerns – if the final model is excessively expensive to engage with it may not be accessible to fringe market participants.

It is extremely hard to put a price tag on the benefits to our organisation as we are a statutory watchdog rather than a profit-or-loss organisation. But we see a wide range of benefits to the interests of the people we represent; energy consumers.

The removal of the ability of a minority of suppliers – in some cases as few as one – to block amendments to licence conditions is likely, over time, to increase the quality of consumer protections by removing a strong, unhealthy, incentive on the regulator to water down proposals to the lowest common denominator in order to avoid them being blocked.

These changes also remove undue discrimination between large licensees and small licensees by giving all licensees equivalent appeal rights. This should help to reduce barriers to entry and create a more level playing field between the Big 6 and the competitive fringe. Consumers need that fringe to flourish to provide competition on price, quality and product innovation, which should drive up standards.

If, as we hope, appeals rights are extended to consumer groups this should also

create more balanced and healthy tension in regulatory risk – i.e. the regulator would need to be as mindful that consumers will be unhappy with protections that are too weak as it (already) needs to be that suppliers will be unhappy with protections that are too strong. As such, it should lead to a more responsive and accountable regulatory framework.

While only a minority of licence modifications are ever likely to be challenged, the creation of a more accountable and balanced dispute regime should have a positive effect on wider regulatory behaviours.

13	**How do you recommend potential costs could be reduced? How could we maximise the potential benefits to the regulatory regime as a whole?**

The model you propose is broadly similar to the existing appeals process for energy code modifications. While we think that is a broadly sensible model, one area where it could be improved on is in the approach to representation and hearings.

In developing its methodology for hearing appeals, the Competition Commission included an expectation that the proceedings would be legalistic and adversarial[6]:

> *'19. Representation at hearings*
> *19.1 At a hearing a party may be represented by:*
> *19.1.1. a qualified lawyer having a right of audience before a court in the United Kingdom; or*
> *19.1.2. such other person as the Commission allows.*
> *Note on rule 19: Code modification appeals are adversarial in nature. The Commission expects each party normally to have only one spokesperson at a hearing.'*

In the sole code modification appeal to date several Queens Counsel were appointed and this will have contributed to its total costs running in to many hundreds of thousands of pounds.

[6] Boxed text extracted from 'Competition Commission: The Energy Code Modification Rules July 2005'.

This approach does not seem to us to be inevitable, or desirable. From a consumers' perspective, the key outcome of an appeal is that a good policy decision is reached. There is a risk that an overly legalistic appeals approach may offer little more than judicial review does, becoming bogged down in disputes on the procedures the regulator followed in reaching its decision, rather than on whether the decision itself is actually a sensible one. More broadly, a QC driven process is inherently likely to be costly which may disenfranchise smaller parties from the appeals process.

A perfect solution to this problem may be hard to find; it is always likely that protagonists will start wheeling in expensive lawyers on any material disputed matter. But we encourage you to consider whether there are any ways to mitigate this risk. One may be to include a clear upfront instruction to the appellate body that it is for the counterparties to the appeal to decide who will represent them in hearings, not the appellate body itself. This may reduce the perceived risk that the appellate body will refuse to let an appellant present its case except through a QC (a risk that exists with the code modification route). Another mitigating step may be to include provisions that the appellate body should take in to account ability to pay when awarding costs (i.e. to try and discourage the scenario where a party with a genuine grievance is too scared to bring forward a case because, were it to lose, its ability to carry on trading would be in jeopardy).

Impact Assessment Questions

These are partial Impact Assessments containing our initial qualitative assessment of the costs and benefits. We therefore would welcome any quantitative evidence to support the further development of these impact assessments. Any information provided will be treated with sensitivity and anonymity.

14	**Are the assumptions made in the Impact Assessment correct and have we correctly identified the costs and benefits associated with this measure? The Government would welcome any information that could improve our analysis of the costs and benefits highlighted in the Impact Assessment.**

We recognise that the range of estimated costs and benefits may be wide. This is because there is a high degree of contingency on factors that cannot easily be forecasted. These include (and are probably not restricted to):

- How frequently an ex post appeal right is invoked when compared to the ex ante objection regime – and the pattern of who can access this right
- The outcomes of appeals – both on the individual policy decisions and on wider market and consumer confidence
- The timescales in which binding decisions are reached under the proposed scheme when compared with the existing scheme, and the extent to which this leverages or reduces the benefits and costs of those decisions
- How regulatory policy differs with the blocking right removed

Given these inherent limitations, we think that the impact assessment does a decent job in setting out the costs and benefits associated with your proposals.

In particular, on the cost assumptions, we agree with your 'best estimate' assumption falling at the low end of the range. The reason for this is past experience of the (very similar) industry code modification appeals regime suggests that stakeholders tend to over-estimate how frequently appeals regimes may be used. At the time the industry code modification route was introduced it was forecast that there would be between five and ten appeals a year[7]. In fact, there have only been two in six years (of which one was swiftly abandoned and did not make it to hearings)[8]. In this light, your low end estimate of costs appears more likely to be an over-estimate than an under-estimate. If licence modification appeals crystallise at the same rate that industry code modification appeals have done, a more realistic present value cost may be £4.5m[9].

Quantifying the benefits is inherently difficult because of the constraints previously identified, but it may be possible to get a sense of their rough order of magnitude by looking at the impact of the current regime on consumers.

To use one example of this, the implementation of a requirement on suppliers to provide customers with an annual statement, intended to help them make better

[7] Para 2.12, http://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/files/file33240.pdf

[8] http://www.competition-commission.org.uk/appeals/energy/completed_cases.htm

[9] We understand your low-end figure of £8.1m as having been calculated on a basis of 0.6 appeals per year. Two code modification appeals in six years is 0.33 per year. £8.1m * (0.33/0.6) = £4.5m.

switching decisions, was delayed by three months as a result of a minority of suppliers using the current blocking powers[10]. The annual switching rate in Great Britain is approximately 19%, so a three month delay may have meant that about 4.75% of GB energy consumers switched without the benefit of annual statement as a result of suppliers using the blocking process. Even if we assume that annual statements only have an extremely small beneficial effect on switching decisions, saving consumers only 1% off their energy bill when compared to the decision they would have made without this tool, this equates to consumer detriment of approximately £11.35m resulting from the regulator being unable to expeditiously implement its decision[11].

If we assume that this is a typical materiality this would lead to a net present value benefit of £75.3m - £613m depending on the number of appeals (between 0.6 and 5 a year), over a 20 year period and applying a 3.5% discount rate.

We agree with the qualitative benefits you set out although we think that the regulatory benefits go beyond simple efficiency. We would not expect this mechanism to simply deliver quicker regulatory policy decisions, but also much better ones.

The removal of the ability of a minority of suppliers – in some cases as few as one – to block amendments to licence conditions is likely, over time, to increase the quality of consumer protections by removing a strong, unhealthy, incentive on the regulator to water down proposals to the lowest common denominator in order to avoid them being blocked.

These changes also remove undue discrimination between large licensees and small licensees by giving all licensees equivalent appeal rights. This should help to reduce barriers to entry and create a more level playing field between the Big 6 and the competitive fringe. Consumers need that fringe to flourish to provide competition on price, quality and product innovation, which should drive up standards.

If, as we hope, appeals rights are extended to consumer groups this should also create more balanced and healthy tension in regulatory risk – i.e. the regulator would need to be as mindful that consumers will be unhappy with protections that are too weak as it (already) needs to be that suppliers will be unhappy with protections that are too strong. As such, it should lead to a more responsive and accountable regulatory framework.

While only a minority of licence modifications are ever likely to be challenged, the creation of a more accountable and balanced dispute regime should have a positive

[10] See Ofgem decision letter on implementing the Energy Supply Probe remedies: http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Implementation%20of%20the%20Energy%20Supply%20Probe%20Retail%20Markets.pdf

[11] Calculated as (19% [annual switching rate] x 25% [three months as proportion of year]) x 20,000,000 [approximate number of GB energy consumers] x (£1,195 [national average dual fuel energy bill based on standard consumption paying by standard credit as at 22 October 2010] x 1% [conservative estimate of consumer efficiency gain in switching decision as a result of having annual statement when compared to not having it])

effect on wider regulatory behaviours.

For the avoidance of doubt, we consider that the benefits of this proposal are likely to (very) considerably outweigh the costs. Although the mandation of an appeals mechanism by the 3rd package means you have no choice but to put one in place, we would support a reform of this kind even in the absence of compulsion because the current blocking regime has a severely deleterious effect on consumers' interests – it desperately needs to be removed.

15	**What would be the likely costs and benefits of the 'minimum implementation option' of having two parallel separate regimes; one for those relating to regulatory tasks and Third Package duties, and one for Ofgem's domestic tasks? How would these compare to the costs and benefits of the proposed implementation option?**

We do not think the separate parallel regime model could actually be made to work, and as such, we do not think it is possible to reach a credible cost or benefit figure for it.

This is because the tasks and duties given to the regulator by the 3rd package are generic and broad-ranging rather than specific and narrow. Almost any area of Ofgem's activities could be linked back to the 3rd package and we do not see how you could draw clear lines between when a regulatory decision relates to domestic duties and when it relates to European ones.

To try and illustrate this point, we looked at the [electricity] supply licence to see if we could identify any clear delineation between domestic and European requirements. The results of that exercise are appended to this document as Attachment 1. In summary, we were not able to identify any licence condition that could not be argued to be required, in part or in whole, by the 3rd package.

Consumers may be negatively impacted in two ways were parallel regimes put in place.

The first is that the lack of clear delineation between domestic and European duties muddies the waters on which appeal route would be followed if two are available. Given that disputed matters almost invariably create winners and losers this may mean that there is inevitably a 'tug of war' on which appeals route should be used if one is seen as being more favourable than the other. This creates uncertainty and is likely to ratchet the costs of bringing forward an appeal by creating substantive legal questions that need to be addressed before the actual merits of the disputed decision

can even be addressed. All of these costs are ultimately backed off on to consumers through their bills. In addition, the hurdle for engaging with the appeals process may be increased for consumer groups and smaller players who lack the deep pockets of the Big 6, reducing the effectiveness and inclusivity of the appeals mechanism.

The second is that, given the pervasive and generic nature of the European requirements, any separate domestic-only appeals regime may – indeed, probably will - turn out to be entirely redundant. The costs associated with creating a scheme that is never likely to be used will ultimately be borne by consumers. This looks like poor value for money.

Additional Comments

We strongly support the removal of the existing powers to block licence amendments.

The blocking thresholds make it unreasonably easy for major energy suppliers to block, or dilute, change intended to benefit consumers. They are also unfairly skewed towards the interests of the larger suppliers.

For example, British Gas - on its own - has more than 20% of the domestic gas supply market. This effectively gives it a right of veto on gas supply licence changes. More generally, with very limited exceptions, any combination of two of the Big 6 will exceed the 20% market share threshold in either electricity or gas supply.

Whilst our main concern is with the market share threshold, the other blocking threshold is also clumsily captured in current legislation. There is no limit on the number of licenses that any supplier may hold. Npower, for example, holds six different domestic electricity supply licences - falling only narrowly short of having a right of veto on domestic electricity supply licence changes[12]. Whilst we see no evidence that suppliers are actively gaming this test, in principle it appears to us that an energy firm could apply for additional licences purely in able to 'stuff the ballot box' when a licence modification is proposed.

Many issues are dual fuel, and would therefore need to have equivalent provisions in both electricity and gas licences in order to work. If a blocking threshold is reached in either electricity or gas it may therefore be sufficient to block changes in both sides of the market.

Unreasonably low thresholds for blocking licence changes result in consumer detriment through two routes:

- Preventing or delaying reform ('explicit blocks')
- Asymmetric bargaining power ('the industry holds the upper hand in

[12] Of 38 total domestic electricity supply licensees = 16%. Correct as at 21 December 2009. Full lists of licensees here

negotiations')

Explicit blocks – minority vested interests are able to frustrate the introduction of consumer protections by blocking licence changes. The Authority was recently forced to delay the introduction of improvements to residential consumer bills and safeguards for small business consumers by a number of months following the receipt of conditional objections from a minority of suppliers[13].

The industry holds the upper hand in negotiations. If a proposed licence change is explicitly blocked, the Authority cannot enact the change without reference to the CC. We would like to see the Authority make more use of the CC. However, it should be noted that the Authority does not exercise this tool. Suppliers are all too aware that the Authority has no appetite to go to the CC.

The combination of:

- the absence of a credible threat of CC referral, and
- a low blocking threshold

creates a situation whereby the Authority is inherently likely to water down proposed licence changes in the face of Big 6 pressure - as this is the only way it can get anything through.

[13] See the Authority's final determination on implementing the Energy Supply Probe remedies - click here.

Attachment 1 – example of the difficulties in arguing that some licence requirements are 'domestic only' and not provided for by the 3rd package

As a sample exercise, we went through one type of licence to see how many licence conditions could be related back to the duties and requirements of regulators set out in the 3rd package. The intent was to gauge whether it would be possible to draw a clear distinction between domestic and European duties such that separate appeals regimes for these duties could be established.

The licence we chose was the electricity supply licence[14]. The choice of the supply licence simply reflects that consumers' most direct relationship with the energy market (and as a consequence, probably the highest area of consumer risk) is in their dealings with suppliers. We think it is unlikely that a similar exercise for network licensees would bring back a materially different result though – indeed, Article 37 sets out a much more extensive range of duties for regulators in relation to networks than to suppliers or generators.

The table below shows the results. The first column sets out the current standard licence conditions. The second column sets out a requirement of Article 36 or 37 that appears directly relevant to the domestic licence condition. Where text is italicised it is directly quoting from the Directive.

Because of resource constraints, in conducting the trawl we simply looked for some evidence that each licence condition is backed by the 3rd package before moving on to the next licence condition, rather than trying to create an exhaustive list of all the duties and requirements on the regulator that might be relevant to each licence condition. We consider it likely that a more exhaustive trawl would identify additional requirements of the 3rd package that necessitate many of these licence conditions.

In summary, we were not able to identify any supplier licence condition that could not be argued to be required in part, or in entirety, by the 3rd package. In this context, the value of running parallel appeal regimes for 'domestic' and 'European' licence requirements appears highly questionable – we would struggle to see circumstances where a licence requirement is ever wholly domestic.

[14] The current version (as at 22 October 2010) is available on the Ofgem website here.

Standard Licence condition	Duty and power of the regulatory authority
Main section of licence: 'Standard conditions for all suppliers'	
Sub-section of licence: 'General arrangements'	
1 Definitions for standard conditions 2 Interpretation of standard conditions 3 Application of Section B of standard conditions 4 Licensee's payments to Authority 5 Provision of information to the Authority 6 Classification of premises	Article 37(4)(b) Rationale: Requires the regulator to *'decide upon and impose [...] any necessary and proportionate measures [...] to ensure the proper functioning of the market'.* The first six licence conditions are essentially administrative – setting out definitions and 'bread and butter' measures requiring the licensee to help fund the regulator and to provide it with information necessary to do its job. While bland, the regulator couldn't enforce the licence or fund itself without these measures – hence they are necessary for the proper functioning of the market.
Sub-section of licence: 'Continuity of supply'	
7 Terms of Contracts and Deemed Contracts	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex I includes requirements on the contents of supply contracts.
7A Supply to micro business customers	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex I includes requirements on the contents of supply contracts.
8 Obligations under Last Resort Supply Direction	Article 37(4)(b) Rationale: Requires the regulator to *'decide upon and impose [...] any necessary and proportionate measures [...] to ensure the proper functioning of the market'.* It is hard to see how the market could properly function without supplier of last resort rules – in the absence of such arrangements large numbers of customers could be left with no supplier indefinitely in the event of bankruptcy.
9 Claims for Last Resort Supply Payment	As above
10 Restriction or revocation of licence	Article 37(4)(d) Rationale: *'to impose effective, proportionate and dissuasive penalties on electricity undertakings not complying with their obligations'*
Sub-section of licence: 'Industry activities and procedures'	
11Compliance with codes	Article 37(4)(b) Rationale: Requires the regulator to *'decide upon and impose [...] any necessary and proportionate measures [...] to ensure the proper functioning of the market'.* The industry codes set out the core requirements that allow interoperability. They also set out the market rules for things like balancing and settlement. Without compliance with these codes, the

	market would not function properly (these codes are the market).
11A Security arrangements	As above – compliance with the Fuel Security Code is necessary for a properly functioning market.
12 Matters relating to electricity meters	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex I (2) includes requirements on the introduction of smart metering. Annex I 1(i) *'[customers] are property informed of actual electricity consumption'* Annex I 1(d) requires *'a wide choice of payment methods'* to be offered (i.e. licence conditions around prepayment meters are likely to be within scope). Article 37(1)(p) *'ensuring access to customer consumption data'*
13 Arrangements for site access	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(a) requires the supply contract to set out *'the services provided, the service quality levels offered'* which appears to overlap with licence requirement to prepare and publish a statement on how its personnel will behave.
14 Customer transfer blocking	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex I 1(b) reiterates the right to switch, covered off in more depth in the EU 2nd Package.
15 Assistance for areas with high distribution costs scheme: payments to System Operator	Article 37(1)(a) Rationale: *'fixing or approving [...] transmission or distribution tariffs or their methodologies'.*
16 Not used	N/A – this licence condition is currently blank.
17 Not used	N/A – this licence condition is currently blank.
18 Not used	N/A – this licence condition is currently blank.
19 Not used	N/A – this licence condition is currently blank.
19A Financial information reporting	Article 37(j) Rationale: *'monitoring the level and effectiveness of market opening and competition at wholesale and retail levels [...] as well as any distortion or restriction of competition'.* This licence condition was introduced as a result of the Energy Supply Probe, prompted by concerns that vertical integration might be distorting the market.
Sub-section of licence: 'Information for all customers'	
20 Enquiry service and supply number	Article 37(4)(b) Rationale: Requires the regulator to *'decide upon and impose [...] any necessary and proportionate measures [...] to ensure the proper functioning of the market'.* This licence condition provides the framework to allow

	customer switching, a key function of the market.
21 Fuel mix disclosure arrangements	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(c) requires that customers *'receive transparent information on applicable prices and tariffs'.* The fuel mix disclosure allows customers to see how 'green' their tariff is which, for some customers, may affect their decision on which supplier (or product of a supplier) to use.
Main-section of licence: 'Section B: Standard Conditions for Domestic Suppliers'	
Sub-section of licence: 'Regulation of Domestic Supply Contracts'	
22 Duty to offer and supply under Domestic Supply Contract	Article 37(4)(b) Rationale: Requires the regulator to *'decide upon and impose [...] any necessary and proportionate measures [...] to ensure the proper functioning of the market'.* It is hard to see how the market could properly function without a requirement to offer terms to domestic customers – 'unattractive' customers would either end up off supply, or on-supply but with no supplier attributable to their consumption.
23 Notification of Domestic Supply Contract terms	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(a) sets out a range of requirements for the contents of supply contracts.
24 Termination of Domestic Supply Contracts	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(a) includes requirements for contracts to set out *'the conditions for renewal and termination of services and of the contract and whether withdrawal from the contract without charge is permitted'.*
25 Marketing electricity to domestic customers	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(d) sets out that *'Customers shall be protected against unfair or misleading selling methods'.*
25A Prohibition of undue discrimination in supply	Article 37(1)(n) Rationale: *'helping to ensure [those measures] set out in Annex I, are effective and enforced'.* Annex 1(d) sets out that customers should be *'offered a wide range of payment methods, which do not unduly discriminate between customers'* Article 37(4)(b) requires the regulator to *'carry out investigations [...] and to decide upon and impose any necessary and proportionate measures to promote effective competition'.* The undue discrimination licence conditions

	were introduced as a result of Ofgem carrying out an investigation (the Energy Supply Probe). Wider EU legal obligations banning undue discrimination pre-date the 3rd package and are clearly a European, as well as a domestic UK, requirement.
26 Services for specific Domestic Customer groups	Article 36(h): Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] contributing to the protection of vulnerable customers'*
27 Payments, Security Deposits and Disconnections	Article 36(h): Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] contributing to the protection of vulnerable customers'*
28 Prepayment meters	Article 36(h): Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] contributing to the protection of vulnerable customers'*
29 Not used	N/A – this licence condition is currently blank.
30 Not used	N/A – this licence condition is currently blank.
31 General information for Domestic Customers	Article 36(h): Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] contributing to the protection of vulnerable customers'* - the licence condition sets out requirements to signpost vulnerable customers to sources of advice.
31A Information about electricity consumption patterns	Article 36(g): Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] promoting effective competition'* Article 37(4)(b) requires the regulator to *'carry out investigations [...] and to decide upon and impose any necessary and proportionate measures to promote effective competition'.* The annual statements and customer switching info contained in licence condition 31A were introduced as a result of Ofgem's Energy Supply Probe investigation in a bid to promote effective retail competition.
32 Reporting on performance	Article 37(1)(j) Rationale: *'monitoring the level and effectiveness of market opening and competition at wholesale and retail levels, including on electricity exchanges, prices for household customers including prepayment systems, switching rates, disconnection rates [...]'*

33 Feed in tariffs	Article 36(e) Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] facilitating access to the network for new generation capacity, in particular removing barriers that could prevent access for new market entrants and of electricity from renewable energy sources'*
34 Implementation of Feed in tariffs	Article 36(e) Rationale: *'the regulatory authority shall take all reasonable measures in pursuit of the following objectives [...] facilitating access to the network for new generation capacity, in particular removing barriers that could prevent access for new market entrants and of electricity from renewable energy sources'*