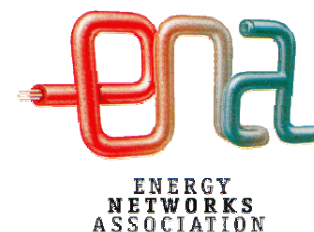


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Date: 15 April 2004

Dear David

### **DEALING WITH UNCERTAINTY**

As you know, distributors believe that one of the key features of the final price control proposals will be the way in which Ofgem proposes to deal with issues of uncertainty regarding new costs and new obligations that may arise between reviews. The working group set up to address this issue has made only slow progress, and, while Ofgem has encouraged discussion of the matter through the wider consultation process, its own position is still some distance from that of the distributors, who favour a more explicit approach than Ofgem's.

In an effort to resolve this issue constructively, the distributors now wish to propose the incorporation of certain new mechanisms in the distribution licence. These mechanisms have been specifically developed to be consistent with Ofgem's expressed preferences while providing a more formalised protection for licensees which will ultimately enhance consumer benefit. The attached paper describes these new mechanisms, along with some illustrative legal drafting, and sets out distributors' agreed view of how uncertainty should be dealt with in Ofgem's final proposals. This paper should be treated as the response of each of them to that part of Ofgem's March document covering this issue.

In essence, distributors believe that the nature and potential scale of uncertain costs at this price control review are such that it is no longer appropriate to rely on an assumption that they can be ignored until they arise and that, if they do arise, and if they are material, then an adjustment can be made. There is a real problem with reliance on letters of comfort from Ofgem, or on statements in its final proposals document, that are intended to give licensees reassurance that unforeseen costs will be dealt with as and when they arise. The problem is not that such commitments are regarded as empty by licensees (and their providers of finance), but that promises of this kind cannot give the licensee the same degree of protection that it has in respect of all the other aspects of a price review, namely a referral to the Competition Commission.

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The purpose of a price control settlement is to provide licensed distributors with the funds necessary to cover the efficient costs that are expected to arise over the forthcoming period. If a licensee considers that insufficient allowance is being made for these costs, it has the option of rejecting Ofgem's final proposals and, hence, of effectively forcing a public-interest reference to the Competition Commission.

By contrast, any costs that are regarded as too uncertain to be remunerated in the price control, and that are therefore the subject of a comfort statement, are placed outside the set of costs in respect of which the licensee enjoys the ultimate protection of a Competition Commission reference. This means both that the nature of the settlement becomes different for those uncertain costs and that the licensee's risk in respect of such costs is significantly increased.

The mechanism that is explained in the distributors' paper is therefore designed to place them in precisely the same position with respect to the uncertain costs as they are in with respect to those costs that are remunerated from the outset by the main control. (The paper also describes a separate licence mechanism for remedying the adverse financial effects of new obligations that were not foreseen at all when the price control was set.) Effectively, the mechanism ensures that the licensees are able to force a reference to the Competition Commission in respect of uncertain costs if they fail to gain a satisfactory outcome in their discussions with Ofgem.

This mechanism puts Ofgem into precisely the same position, too, for if Ofgem considers that the licensee's view of the efficient level of uncertain costs is not reasonable, then it can propose a different set of cost allowances and, failing agreement with the licensee, may refer the matter to the Commission.

Distributors see four main benefits from this kind of mechanism:

- Firstly, since it mitigates the additional risk borne by companies, it may be assumed to be beneficial for consumers as it prevents the increased risk from feeding through into the observed cost of capital, and so into prices.
- Secondly, it preserves the incentive properties of the main control as far as possible with respect to costs that are too uncertain to be remunerated under that control.
- Thirdly, it will enable Ofgem to set a level of allowed costs for the main control that is not unnecessarily inflated to cover elements of uncertainty.
- Finally, it should eliminate the risk that Ofgem's comfort statements could become the subject of dispute or legal challenge.

We hope that you will find this clarification of our common position helpful and that you and other members of your team will want to explore these matters further in a meeting with distributors as soon as is convenient.

Yours sincerely

**Jim Tame**

Chairman

ENA Regulation Group

# **Dealing with uncertainty: a paper for Ofgem**

## **Introduction**

1. This paper has been prepared for Ofgem by the fourteen price-controlled distributors of Great Britain and sets out their agreed view of how the issue of uncertainty should be treated in Ofgem's final DPCR4 proposals.
2. It is common ground that there may be increasing uncertainty regarding the future costs and obligations of distributors. Despite this, it is clear from Ofgem's December and March consultation papers that Ofgem does not wish to adopt the Ofwat approach for dealing with uncertainty between reviews. Ofgem would prefer instead to either:
  - review companies' exposure to substantial new costs and obligations on a case by case basis, or
  - provide 'prior comfort' in specific areas (for example, lane rental charges) that some allowance will be made for certain costs that are expected to arise between price control reviews.
3. While we may agree that the Ofwat approach could be cumbersome, we believe that a more formalised approach than Ofgem's should be taken. Indeed, we are surprised that Ofgem has sought to cast doubt on the appropriateness, in principle, of trying to address uncertainty under a formal mechanism. In particular, Ofgem's attempts to distinguish the water regulatory regime from that of electricity by reference to differences in the statutory duties have been unconvincing, since the legal requirement on the regulator to ensure that companies can finance their continuing investment is, in practical terms, identical in both industries.
4. The following mechanisms – comprising the introduction of a new standard condition into the distribution licence, along with the amendment of the special price control conditions – are proposed as a means to resolve this issue and have been developed to be consistent with Ofgem's expressed preferences while providing a more formalised protection for licensees.

## **Proposed mechanisms**

5. If uncertain costs were to be dealt with under the normal price control methodology:
  - the distributor would carry the risk that the level of costs assumed by Ofgem would be too low, and
  - customers would bear the risk that Ofgem would have allowed an amount that is higher than is necessary.
6. We believe that it is possible to improve on this situation by introducing mechanisms into the licence that offer protection for both distributors and customers (a) from the impact of costs that were not allowed for at all when the price control was set, and (b) from significant movements in costs that were allowed for, but over which there is still considerable uncertainty at the time that the price control is finalised.

7. It is possible to cater sensibly and equitably for both these kinds of uncertainty without encumbering licensees, and Ofgem, with all the onerous machinery, as in water, of an interim price determination provision. Our proposed alternative approach is set out in two parts below. We believe that it would be suitable for dealing both with major items of cost that were not contemplated at all when the price control was being set, and also with cost categories where there is considerable uncertainty at the time that the price cap is set, but where greater confidence is likely to emerge in due course.
8. As mentioned above, both parts of the alternative approach can be incorporated within the existing structure of the distribution licence. We have produced some illustrative drafting (which is attached) to show how this could be done.

## **1. Dealing with new obligations**

9. The first mechanism that is needed to deal with material uncertainty in the distribution sector is an enhancement of the ability of licence holders to withstand major cost shocks which were not foreseen when the price control was set, and which have arisen from events beyond their reasonable control. (This would include the cumulative effect of a series of minor cost shocks arising in this way.)
10. Events of this kind are most likely to arise for distributors from the application to their operations of a new or an amended legal requirement which, absent a change to the price control, would adversely affect, or would be likely to adversely affect, the recovery of the resulting costs in the charges made to suppliers and other users. For distributors, such new requirements can arise from a wide variety of sources, including:
  - primary legislation (i.e. statute law)
  - secondary legislation, including regulations, orders, and schemes
  - judicial determinations which have the effect of changing the law
  - European directives that have direct effect in UK law without transposition
  - licence modifications required by Ofgem or the Secretary of State, and
  - (indirectly) the decisions of a range of other (especially environmental and health and safety) agencies with rule-making powers.
11. To deal with such requirements, we propose that the distribution licence should contain an explicit relevant change of law provision, under which Ofgem would be required to determine, on application by the licensee, whether a relevant change of law has had, or is likely to have, a material adverse effect on the licensee's financial position. This approach is intended to facilitate the assured recovery of costs that have the combined qualities of being material and unforeseen, while giving Ofgem an appropriate role in the selection of those items that are to qualify for such treatment.
12. For the purposes of this licence provision, a relevant change of law would be defined as the application to the licensee of any legal requirement (other than a value added tax requirement) which did not previously apply to its authorised activities. Where a material adverse effect was found to be caused, or likely to be caused, as a result of such a change of law, Ofgem would have to determine what change should be made to any of the licence obligations of the distributor so as to ensure that its financial position would be broadly the same as if the change of law had not taken place.

13. In making its determination, Ofgem could be guided by a number of financial indicators set out in the licence, and would also need to have proper regard to:
- any costs (including consequential and financing costs) which the distributor had incurred, or was likely to incur, by virtue of the relevant change of law,
  - the period over which any such costs had been, or were likely to be, incurred, and
  - all the other circumstances of the case, including the extent to which the material adverse effect could be mitigated by prudent management action on the part of the licensee with respect to those costs.
14. It is for consideration whether such a new licence provision should be enhanced by the inclusion of relevant unforeseen changes of circumstance, other than legal innovations alone, which might also be likely to give rise to material cost shocks for distributors. Such changes might include, for example, the sudden occurrence of some generic – but unpredictable – network asset failure, or an unforeseen scientific or environmental development unrelated to a legal change.
15. Risks associated with such factors may well be beyond the control of any management of a network company, prudent or otherwise, and a case can therefore be made that these should also be brought within the scope of the licence by an enlarged uncertainty provision going beyond what is contemplated here.
16. This first part of our alternative approach embodies three key principles:
- it provides reasonable protection for the distributor against material adverse effects arising from previously unforeseen events, while
  - maintaining Ofgem’s ultimate jurisdiction over the price control in the interests of consumers, and
  - avoiding the disproportionate and inflexible machinery of a disapplication request under special condition F.
17. An illustrative draft of a relevant change of law provision is shown at Attachment 1 in the form of a standard licence condition. If Ofgem rejected a case presented to it under such a condition, the licensee’s remedy would be by way of judicial review.

## **2. Dealing with cost uncertainty**

18. The second part of our alternative approach would be suitable where, at the time that the price control is being set, there is significant uncertainty about the level of the costs likely to arise from certain identifiable cost categories during the forthcoming price control period. This mechanism would operate by:
- isolating those cost categories from the main body of the control,
  - recovering the income relating to them under separate components of the price control formula (there might be a number of such components dealing with each uncertain cost category), and
  - incentivising both distributors and Ofgem to be reasonable in amending any such component to allow recovery of an efficient level of costs.

19. Under this proposal, the price control would comprise a main control that covers most of the income of the licensee (as now) *and* a series of additional income components that are themselves derived from separate, stand-alone sub-controls, each dealing with the recovery of specified uncertain costs.
20. The main price cap would, as now, be set on the expectation that it would operate for five years. This expectation would be set out in the final proposals.
21. The next step would be for the licence to set out supplementary price caps dealing with the remuneration of these uncertain cost categories. These price caps would include Ofgem's best estimate (at the time the price control is set) of the efficient level of costs in each of the uncertain categories. (Obviously, the amount could be set initially at zero if Ofgem seriously doubted whether the cost would arise at all.)
22. However, each such price cap would contain a right for the licensee to notify Ofgem at any time that the amount built into that particular supplementary price cap from the outset should be replaced by another amount that corresponds to what the licensee now believes will represent a more accurate view of the level of costs that are likely to be efficiently incurred.
23. The supplementary price cap would provide that, on receipt of such a notice, Ofgem could either:
  - do nothing, in which case the revised amount notified by the licensee would become effective in the supplementary price cap, or
  - serve a counter-notice on the licensee stating either:
    - (a) that Ofgem considers that the original value should be maintained, or
    - (b) that Ofgem proposes an alternative value.
24. On receipt of such a counter-notice, the licensee would be given a certain period of time in which to object to, or to accept, Ofgem's alternative. If the licensee accepted, then the revised Ofgem value would enter the licence. Importantly, this need not require a full 'licence modification by agreement': it could be achieved by providing, within the licence condition, for alteration by notice where both Ofgem and the licensee are in agreement (see section 7(5)(b) of the Electricity Act 1989).
25. On the other hand, if the licensee decided to reject Ofgem's alternative value, then the licensee's proposed value (in its original notice) would apply unless Ofgem wished to refer the matter to the Competition Commission.
26. The device would have some elements of symmetry, in that, if Ofgem's original cost estimate looked likely to be too generous to the licensee, then a similar mechanism would be needed to bring about a reduction in income compared to the initial view taken in the setting of the supplementary price cap. In such a case, the device would work as follows:
  - Ofgem would propose a new value (perhaps after seeking information from licensees or other relevant bodies) and the licensee would have to either accept this proposal or reject it.
  - If it rejected Ofgem's proposal, the licensee could propose its own alternative.

- Ofgem would then have to either accept that alternative, leave the amount as it stood, or refer the matter to the Competition Commission.
- 27.** This device would encourage both licensees and Ofgem to be reasonable, since there would be risks and costs for each side in the referral of a supplementary price cap to the Competition Commission. However, the mechanism will only work if the right to force such a reference at short notice if agreement cannot be reached is embedded within it. In the event of a reference, the supplementary price cap would continue unchanged until the Commission reported. Subject to that, however, if the distributor cannot agree with Ofgem on revised values, then it is the distributor's preferred value, not Ofgem's, that is the default position.
- 28.** To support this approach, Ofgem's final price control proposals should clearly state:
- that the purpose of separation into supplementary price caps is to isolate these uncertain costs from the main price control, to remunerate them separately, and to allow the original assumptions for these terms to be revised if the outturn is, or is likely to be, materially different from the initial assumption, and
  - that the price cap has been designed in this way for the purpose of facilitating a specific kind of Competition Commission reference that is confined to the particular part of the price control that governs the uncertain costs over which agreement could not be reached.
- 29.** An amended form of special licence condition B would be needed to give effect to this mechanism. The amendments would incorporate new special conditions B1, B2, B3 (etc) as supplementary caps under condition B, depending on the number of categories in which there was significant uncertainty over the magnitude of future costs when the price control was set.
- 30.** An illustrative draft of a new special condition B1, embodying this approach, is set out at Attachment 2. In this case, as the purpose clause makes clear, the mechanism is to enable the licensee to recover the efficient costs of complying with lane rental charging schemes. But the same drafting approach would be equally applicable, with necessary adaptations, to the recovery of distribution rates, or pension deficiency payments, or the costs of implementing ESQC regulations, to name the most likely other potential candidates for such treatment.
- 31.** It should be stressed that the approach suggested above does not provide for a full and automatic pass-through of the uncertain costs. This is partly because the mechanism is designed to be used even where the costs covered by it may be less easy to distinguish from other distribution business costs, but also, and primarily, because distributors are not seeking to achieve automatic pass-through in all circumstances.
- 32.** In fact, the approach lies somewhere between a fully pass-through approach and a fully incentivised RPI-X approach. This is because the mechanism:
- gives Ofgem the opportunity to challenge the actual costs as being inefficient (i.e. to challenge the allowed amount on the ground that the costs have not been efficiently incurred and that full allowance would not meet the purpose of the condition), and

- gives the licensee the opportunity to retain efficiency gains for at least one year if the costs turn out to be lower than the assumption made in setting the initial (or subsequent values), but
  - prevents Ofgem from clawing back amounts where the licensee has achieved a lower level of costs.
33. As such, the mechanism obviously has weaker incentive properties than those inherent in the five-year deal for the main control, but it is not equivalent to full pass-through, where the licensee would be truly indifferent to the costs.

### **Adaptation of other mechanisms**

34. Both the mechanisms proposed above can be looked on as logical developments of the underlying legal form of the existing price control regime, and particularly of special condition F (otherwise known as the ‘disapplication option’). For example, under the existing regime, a licensee can *request* that Ofgem makes allowance for unanticipated costs that arise during the currency of the price control. However, if Ofgem refuses such a request, the licensee’s only remedy is through judicial review.
35. A different weakness applies to the disapplication option. While the licensee is free, in principle, to force a disapplication of the ongoing price control, it cannot do so without giving eighteen months’ notice of termination and, most significantly, that notice may not have effect (except where Ofgem agrees otherwise) before the fifth anniversary of the effective date of the implementation of the control.
36. On this analysis, the licensee’s rights to ask that a price control be re-opened because of unanticipated costs, or to activate the disapplication machinery of the licence, are at best unhelpful and at worst unworkable as a means of dealing efficiently with issues of cost uncertainty and new obligation.
37. By contrast, the mechanisms that we propose would:
- enable the licensee to force Ofgem to review these uncertainties as information arises about the efficient costs of discharging the associated obligations, and
  - ensure that in the event of a disagreement over the level of such costs the matter is settled by the Competition Commission.
38. The other major difference is that, instead of disapplying the control, the mechanisms we propose would work by either:
- enabling licence conditions to be modified to the extent necessary to mitigate the adverse financial effects of a cost shock that was not foreseen at all when the price control was being set, or
  - replacing an uncertain number, inserted into the price control from the outset in relation to a foreseen cost category, with a more robust number.
39. This preserves the rightful position of special condition F as a last-resort provision under which the licensee can effectively trigger a price control review at five-yearly intervals and thus restrict Ofgem’s otherwise unlimited power to allow a particular price control to remain in force for the duration of the distributor’s licence.



40. With that caveat, we believe that the mechanisms that we propose are more appropriate for dealing with the uncertainties that will remain at the initial setting of the price control. They are faster, and they are also more particularised, since they seek to deal either with the adverse financial effects of unpredicted changes in the legal environment of the licensee, or with variations in single items of significant uncertainty within a licensee's cost base. They are therefore more flexible and more helpful for all concerned.

## **Summary and conclusions**

41. Distributors believe that the mechanisms set out above would:
- present a rational and equitable approach to the task of dealing with uncertainty, new obligations, and new costs within a price control framework,
  - provide an enforceable protection for distributors in the event that their financial position is affected adversely by changes in relevant law,
  - enable Ofgem to set price controls on the basis of assumed levels of costs (which may be nil) in areas of considerable uncertainty,
  - offer distributors and Ofgem the opportunity to force a reconsideration of those assumptions as uncertainty diminishes,
  - provide the protection (for distributors and also for customers) of references to the Competition Commission in the event of dispute, and
  - maintain as much as possible of the incentive properties of price cap regulation in those areas where distributors can influence the level of cost but which are nevertheless subject to considerable uncertainty when the price cap is set.
42. The case for such mechanisms should be seen in the context of the introduction of special administration provisions under the Energy Act 2004 for insolvent monopoly network operators in gas and electricity. There is clearly a danger that the future availability of special administration as a safeguard against a disastrous breakdown of energy supply may increase the perception of regulatory risk attached to distributors, and so increase the cost of capital for the industry.
43. In these circumstances, a decision by Ofgem to strengthen the existing protections for distributor finances, through the introduction of robust uncertainty mechanisms into the distribution licences, would strongly signal that special administration regimes are likely to be unnecessary except in the most extreme cases.

*draft licence conditions  
are attached*

**Attachments 1 and 2:  
illustrative draft  
licence conditions**

## **Attachment 1**

### **Standard Condition XX. Relevant Change of Law**

1. This condition applies where a change of law materially and adversely affects or may affect the financial position of the licensee and provides in such circumstances for the licensee to be placed in the same financial position as it was before that change of law.
2. Where the licensee considers that any relevant change of law has had, or is likely to have, a material and adverse effect on its financial position, it may apply to the Authority for a determination in accordance with paragraph 4.
3. An application under paragraph 2 must include details of the relevant change of law and of the actual or likely effect of that change on the financial position of the licensee.
4. On receipt of an application under paragraph 2, and of such further information as it may reasonably request from the licensee in relation to that application, the Authority must determine:
  - (a) whether there has been a relevant change of law; and, if so,
  - (b) whether the financial position of the licensee has been or is likely to be materially and adversely affected by that.
5. Where the Authority determines that there has been a relevant change of law which has had, or is likely to have, a material and adverse effect on the financial position of the licensee, it must:
  - (a) consider, after consulting with the licensee, what modifications to the conditions of its licence would return the licensee to, so far as is practicable, the financial position in which it would have been but for the change of law;
  - (b) propose such modifications as in the reasonable opinion of the Authority will achieve the effect of returning the licensee to that position; and
  - (c) where it obtains the requisite consent, make those modifications.
6. In considering and proposing licence modifications in accordance with paragraph 5, the Authority must have regard to:
  - (a) any costs, including consequential and financing costs, which the licensee has incurred, or is likely to incur, by virtue of the relevant change of law;
  - (b) the period over which any such costs have been, or are likely to be, incurred; and

- (c) all the other circumstances of the case, including the extent to which the material and adverse effect identified under paragraph 5 could have been, or could be, mitigated by prudent management action on the part of the licensee.
- 7. For the purposes of this condition, ‘relevant change of law’ means the application to the licensee of any new or amended legal provision, in so far as that provision relates to and affects or may affect the management or operation of the licensee in the course of any of its distribution business activities.
- 8. For the purpose of paragraph 7, a judgement of a competent court or tribunal is a ‘new legal provision’ where it contains an interpretation of law which is different from that which had effect, or which was taken by the Authority or the Secretary of State to have effect, before the time of the judgement.
- 9. In this condition:
  - (a) ‘competent authority’ means the Authority, the Secretary of State, or any local or national agency, authority, department, inspectorate, minister, ministry, official, or public or statutory person (whether autonomous or not) of, or of the government of, the United Kingdom, Scotland, Wales, or the European Union;
  - (b) ‘financial position’ means (in particular, but without limitation) the financial status or performance of the licensee as measured by any one or more of the following indicators:
    - (i) earnings per share
    - (ii) dividend per share
    - (iii) dividend cover
    - (iv) interest cover
    - (v) operating profit
    - (vi) return on capital employed
    - (vii) net cashflow, and
    - (viii) debt:equity ratioand
  - (c) ‘legal provision’ means:
    - (i) an enactment of the United Kingdom Parliament, the Scottish Parliament, the Welsh Assembly, the Council of the European Union, or of any competent authority;

- (ii) a regulation of the Council or the Commission of the European Union, or a decision of the Commission of the European Union which is binding on the licensee;
- (iii) a judgement made by a court or tribunal of competent jurisdiction, and in respect of which the period for appealing against that judgement has expired, which contains an interpretation of law in relation to a legal provision of a type referred to at sub-paragraph (i) or (ii) above;
- (iv) a direction or requirement of a competent authority which is binding on the licensee, including any direction or requirement made under a condition of the licence by the Authority or the Secretary of State; or
- (v) a modification of any condition of the licence made by the Authority or the Secretary of State,

except for any such provision which relates to value added tax.

**10.** For the avoidance of doubt, an application under paragraph 2 may relate to more than one relevant change of law, and, where this is the case:

- (a) the reference in that paragraph to a material and adverse effect is to be read as a reference to the cumulative effect of such changes taken one with another; and
- (b) the functions of the Authority under this condition are to be exercised accordingly.

## Attachment 2

(a) **Amend paragraph 1 of Special Condition B to read as follows:**

**Basic Formula**

1. Without prejudice to Special Condition E (Allowance in respect of security costs), the licensee shall in setting its charges for the provision of distribution services use its best endeavours to ensure that in any relevant year the average charge per unit distributed does not exceed the maximum average charge per unit distributed calculated in accordance with the following formula:

$$M_{dt} = P_{dt} + PN_{dt} + PUN_{dt} - PM_{dt} - K_{dt}$$

(b) **Insert at the end of paragraph 4 of Special Condition B a new paragraph 4A to read as follows:**

- 4A. For the purposes of paragraph 1,  $PUN_{dt}$  is derived from the following formula:

$$PUN_{dt} = \frac{PUNC_{dt}}{D_t}$$

where:

$PUNC_{dt}$  means the sum of the qualifying amounts (whether positive or negative) derived from the application of Special Conditions B1, B2, B3, B4 [etc].

(c) **Insert new Special Condition B1 to read as follows:**

*Special Condition B1: Recovery of lane rental costs*

1. The purpose of this Condition B1 is to enable the licensee to recover the efficient costs of complying with its obligations under any regulations made under section 74A of the New Roads and Street Works Act 1991 ('the purpose').
2. Subject to the following paragraphs of this Condition B1, for the purposes of calculating  $PUNC_{dt}$  under paragraph 4A of Special Condition B, the qualifying amount arising under this Condition B1 shall be, in respect of the relevant year specified in the first column below, the amount set against that year in the second column below:

<b>For the relevant year commencing on</b>	<b>Qualifying amount (£m)</b>
1 April 2005	0
1 April 2006	3.5
1 April 2007	7
1 April 2008	7
1 April 2009	7

For relevant years commencing on or after 1 April 2010, the qualifying amount shall be £7m.

3. If, in respect of any relevant year, the licensee has reason to suppose that its efficiently incurred costs are, or are likely to be, materially higher than the qualifying amount specified in paragraph 2, the licensee may, by notice to the Authority, specify a revised qualifying amount which, in the licensee's opinion, more accurately represents the efficient costs incurred, or to be incurred, in that relevant year by the licensee in complying with the obligations referred to in paragraph 1.
4. Only one notice may be served under paragraph 3 in respect of any relevant year and such a notice must set out the basis on which the licensee has calculated the revised qualifying amount.
5. A notice under paragraph 3 may be served, in respect of the relevant year to which it applies, at any time prior to the commencement of that year but no later than three months after the end of that year.
6. Unless the Authority serves a counter-notice on the licensee in accordance with paragraph 7 below, the revised qualifying amount in respect of any relevant year notified under paragraph 3 above shall replace the amount shown in respect of that relevant year in paragraph 2.
7. Where the Authority considers that the information provided with the notice served under paragraph 3 does not demonstrate that the purpose will be better served by revising a qualifying amount set out in paragraph 2 in accordance with the terms of the notice, the Authority may serve a counter-notice on the licensee.
8. That counter-notice is not effective unless it is served by the Authority as soon as is reasonably practicable and, in any case, within three months of the receipt by the Authority of a notice under paragraph 3.

9. If the Authority has served a counter-notice in accordance with paragraph 8, the revision to the qualifying amount proposed in the notice served under paragraph 3 shall have no effect for the time being.
10. Where the Authority considers that any qualifying amount specified in paragraph 2 is such that it is not likely to serve the purpose, the Authority may, by notice to the licensee, propose an alternative qualifying amount.
11. That notice is not effective unless it is accompanied by a statement from the Authority of its reasons for concluding that the purpose will be better served by varying the qualifying amount in accordance with the terms of the notice.
12. If on receipt of a notice under paragraph 10 the licensee does not serve a counter-notice under paragraph 13 as soon as is reasonably practicable and, in any case, within three months of such receipt, the alternative qualifying amount in respect of any relevant year set out in the notice given under paragraph 10 shall be substituted for the corresponding qualifying amount set out in paragraph 2, save that no change shall be effective with respect to any relevant year that has passed or has already commenced.
13. On receipt of a notice under paragraph 10, the licensee may serve a licensee's counter-notice on the Authority, in which event the variation to any qualifying amount set out in the notice given by the Authority shall have no effect.
14. That counter-notice must be accompanied by a statement of the reasons why the licensee does not consider that the purpose will be better served by the implementation of the alternative qualifying amount set out in the notice given by the Authority under paragraph 10.
15. If within three months from the serving of a counter-notice by the Authority under paragraph 7 the licensee and the Authority have not agreed:
  - (a) a variation to any disputed qualifying amount set out in paragraph 2, or
  - (b) that a disputed qualifying amount set out in paragraph 2 should remain unchanged,the provisions of paragraph 16 or 17 (as the case may be) shall apply.
16. Where the circumstances described in paragraph 15 apply and the Authority has not referred the operation of this Condition B1 to the Competition Commission under section 12(1) of the Act within the period referred to in that paragraph, the qualifying amount in respect of any relevant year shall be the amount specified in the notice given by the licensee under paragraph 3.
17. Where the circumstances described in paragraph 15 apply and the Authority has referred the operation of this Condition B1 to the Competition Commission under section 12(1) of the Act within the period referred to in that paragraph, the qualifying amount shall remain as set out in paragraph 2 until such time as the



Authority gives effect to the findings of the Competition Commission following such a reference.

- 18.** If within three months from the serving of a licensee's counter-notice under paragraph 13 the licensee and the Authority have not agreed:
  - (a) a variation to any disputed qualifying amount set out in paragraph 2, or
  - (b) that a disputed qualifying amount set out in paragraph 2 should remain unchanged,

the provisions of paragraph 19 shall apply.

- 19.** Where the circumstances described in paragraph 18 apply, the qualifying amount shall remain as set out in paragraph 2 until such time as the licensee and the Authority agree a different qualifying amount or the Authority gives effect to the findings of the Competition Commission following a reference by the Authority of the operation of this Condition B1 to the Commission under section 12(1) of the Act within the period referred to in paragraph 18.