
Department for Environment, Food and Rural Affairs

Introduction of an appeals mechanism for Ofwat's proposals to amend codes made under the Water Industry Act 1991

RPC rating: validated

Description of proposal

Defra is introducing regulations which allow participants in the water industry a quicker and more effective system to appeal against decisions by the regulator (Ofwat). The appeals process will shift from a judicial review basis to a fast-track mechanism with rulings issued by the Competition & Markets Authority (CMA). CMA appeals will be timetabled, so will last no more than 2.75 months.

The assessment states that CMA reviews will streamline the appeals process and allow for the consideration of “merit cases” which assess the technical aspects of the decision. Previously, judicial reviews could only consider the legality of decisions. The process also allows for a business to become party to an appeal as an “intervener” in a case; either in support of or opposing a particular appeal. The Department expects this to minimise regulatory uncertainty and reduce the length of the appeal process.

Impacts of proposal

The Department conducted a consultation of business to evaluate the impacts of the proposal. It received 13 responses.

To calculate the impacts on business, the Department contrasts introducing the new appeals mechanism (option two) with a baseline (option one) that maintains the current judicial review system. The new judicial review process will affect only those businesses wishing to appeal against an Ofwat decision or intervene in a case. Using historical case studies from the water and energy industries, the Department expects around two appeals during the 10-year appraisal period under both the CMA and judicial systems.

Cost of instigating and maintaining an appeal

The submission uses case studies of similar judicial reviews to provide a central estimate of twelve months for the duration of an appeal. The IA assumes that the legal costs involved in launching appeals will be the same regardless of business-size. Under the baseline, it estimates a cost per case of £2.09 million. This estimate

is based on baseline costs provided in a separate IA on the transition to similar, “merit-based” appeals against regulatory decision-making.

Under option two, the CMA will be expected to complete a review within 2.25 months, with the option to extend it to 2.75 months if required. This represents a time-saving of nearly ten months relative to the judicial review system. Although the assessment estimates that the monthly cost for merit-based appeals will be 25% higher than for judicial reviews, the significant time saving leads it to estimate a total cost to appellants per case of only £490,000. This represents a saving of £1.5 million per case or £3.04 million over ten years in present value terms.

Cost of intervening in a case

The Department draws upon studies of similar judicial reviews and CMA appeals to estimate the number of interveners under each option. Under option two, the submission assumes there will be one intervener per case. No interveners are expected under the baseline.

The assessment bases interveners’ costs on calculations from the separate IA on merit-based reviews. The Department assumes that interveners’ costs will be about 50% of main applicants’ costs, equal to about £240,000 per case.

Costs to Ofwat

As Ofwat is funded by a levy on business, costs incurred by the regulator from appeals are treated as a cost to business.

Under option one, Ofwat would face the legal and administrative costs of preparing for cases. Following consultation with the regulator, the IA estimates these to be £150,000.

Under option two, the assessment estimates that the regulator will face higher costs as a result of having a shorter timeframe within which to respond to cases. It may also incur costs by attempting to “appeal-proof” decisions given the greater accountability it faces, and will incur familiarisation costs as a result of engaging with a new appeals system. This is in addition to the legal and administrative costs set out in option one. Following consultation with Ofwat, the Department estimates a total cost per case of £190,000.

The assessment therefore estimates that costs to Ofwat will increase by £70,000 over ten years in present value terms.

Costs to the adjudicator

Costs to the CMA under option two were estimated to be £200,000 per case, with these costs drawn from a separate IA looking at similar “merit-based” appeals to the Competition Commission. Costs incurred by the CMA are treated as a cost to business, as the authority is funded by a levy on business. When contrasted with the baseline, the funding of CMA adjudication therefore represents an additional cost to business of £370,000 over the assessment period in present-value terms.

The assessment estimates costs to the High Court under the baseline of £1.93 million per case. This cost is borne by public bodies. The estimate was based on the cost assumptions of a separate IA looking at similar judicial cases.

The submission also notes that there are wider benefits from the adoption of the appeals system. With quicker appeals and the introduction of “merit-based” cases, for example, the Department expects arrangements to incentivise innovation within the industry and lower prices for consumers.

Aggregating total costs and benefits, the IA estimates an equivalent annual net direct cost to business (EANDCB) of -£200,000.

Quality of submission

As initially submitted for RPC scrutiny, the IA was not considered fit for purpose for a number of reasons. Following the RPC’s initial review, the Department submitted a revised IA that responded to these points, as set out below.

The IA now provides a proportionate assessment of the impacts of both options, and adequately monetises the costs and benefits associated with the proposal.

The submission could have been improved by detailing whether respondents to its survey represented a significant and proportionate sample of affected businesses.

Issues addressed following RPC’s initial review

Support for assumptions

The IA has provided further justification for its use of figures from a separate IA. The assessment has also outlined where information relevant to its cost calculations was unavailable, and provided evidence in support of its use of alternative figures.

The breakdown of costs and cost calculations within the IA

The assessment now provides a clear description of the cost calculations and appropriately referenced sources. It has provided step-by-step reasoning to aid the RPC in validating calculations.

Inappropriate base year for costs

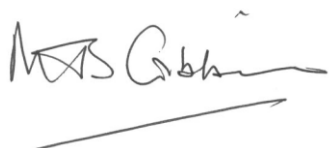
The IA has adjusted the costs and benefits of the policy to the prices of the appropriate base year.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£0.2 million
Business net present value	£2.1 million

RPC assessment¹

Classification	Qualifying regulatory provision (OUT)
EANDCB – RPC validated	-£0.2 million
Business impact target score	-£1 million



Michael Gibbons CBE, Chairman

¹ For reporting purposes, the RPC validates EANDCB and BIT figures to the nearest £100,000