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### **DECC consultation on licence modification appeals**

Thank you for the opportunity to respond to this consultation.

We do not support the proposals outlined in the consultation document because:

- It is clear that no change is required, as the UK already complies with the requirements of the Third Package;
- As noted by DECC in the Impact Assessment, the proposals go beyond minimum EU requirements; and
- Even if change was necessary, the proposals outlined would undermine investor confidence in the UK energy sector.

The implementation proposals in the consultation document clearly gold-plate the Third Package and appear to cite EU legislation as a reason for rushing through a significant, widespread and fundamental change to the UK regulatory regime. It does not seem appropriate that the government would use the excuse of EU legislation to give the regulator excessive powers to issue and implement binding decisions on energy market participants prior to any appeal being heard, particularly when DECC themselves accept that their proposals go beyond minimum EU requirements.

#### **DECC's case for change**

DECC are proposing to remove the existing collective licence modification process and replace it with an ex-post appeal system on the basis that this is needed to implement what DECC considers to be new requirements in the Third Package. As detailed in DECC's Impact Assessment, they consider these new requirements to be threefold –

1. The regulator must have powers enabling it to perform regulatory tasks in an efficient and expeditious manner;
2. A suitable right of appeal must be available to all parties affected by a decision of the regulator; and
3. The regulator must be able to implement binding decisions.



However, only two of these requirements are actually new. The first requirement appears in the Second Energy Package, Directive 2003/54/EC in Article 23, Clause 7 as "Member States shall take measures to ensure that regulatory authorities are able to carry out their duties... in an efficient and expeditious manner." Given that the government has already implemented this 2003 Directive and has received no infringement notice from the European Commission relating to this specific matter, it is clear that the UK already complies with this requirement and no additional action is required.

Therefore, it appears that DECC propose to overhaul the existing process based on only the second and third requirements above; a need for all affected parties to have a suitable right of appeal and for the regulator to be able to implement binding decisions.

With regard to the second requirement, it is clear that the existing licence modification process already provides a suitable right of appeal for affected parties. Directly-affected licensees have the opportunity to have a decision referred to the Competition Commission, whilst indirectly affected parties have the right of judicial review. This existing arrangement where all parties have a suitable right of appeal ensures that the UK complies with the Third Package and that no further action is required.

In this respect, it is apparent that the DECC proposals for implementation are solely based on the third requirement; need for the regulator to be able to implement binding decisions.

The Third Package Directives require that the regulator is able "to issue binding decisions..." rather than implement binding decisions, as detailed in the DECC consultation. Whilst this may seem like an insignificant difference in wording, it is clear that, whether or not the regulator chooses to implement binding decisions, the regulator certainly already has the power to issue binding decisions through the existing licence modification process.

The existing licence modification process can be described as having two distinct stages – issuing and implementation. In summary, the existing process allows the regulator to issue a binding decision (issuing stage) which, if the licensee has no objection to, is then transposed into the relevant licence (implementation stage). If the licensee objects to the decision, the decision is then referred to an independent appeal process (Competition Commission). Once this appeal process is complete, the final binding decision is then transposed into the relevant licence. The implementation stage is not necessarily required to be concurrent with the issuing stage, as is illustrated by the recent Code Governance Review.

The DECC proposals suggest that the regulator issues a binding decision which is then transposed into the relevant licence – in this case, both issuing and implementation stages run concurrently. If the licensee objects to the decision, the decision is then referred to an independent appeal process. Once this appeal process is complete, the final binding decision will be reflected in the



relevant licence, which may require amendment or even removal of the licence condition previously implemented.

In effect, the only difference between the existing licence modification process and the DECC proposal is the relocation of the implementation stage to a point prior to an appeal being heard. Given that the Third Package makes no mention of implementing binding decisions, and is concerned only with the issuing of binding decisions, it is unnecessary to make the proposed changes to the existing licence modification process.

### **Inefficient outcomes and unintended consequences**

If DECC were to insist on the unnecessary implementation of the proposals contained in the consultation document, there would be a number of significant unintended consequences.

#### **1. Implementation prior to appeal increases costs to customers**

The current and proposed appeal processes have the power to accept, amend or overturn a regulatory decision. If the decision was implemented prior to an appeal being heard, and then the outcome of the appeal required an amendment or reversal of the decision, it is likely that this would result in costs for licensees which are ultimately reflected in the cost to consumers. For example, a change in charging methodology will often require costly IT system changes for licensees. It would not be cost-effective to implement these changes only to have them negated should an appeal process require the amendment or reversal of an already implemented decision.

If the proposed appeal process has a suspensive effect on the implementation of a regulatory decision, this would avoid unnecessary costs to licensees and, ultimately, consumers. However, this brings the proposed process entirely in line with the existing process in allowing the implementation stage to take place post-appeal. This further reinforces the suitability of the existing licence modification process.

#### **2. Inappropriate balance of power in favour of the regulator**

Whilst the regulator can currently issue binding decisions, it would not be appropriate for the regulator to have the powers to unilaterally implement those binding decisions prior to the outcome of an appeal, particularly where the launching of that appeal is much more difficult after the event.

The DECC proposals are clearly undemocratic. It is one thing for an unaccountable regulator to be independent. However, it is quite another to have the balance of power tilted so far towards the regulator without having sufficient and appropriate checks and balances already firmly in place. Although DECC assert that Public Service Obligations will provide a suitable framework for what the regulator can decide, there are already debates around whether the single existing PSO on Connect and Manage is in fact legally enforceable. We question the effectiveness of PSOs in constraining the regulator and doubt that DECC can implement sufficient



PSOs, prior to implementing their proposals, to ensure that the regulator is actually accountable. In this case, the government will always be running to catch up with the regulator.

### **3. Excessively onerous appeals process increases costs to customers**

The reasons that a licensee might object to a regulatory decision range from a fundamental disagreement with the principle behind the decision to simply requiring a longer timescale to comply with the decision. At present, once the regulator has issued a decision, the licensee has options available to seek a resolution to any objection prior to implementation of that decision. It is for that reason that there have been relatively few Competition Commission appeals in recent years.

However, if the regulator is given powers to implement decisions prior to appeal, the licensee will have no option but to launch a full-blown appeal, whether the objection is merely on grounds of practicality or on fundamental principles. This seems both inappropriate and disproportionate.

It is, therefore, certain that DECC's proposals will increase the number of appeals launched by licensees, given that they will have no other route to resolve any objections. With the cost of an appeal ranging from £500k to £1m, it is equally certain that customers will ultimately bear the cost of DECC's proposals.

### **4. Increased regulatory uncertainty damages investor confidence**

Moving from a regulatory regime where the regulator issues decisions but implementation follows appeal, to one where the regulator can issue and implement decisions without appeal will increase regulatory uncertainty and inhibit investment in the energy sector. It is unlikely that GB will attract the £200bn investment required over the next 10 years when potential investors realise that the terms under which they operate can be varied and changes imposed unilaterally by the regulator before any appeal has been heard.

This has exactly the opposite effect to that which DECC propose in the Impact Assessment. Whilst they state that "having appeals may increase regulatory stability and lower the cost of capital," it is clear that, in fact, the resulting increase in regulatory risk will lead to investors requiring a higher rate of return. These increased investment costs simply translate into higher customer bills.

### **5. A single party can impose their wishes on the wider group of licensees**

At present, each licence is split into Standard and Special conditions. Standard Conditions apply equally to all licensees who hold the same type of licence and they ensure that these licensees are obliged to operate under consistent and comparable conditions without discrimination.



When Ofgem issues a Standard Licence Condition decision, if the majority of licensees have no objection, it can be implemented into all licences without a Competition Commission appeal. If a single licensee objects to the decision, they have the right to mount a judicial review (which is defined in European case law as a “suitable right of appeal”) but not a Competition Commission appeal. Whilst this ensures that the Standard Licence Condition arrangements cannot be disrupted by a single party, DECC perceive that a lone objector does not have sufficient appeal rights and can have decisions imposed upon them by the actions of the majority. This is a key driver for their proposal to remove the collective licence modification process.

However, DECC’s proposals result in exactly the opposite situation. Following DECC’s proposal, if a single party objects to a Standard Licence Condition decision and decides to mount an ex-post appeal which is successful, the outcome of that appeal would then be applied to the rest of the non-appellant licensees, as the decision relates to a Standard Licence Condition. In this case, a single party imposes their wishes on the majority, which appears entirely unreasonable and undemocratic. This is a particular concern if the terms of reference set by the appellant only consider appellant-specific issues and not those issues of concern to other licensees. It is not clear what options for recourse the non-appellant licensees would have if they were not satisfied with the outcome of a single party’s appeal. Furthermore, if a single party appeals a Standard Licence Condition but the outcome of the appeal is not applied across the rest of the licensees, this can only lead to diverging licences and the breakdown of the Standard Conditions.

## **6. Multiple appeals on similar issues**

If DECC remove the collective nature of Standard Licence Condition decisions and allow single parties to raise an appeal, it is very likely that there will be multiple appeals on similar issues. At present, licensees can object to the regulator’s decision on many different grounds - what affects one licensee, may not affect another. Therefore, if one licensee raises an appeal on one aspect of the regulator’s decision, another licensee may be forced to raise a separate appeal on another aspect of the regulator’s decision if the terms of reference of the first appeal do not cover their concerns. This does not seem either cost-effective or proportionate.

Furthermore, it is appropriate that the appellant set the terms of reference for the appeal. It might be suggested, given what has been detailed above, that the Competition Commission, or even Ofgem, should set the terms of reference for an appeal – however, this immediately detracts from the ability of the licensee to appeal on exactly the grounds appropriate for that licensee, dilutes the effectiveness of the right of appeal and fundamentally undermines the proposed reform. In this case, retaining the collective nature of Standard Licence Condition decisions appears to be the best option.



It remains a concern that the Third Package, which was expected to enhance competition and provide benefits for consumers, is being used by DECC to usher in a fundamental change to the GB regulatory regime which will have the opposite effect on consumers to that which was intended in Europe. At no time, during the Third Package negotiations, was it suggested that there would have to be such a significant rewrite of Ofgem's powers. It was neither openly debated nor were any views sought through consultation. In fact, it was suggested that Ofgem were the model regulator and that the GB system could be replicated across Europe. It is, therefore, surprising that now, nearing the transposition deadline, DECC suddenly perceive there to be an urgent need for such far-reaching change.

In summary, it is clear that the three reasons that DECC use to justify their proposed changes to the existing licence modification process are unfounded and that changes are, in fact, unnecessary. Furthermore, if DECC insist on implementing their proposals, any assumed implementation benefits will be greatly outweighed by the unintended consequences.

We strongly urge DECC to rethink their proposals and adopt a minimum-change approach.

If you would like to discuss our response or require further information, please do not hesitate to contact me.

Yours sincerely,

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