




**CHANGES TO LICENCE FEE  
ARRANGEMENTS FOR FUNDING  
CODE MODIFICATION APPEALS  
AND LICENCE MODIFICATION  
REFERENCES**

A joint Ofgem/DTI Consultation

4TH OCTOBER 2004



The DTI drives our ambition of 'prosperity for all' by working to create the best environment for business success in the UK.

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We champion UK business at home and abroad. We invest heavily in world-class science and technology. We protect the rights of working people and consumers. And we stand up for fair and open markets in the UK, Europe and the world.

**Changes to licence fee arrangements for funding code modification appeals and licence modification references.**

The Energy Act 2004 provides for a right of appeal to the Competition Commission against Ofgem decisions on modifications to certain gas and electricity industry codes. It also gives the Competition Commission the power to direct how the costs of any licence references should be recovered. As part of these provisions the Act gives the Secretary of State the power to make licence modifications to allow the recovery of the costs of appeals and licence references through licence fees.

This document consults on proposed licence changes that will be required to implement the funding mechanism for this right of appeal. The aim of these changes is to ensure that the Competition Commission and Ofgem can effectively recover any costs arising from this right of appeal through licence fees.

These proposals will affect the holders of licences for electricity generation, electricity transmission, electricity distribution, electricity supply, gas shipping, gas transportation and gas supply.

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**Respond by:** 27th December 2004  
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## 1. Executive Summary

The Gas and Electricity Markets are governed by a number of industry codes. In most cases, proposed amendments to these codes are subject to decision by the Gas and Electricity Market Authority (Ofgem). The Energy Act 2004 introduces a right of appeal to the Competition Commission against decisions by Ofgem on modifications to certain industry codes. The introduction of this appeals mechanism is designed to increase accountability for code modification decisions in a proportionate manner. It is intended that this appeals mechanism will be in place for April 2005. Which codes will be subject to appeal, and the circumstances under which appeals will be allowed, are currently the subject of a separate DTI consultation, details of which can be found at:

[www.dti.gov.uk/energy/consultations/](http://www.dti.gov.uk/energy/consultations/)

The Energy Act gives the Competition Commission the power to allocate the costs it incurs in connection with the appeal. Where the appeal is allowed, the order must require the costs to be paid by Ofgem. Where the appeal is dismissed, the order must require those costs to be paid by the appellant (if there is more than one appellant, the Competition Commission has the discretion to allocate division of the costs between the appellants).

The Competition Commission also has the discretion to require a party to the appeal to make a payment to another party in connection with the costs incurred by that other party in connection with the appeal.

In the case of licence modification references the Energy Act gives the Commission the ability to issue a direction to Ofgem setting out how the costs of that reference should be recovered.

Licence modifications under Section 177 of the Energy Act 2004 will also represent the final stage of implementation for the policy of changing the existing arrangements for licence modification references (i.e. references to the Competition Commission under Section 24 of the gas Act 1986 or section 12 of the Electricity Act 1989). The Energy Act gives the Competition Commission, rather than Ofgem (as at present), the discretion to allocate the Competition Commission's costs in licence modification references. The licence modifications will allow Ofgem to recover these costs from licencees as directed by the Competition Commission.

The Energy Act grants the Secretary of State powers to make licence modifications he considers appropriate for the functioning of this appeals mechanism and for the licence modification arrangements. This consultation is concerned with the following key proposals:

- That licence modifications are not necessary to fund the appeals mechanism. Instead, where Ofgem is required to pay a proportion of costs in cases where an appeal is upheld, these will be treated as part of Ofgem's normal running costs, which are funded by licence holders. Ofgem will not have any discretion in how these costs are allocated
- That in order to enable Ofgem to comply with a direction by the Competition Commission as to the allocation of its costs in a licence modification reference (and to treat the costs on the same basis as normal running costs in the absence of a direction), all licences should be changed to allow the relevant proportion of the

costs on *any* licence reference to be recovered as the Competition Commission may direct. At present the terms of the licences are such that costs can only be recovered from holders of the same type of licence as that which was the subject of the reference.

## 2. How to respond

- 2.1 The DTI and Ofgem invite views on any aspects of this document and the draft licence modifications, and in particular on parts where views have been specifically requested.
- 2.2 When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of the members were assembled. A written response can be submitted by letter, fax or e-mail to:

**David Curran**

Department of Trade and Industry  
1 Victoria Street  
London SW1H 0ET  
E-mail: [david.curran@dti.gsi.gov.uk](mailto:david.curran@dti.gsi.gov.uk)  
Fax: 020 7215 2867  
Tel: 020 7215 2779

He will also be able to arrange for copies of the consultation document to be provided in other formats if necessary.

- 2.3 Questions about the policy issues raised in the document can be addressed to David Curran at DTI, or Maxine Frerk at Ofgem:

**Maxine Frerk**

Ofgem  
9 Millbank  
London SW1P 3GE  
E-mail: [Maxine.Frerik@ofgem.gov.uk](mailto:Maxine.Frerik@ofgem.gov.uk)  
Fax: 020 7901 7196  
Tel: 020 7901 7291

- 2.4 Responses to this consultation will normally be made public by DTI and Ofgem unless respondents request that they should remain confidential. Respondents should clearly mark any part of their response (or the entire response) which is to remain confidential. If this is the case, where possible, any confidential material should be confined to appendices. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has been requested.

2.5 The Cabinet Office Consultation Code of Practice Criteria, and a link to the complete Cabinet Office Code of Practice on Consultations, can be found at Annex B. If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

**Nick van Benschoten**

Consultation Co-ordinator

Department of Trade and Industry

Room 723

1 Victoria Street

London SW1H 0ET

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Tel: 020 7215 6206



### 3. Consultation Questions

3.1 Views are sought on the following questions:

Q.1 Our first objective is for Ofgem to be able to recover costs which the Competition Commission has charged it in association with code modification appeals. Under this proposal it is assumed that Ofgem will be able to recover such costs as part of its running costs, and that licence modifications will therefore not be necessary in order to achieve this objective.

- i. Do you have any comments to make on the validity of this assumption?
- ii. In particular, do you think that licence modifications are necessary to enable Ofgem to recover its costs effectively?

Q.2 The second objective of the licence modifications as drafted is to ensure that Ofgem is able to recover costs incurred in association with licence modification references from licence holders in a transparent manner and in line with the Competition Commission's directions.

- i. Do you consider that the amendments as drafted satisfy this objective?
- ii. Are there any particular areas of the amendments as drafted that could give rise to unintended or undesirable consequences?
- iii. Do you think that any of the licence amendments as drafted give rise to an undesirable level of ambiguity?
- iv. Do you think that any of the licence amendments as drafted give rise to an undesirable level of inflexibility?

Q.3 Views on any other aspect of the proposals contained in this consultation are also welcomed.

3.2 A Regulatory Impact Assessment (RIA) for the proposed appeals mechanism was included in the RIA for the Energy Act. An amended RIA for the appeals mechanism is included in Annex D of this document.

## **4 The proposals**

- 4.1 The Energy Act 2004 introduces a right of appeal to the Competition Commission against certain Ofgem decisions on modifications to certain Gas and Electricity industry codes. The Act requires the Competition Commission to make an order requiring payment of the costs it incurred in connection with the appeal.
- 4.2 Where the appeal is allowed, the order must require the costs to be paid by Ofgem. Where the appeal is dismissed, the order must require those costs to be paid by the appellant. In cases where there is more than one appellant, the Competition Commission has the discretion to allocate division of the costs between the appellants, including the discretion to direct that the costs be allocated to only one or more of the appellants.
- 4.3 The Competition Commission also has the discretion to require a party to the appeal to make a payment to another party in connection with the costs incurred by that other party in connection with the appeal.
- 4.4 The appeal mechanism is designed to increase accountability for code modification decisions in a proportionate manner
- 4.5 The Energy Act grants the Secretary of State powers to make licence modifications he considers appropriate in connection with the functioning of this appeals mechanism. Licence modifications under section 177 of the Energy Act 2004 for funding appeals would constitute the third and final part of the implementation of the appeals mechanism for code modification decisions by Ofgem, which we intend to have in place for April 2005. The first and main part of the implementation was Chapter 4 of Part 3 of the Energy Act 2004. The second part of implementation will be the orders necessary for the appeals mechanism to be up and running in the manner intended. These are the subject of a separate DTI consultation, details of which can be found at:

[www.dti.gov.uk/energy/consultations](http://www.dti.gov.uk/energy/consultations)

- 4.6 Licence modifications under Section 177 of the Energy Act 2004 will also represent the final stage of implementation for the policy of changing the existing arrangements for licence modification references (i.e. references to the Competition Commission under Section 24 of the gas Act 1986 or section 12 of the Electricity Act 1989). The Energy Act gives the Competition Commission, rather than Ofgem (as at present), the discretion to allocate the Competition Commission's costs in licence modification references. The licence modifications will allow Ofgem to recover these costs from licencees as directed by the Competition Commission.

### **Code Modification Appeals**

- 4.7 For code modification appeals Ofgem will be required to pay the Competition Commission's costs in cases where an appeal is upheld and may also be required to pay a proportion of the appellant's costs. The intention is that these should then be treated as a part of Ofgem's normal running costs and that Ofgem should not have any discretion in how they are allocated.
- 4.8 Given that Ofgem will be bound by the terms of the order to pay the Competition Commission's costs where an appeal is upheld, these costs will form part of

Ofgem's running costs and will have to be met from Ofgem's budget. The distribution, transmission and transportation licences already contain conditions enabling Ofgem to recover costs incurred by the Authority through the licence fees.

### **Licence Modification References**

- 4.9 The Energy Act gives the Competition Commission the power to direct Ofgem as to how the costs of licence modification references should be recovered. At present the terms of the licences are such that costs can only be recovered from holders of the same type of licence as that which was the subject of the reference.
- 4.10 In future the intention is that where the Competition Commission does not give directions as to how the costs should be recovered, they should be apportioned on the same basis as Ofgem's normal running costs. The Competition Commission may, however, direct that the costs be recovered in other ways – for example from the company which is the subject of the reference or across several types of licence if there are points of general principle that have been clarified.
- 4.11 In order to enable Ofgem to comply with such a direction, and to treat the costs on the same basis as normal running costs in the absence of a direction, changes are needed to all licences to allow the relevant proportion of the costs of *any* licence reference to be recovered.
- 4.12 Ofgem also intends to consult on an update to its licence recovery principles document which would make clear that the “relevant proportion” for the costs of a Competition Commission reference would be the proportion directed by the Competition Commission where they issue a direction and that where they do not the costs would be apportioned on the same basis as Ofgem's running costs.
- 4.13 The Draft licence modifications are set out in **Annex A**.

### **Background**

- 4.14 Sections 173 to 176 of the Energy Act 2004 provide for a right of appeal to the Competition Commission in relation to decisions by Ofgem on certain code modifications. Schedule 22 sets out details of the procedure for appeals including the arrangements for dealing with the costs of the appeal.

### Appeals

- 4.15 Under Schedule 22(13) of the Energy Act 2004, where the Competition Commission determines an appeal, it must make an order requiring the payment to the Commission of the costs it has incurred in dealing with the appeal. Where the appeal is allowed, the order must require those costs to be paid by Ofgem. Where the appeal is dismissed the order must require those costs to be paid by the appellant(s). If there is more than one appellant the order may specify that only one or more of them are liable and must specify the proportions. The Commission may also make an order requiring a party to the appeal to pay any other party's costs. A person who is required by an order to pay a sum to another person must comply with the order within 5 days.

- 4.16 Section 177 of the Energy Act gives the power to make licence modifications to implement these provisions but we do not propose to use the power for the reasons given at paragraph 4.8 above.

#### Licence modification references

- 4.17 Section 177(3) of the Energy Act 2004 gives the Competition Commission the power to give directions to Ofgem about the manner in which the Competition Commission's costs in connection with a licence references are to be recovered.
- 4.18 Before making such modifications the Secretary of State must consult the holders of the licences and such other persons as he considers appropriate. This consultation meets that obligation.
- 4.19 Currently, all licences contain a standard condition relating to licence fees. In the case of generation, supply and shipper licences this deals only with the recovery of Competition Commission costs. In the case of distribution, transmission and transportation licences it also covers recovery of the costs incurred by the Authority for the year in question (as well as costs incurred by eg Energywatch).
- 4.20 Specifically, paragraph 2 (a) of standard licence condition (SLC) 4 (Payments by the Licencee to the Authority) of generation licences provides that the licence fee payable by a generator will include "an amount which is the relevant proportion of the estimated costs incurred by the Competition Commission in the previous relevant year in connection with any references made to it with respect to the licence or any other electricity generation licence." Each type of standard licence includes a similar provision. The effect of the licence condition is that the Authority can currently only recover the costs of a licence modification reference from licencees holding licences of the same type as that which was the subject of the reference.
- 4.21 The phrase "relevant proportion" used in relation to both Ofgem's costs and the Competition Commission costs is defined as meaning "the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority for the purposes of this condition generally and notified to the licensee." A document setting out these principles, other than in relation to CC costs, was issued in February 2002 ("Licence fee cost recovery principles"). This document is available online at:

[www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3701\\_licfeescostrecfeb2002.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3701_licfeescostrecfeb2002.pdf)

Under the terms of this document, all of Ofgem's running costs are currently recovered from network operators (gas transporters and electricity transmission and distribution operators), apportioned across gas and electricity operators by number of customers connected and not by reference to whether a particular cost related to gas or electricity.

## Annex A: The draft licence modifications

### ELECTRICITY DISTRIBUTION

#### Condition 3. Payments by Licensee to the Authority

1. The licensee shall, at the times stated, pay to the ~~A~~ authority such amounts as are determined by or under this condition.
  
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  - (b) an amount which is the relevant proportion of the estimated costs of the Consumer Council during the year in question;
  - (c) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other ~~electricity distribution~~ licence;
  - (d) an amount which is the relevant proportion of the Secretary of State's costs during the year in question;
  - (e) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority or, in the case of sub-paragraph 2(d), the Secretary of State in the previous relevant year under sub-paragraphs 2(a), (b), (c), and (d); and
    - (bb) the actual costs of the Authority, the Consumer Council, the Competition Commission (in connection with that reference and the Secretary of State for the previous relevant year or, in the case of the

Competition Commission, for the relevant year prior to the previous relevant year; and

(f) in respect of the relevant year ending on 31 March 2002, an amount which is the relevant proportion of the actual unrecovered costs of the Director General of Electricity Supply and the Relevant Consumers' Committees.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with:

(a) the first instalment being due for payment by 30 June in each year; and

(b) the second instalment being due for payment by 31 January in each year

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).

4. Where the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.

5. In relation to any data or information specified by the Authority in a direction given for the purposes of this condition generally, the licensee shall submit a certificate to the Authority, approved by a resolution of the board of directors of the licensee and signed by a director of the licensee pursuant to that resolution. Such certificate shall be submitted to the Authority each year on the date specified by the Authority. Each certificate shall be in the following form –

“In the opinion of the directors of [the licensee], all data and information provided to the Authority on [date provided to the Authority] for the purposes of enabling the

Authority to calculate the licence fee payable by [the licensee] pursuant to standard condition 3 (Payments by the Licensee to the Authority) is accurate.”

6. In this condition:

“estimated costs” means costs estimated by the Authority as likely to be:

- (a) the costs of the Authority and the Consumer Council; and
- (b) the costs incurred by the Competition Commission in connection with references to it.

“relevant proportion” means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority for the purposes of this condition generally and notified to the licensee and with any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004.

“relevant year” means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.

“Secretary of State’s costs” means costs estimated by the Secretary of State as likely to be his costs in relation to:

- (a) the establishment of the Authority and the Consumer Council; and
- (b) Schedule 7 to the Utilities Act 2000.

5. In sub-paragraph 2(f) of this condition:

“Director General of Electricity Supply” means the office previously established under section 1 of the Act;

“Relevant Consumers’ Committees” means the committees previously appointed by the Director General of Electricity Supply under section 2 of that Act

## ELECTRICITY GENERATION

### Condition 4. Payments by the Licensee to the Authority

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs incurred by the Competition Commission in the previous relevant year in connection with any reference made to it with respect to the licence or any other **electricity generation** licence; and
  - (b) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority in the previous relevant year under sub-paragraph 2(a); and
    - (bb) the actual costs of the Competition Commission (in connection with that reference) for the relevant year prior to the previous relevant year.
3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in one instalment being due for payment by 31 October in each year, provided that if the Authority has not given notice of the amount of the instalment at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).
4. When the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.
5. In this condition:



|                       |   |
|-----------------------|---|
| “estimated costs”     | means costs estimated by the Authority as likely to be the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission.  |
| “relevant proportion” | means the proportion of the costs attributable to the licensee in accordance with <u>any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004 and otherwise with</u> principles determined by the <u>A</u> authority for the purposes of this condition generally and notified to the licensee. |
| “relevant year”       | means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.  |

## ELECTRICITY SUPPLY

### Condition 4. Payments by the Licensee to the Authority

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs incurred by the Competition Commission in the previous relevant year in connection with any reference made to it with respect to the licence or any other ~~electricity~~ **supply** licence; and
  - (b) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority in the previous relevant year under sub-paragraph 2(a); and
    - (bb) the actual costs of the Competition Commission (in connection with that reference) for the relevant year prior to the previous relevant year.
3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in one instalment being due for payment by 31 October in each year, provided that if the Authority has not given notice of the amount of the instalment at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).
4. When the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.
5. In this condition:

|                       |  |
|-----------------------|--|
| “estimated costs”     | means costs estimated by the Authority as likely to be the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission.   |
| “relevant proportion” | means the proportion of the costs attributable to the licensee in accordance with <u>any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004 and otherwise with</u> principles determined by the Authority for the purposes of this condition generally and notified to the licensee. |
| “relevant year”       | means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.   |

## ELECTRICITY TRANSMISSION

### Condition 4. Payments by the Licensee to the Authority

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  - (b) an amount which is the relevant proportion of the estimated costs of the Consumer Council during the year in question;
  - (c) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other **electricity transmission** licence;
  - (d) an amount which is the relevant proportion of the Secretary of State's costs during the year in question;
  - (e) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority or, in the case of sub-paragraph 2(d), the Secretary of State in the previous relevant year under sub-paragraphs 2(a), (b), (c), and (d); and
    - (bb) the actual costs of the Authority, the Consumer Council, the Competition Commission (in connection with that reference) and the Secretary of State for the previous relevant year or, in the case of the Competition Commission, for the relevant year prior to the previous relevant year; and

(f) in respect of the relevant year ending on 31 March 2002, an amount which is the relevant proportion of the actual unrecovered costs of the Director General of Electricity Supply and the Relevant Consumers' Committees.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with:

- (a) the first instalment being due for payment by 30 June in each year; and
- (b) the second instalment being due for payment by 31 January in each year

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the authority to the licensee (whenever notice is given).

4. Where the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.

5. In relation to any data or information specified by the Authority in a direction given for the purposes of this condition generally, the licensee shall submit a certificate to the Authority, approved by a resolution of the board of directors of the licensee and signed by a director of the licensee pursuant to that resolution. Such certificate shall be submitted to the Authority each year on the date specified by the Authority. Each certificate shall be in the following form –

“In the opinion of the directors of [the licensee], all data and information provided to the Authority on [date provided to the Authority] for the purposes of enabling the Authority to calculate the licence fee payable by [the licensee] pursuant to standard condition 4 (Payments by the Licensee to the Authority) is accurate.”

6. In this condition:

|   |  |
|---|--|
| “estimated costs”                           | means costs estimated by the Authority as likely to be: <ul style="list-style-type: none"> <li>(a) the costs of the Authority and the Consumer Council; and</li> <li>(b) the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission.</li> </ul>      |
| “relevant proportion”                       | means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority for the purposes of this condition generally and notified to the licensee <u>and with any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004.</u> |
| “relevant year”                             | means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.   |
| “Secretary of State’s costs”                | means costs estimated by the Secretary of State as likely to be his costs in relation to: <ul style="list-style-type: none"> <li>(a) the establishment of the Authority and the Consumer Council; and</li> <li>(b) Schedule 7 to the Utilities Act 2000.</li> </ul>  |
| 5. In sub-paragraph 2(f) of this condition: |  |
| “Director General of Supply”                | means the office previously established under Electricity section 1 of the Act;  |
| “Relevant Consumers’ Committees”            | means the committees previously appointed by the Director General of Electricity Supply under section 2 of that Act  |

## **GAS SUPPLIER**

### **Condition 4. Payments by the Licensee to the Authority**

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs incurred by the Competition Commission in the previous relevant year in connection with any reference made to it with respect to the licence or any other ~~gas supplier~~ licence; and
  - (b) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority in the previous relevant year under sub-paragraph 2(a); and
    - (bb) the actual costs of the Competition Commission (in connection with that reference) for the relevant year prior to the previous relevant year.
3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in one instalment being due for payment by 31 October in each year, provided that if the Authority has not given notice of the amount of the instalment at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).
4. When the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.
5. In this condition:

|                       |   |
|-----------------------|---|
| “estimated costs”     | means costs estimated by the Authority as likely to be the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission.  |
| “relevant proportion” | means the proportion of the costs attributable to the licensee in accordance with <u>any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004 and otherwise</u> principles determined by the Authority for the purposes of this condition generally and notified to the licensee. |
| “relevant year”       | means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.  |



## **GAS SHIPPER**

### **Condition 2. Payments by the Licensee to the Authority**

1. The licensee shall, at the times stated, pay to the Authority such amounts as are determined by or under this condition.
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs incurred by the Competition Commission in the previous relevant year in connection with any reference made to it with respect to the licence or any other ~~gas shipper~~ licence; and
  - (b) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority in the previous relevant year under sub-paragraph 2(a); and
    - (bb) the actual costs of the Competition Commission (in connection with that reference) for the relevant year prior to the previous relevant year.
3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in one instalment being due for payment by 31 October in each year, provided that if the Authority has not given notice of the amount of the instalment at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).
4. When the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.
5. In this condition:

|                       |  |
|-----------------------|--|
| “estimated costs”     | means costs estimated by the Authority as likely to be the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission.   |
| “relevant proportion” | means the proportion of the costs attributable to the licensee in accordance with <u>any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004</u> principles determined by the <del>A</del> authority for the purposes of this condition generally and notified to the licensee. |
| “relevant year”       | means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.   |

## **GAS TRANSPORTER**

### **Condition 3. Payments by the Licensee to the Authority**

This condition is currently subject to a separate consultation which is being conducted jointly by the DTI and Ofgem. The proposed text will be issued shortly.

1. The licensee shall, at the times stated, pay to the authority such amounts as are determined by or under this condition.
  
2. In respect of each relevant year at the beginning of which the licensee holds this licence, the licensee shall pay to the Authority the aggregate of:
  - (a) an amount which is the relevant proportion of the estimated costs of the Authority during the year in question;
  
  - (b) an amount which is the relevant proportion of the estimated costs of the Consumer Council during the year in question;
  
  - (c) an amount which is the relevant proportion of the estimated costs incurred in the previous relevant year by the Competition Commission in connection with references made to it with respect to the licence or any other ~~gas transporter~~ licence;
  
  - (d) an amount which is the relevant proportion of the Secretary of State's costs during the year in question;
  
  - (e) an amount which is the relevant proportion of the difference (being a positive or negative amount), if any, between:
    - (aa) any costs estimated by the Authority or, in the case of sub-paragraph 2(d), the Secretary of State in the previous relevant year under sub-paragraphs 2(a), (b), (c), and (d); and
    - (bb) the actual costs of the Authority, the Consumer Council, the Competition Commission (in connection with that reference) and the Secretary of State for the previous relevant year or, in the case of the

Competition Commission, for the relevant year prior to the previous relevant year; and

- (f) in respect of the relevant year ending on 31 March 2002, an amount which is the relevant proportion of the actual unrecovered costs of the Director General of Electricity Supply and the Relevant Consumers' Committees.

3. The amounts determined in accordance with paragraph 2 shall be paid by the licensee to the Authority in two instalments, with:

- (a) the first instalment being due for payment by 30 June in each year; and
- (b) the second instalment being due for payment by 31 January in each year

provided that, in each case, if the Authority has not given notice of the amount of the instalment due at least 30 days before the payment date stated above, the licensee shall pay the amount due within 30 days from the actual giving of notice by the Authority to the licensee (whenever notice is given).

4. Where the licensee fails to pay the amount determined in accordance with paragraph 2 within 30 days of the due date set out in paragraph 3, it shall pay simple interest on the amount at the rate which is from time to time equivalent to the base rate of NatWest Bank plc or, if there is no such base rate, such base rate as the Authority may designate for the purposes hereof.

5. In relation to any data or information specified by the Authority in a direction given for the purposes of this condition generally, the licensee shall submit a certificate to the Authority, approved by a resolution of the board of directors of the licensee and signed by a director of the licensee pursuant to that resolution. Such certificate shall be submitted to the Authority each year on the date specified by the Authority. Each certificate shall be in the following form –

“In the opinion of the directors of [the licensee], all data and information provided to the Authority on [date provided to the Authority] for the purposes of enabling the Authority to calculate the licence fee payable by [the licensee] pursuant to standard condition 3 (Payments by the Licensee to the Authority) is accurate.”

6. In this condition:

“estimated costs”

means costs estimated by the Authority as likely to be:

- (a) the costs of the Authority and the Consumer Council; and
- (b) the costs incurred by the Competition Commission, such estimate having regard to the views of the Competition Commission in connection with references to it.

“relevant proportion”

means the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority for the purposes of this condition generally and notified to the licensee and with any direction issued by the Competition Commission under section 177(3) of the Energy Act 2004.

“relevant year”

means a year beginning on 1 April of each calendar year and ending on 31 March of the following calendar year.

“Secretary of State’s costs”

means costs estimated by the Secretary of State as likely to be his costs in relation to:

- (a) the establishment of the Authority and the Consumer Council; and
- (b) Schedule 7 to the Utilities Act 2000.

7. In sub-paragraph 2(f) of this condition:

“Director General of Gas Supply”

means the office previously established under section 1 of the Act;

“Gas Consumers’ Council”

means the body previously established by the Director General of Gas Supply under section 2 of that Act

## **Annex B: Cabinet Office Code of Practice on Consultations**

### **The Consultation Code of Practice Criteria**

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site:

<http://www.cabinet-office.gov.uk/servicefirst/index/consultation.htm>

### **Comments or complaints**

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to Nick van Benschoten, DTI Consultation Co-ordinator, Room 723, 1 Victoria Street, London SW1H 0ET, or telephone him on 020 7215 6206, or email to: [nick.vanbenschoten@dti.gsi.gov.uk](mailto:nick.vanbenschoten@dti.gsi.gov.uk)

### **Annex C: List of those being consulted**

Holders of licences under the Gas Act and Electricity Act, which are being modified.

Energywatch

Responses from other parties are welcome

### Accountability of the Gas and Electricity Code Modification Process

#### 1 Purpose and Effect of the Intended Measure

##### Objective

- 1.1 The Government's aim is to strike a proportionate balance between increasing accountability and avoiding unnecessary regulatory uncertainty with its associated costs. This will be done by an order implementing part of the statutory appeals mechanism in relation to decisions made by the Gas and Electricity Markets Authority (GEMA).<sup>1</sup>

##### Background

- 1.2 Many of the detailed rules that govern activities in the gas and electricity markets are set out in various industry codes. The three most commercially significant codes are:
- The Transco Network Code – intended to ensure that gas transportation services in Great Britain are non-discriminatory and consistent with system security;
  - The Balancing and Settlement Code (BSC) – principally provides mechanisms for the settlement of wholesale electricity trading and for balancing the high voltage transmission network in England and Wales (shortly to be extended to Scotland); and
  - The Connection and Use of System Code (CUSC) – sets out the contractual arrangements for using the electricity transmission network in England and Wales (also to be extended to Scotland).
- 1.3 The codes are designed to allow ongoing amendment and modifications can currently be proposed by any party to the code. Such proposals are then considered in accordance with the modification procedure set out in the code. In the case of the BSC, the code panel – composed of industry representatives, energywatch and independent members – makes a recommendation to Ofgem. In the case of the CUSC and Transco Network code, NGC or Transco respectively submit a report on the proposed modification to Ofgem, which in the case of the CUSC may include individual recommendations of panel members.<sup>2</sup>
- 1.4 Once these procedures have been completed, Ofgem makes the final decision whether the proposed modification should be accepted or rejected. The regulator is not bound to accept the BSC Panel's recommendation or to make a decision in accordance with the majority opinion of CUSC panel members or respondents to consultations on the proposed modifications, although it must issue a decision letter explaining its reasons. Market participants' only means of redress at present is to initiate a judicial review of Ofgem's decision, which could be costly and time consuming.
- 1.5 On 20 April 2003 the DTI issued a consultation document entitled, "Strengthening the Transparency and Accountability of the Gas and Electricity Industry Code

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<sup>1</sup> Also known as Ofgem. The terms are used interchangeably in the RIA.

<sup>2</sup> Changes are being proposed to the code governance arrangements in the gas sector, which involve a code panel making recommendations to the Authority.

Modification Process”,<sup>3</sup> which requested views as to whether a formal appeals mechanism should be established through which interested parties could contest certain Ofgem decisions. The consultation was the fulfilment of an undertaking made in section 9.16 of the February 2003 Energy White Paper<sup>4</sup> that committed the Government to “work with Ofgem to strengthen the transparency and accountability of the code modification process” and “also [to] consult on a range of further measures, including whether it would be appropriate to provide for appeals against Ofgem decisions on certain code modifications.”

- 1.6 The Government’s response<sup>5</sup> to the consultation was published on 7 November 2003. In accordance with the wishes of a large majority of the respondents, the DTI concluded that an appropriately structured appeals mechanism would improve the accountability of Ofgem’s decision-making process.
- 1.7 Sections 173-177 of the Energy Act 2004 provide for the creation of a statutory right of appeal to the Competition Commission (CC). It is intended that this will take effect in April 2005 following the enactment of the necessary secondary legislation. The appeals system established by sections 173 – 177 of the Act is one which limits the right of appeal in the following ways:
- only parties that are materially affected by a particular code modification may appeal;
  - appeals that are trivial or vexatious will not be granted leave;
  - appeals with no reasonable prospect of success will not be granted leave;
  - the determination of the appeal will take the form of a review on the merits of the decisions, assessing whether Ofgem failed to have proper regard to the applicable code objectives or to the regulator’s statutory obligations, failed to give the appropriate weight to one or more of those objectives and obligations or whether the decision was based on an error of fact and/or the decision was wrong in law. It would not involve a full rehearing of the case for a code modification;
  - the requirements of the modification will continue as scheduled (i.e., the “clock” would not stop) unless a case was made out to the satisfaction of the CC that this would result in disproportionate costs;
  - the appeals process will normally be kept to 12 weeks and a maximum of 14 weeks; and
  - the judgement would confirm Ofgem’s decision, reject it or remit it back to Ofgem for further consideration taking into account certain factors.
- 1.8 The proposed Order will restrict this right of appeal to decisions (a) that do not have a material impact on the security of energy supply; and (b) where Ofgem disagrees with the recommendation or majority opinion of the relevant code panel, if there is one, or with a majority of respondents to a consultation on a proposed modification.

### **Risk assessment**

- 1.9 Responses to the DTI’s consultation revealed a widespread concern within the gas and electricity industries about the accountability of Ofgem’s decision-making process in relation to certain code modifications. Judicial Review is the only way in which Ofgem’s decisions can be overturned at present and allows only an examination of the process applied to modification, its lawfulness and to a limited

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<sup>3</sup> [www.dti.gov.uk/energy/consultations/elec\\_mod.pdf](http://www.dti.gov.uk/energy/consultations/elec_mod.pdf)

<sup>4</sup> [www.dti.gov.uk/energy/whitepaper/ourenergyfuture.pdf](http://www.dti.gov.uk/energy/whitepaper/ourenergyfuture.pdf)

<sup>5</sup> [www.dti.gov.uk/energy/consultations/govresponse.pdf](http://www.dti.gov.uk/energy/consultations/govresponse.pdf)



extent, its reasonableness. This, in the view of a number of respondents, means that the balance of the code modification process gives too much discretion to the regulator, which could give rise to an increased risk of sub-optimal decisions being taken. The introduction of an appropriate appeals process would overcome this.

## 2 Options

- 2.1 Given that Parliament has enacted legislation establishing a formal appeals mechanism for the modification process, the two options open to the Government at this stage are:
- (i) to implement the proposed limitations (agreement with panel decisions and security of supply) to the right of appeal; or
  - (ii) not to implement the proposed limitations.
- 2.2 An earlier option was considered in the partial RIA that accompanied the introduction of the Energy Act to Parliament, but it was rejected. This was the option of a non-statutory scrutiny panel that would make non-binding recommendations to Ofgem in response to “minded to” statements issued by the regulator before the publication of contentious decision letters. It was concluded that the overall net benefit from this option would not be significant on the grounds that the scrutiny panel’s powers would be very limited and so would not materially improve the accountability of Ofgem’s decision-making process.

## 3 Costs and Benefits

### Business sectors affected

- 3.1 The proposed changes would impact on every firm in the gas and electricity markets that is a party to the Transco Network Code, BSC and CUSC. The biggest firm is National Grid Transco, which is a party to all three codes.

### Benefits

- 3.2 The benefits of options (i) and (ii) are the same, although these are very difficult to estimate numerically given that they exist in the form of ensuring optimum outcomes in Ofgem’s code modification decisions. As a purely illustrative example of the sums that could be at stake in likely contested decisions, consider the case of Modification P98 (“Dual Notification of Contract Positions”) to the BSC, which was approved by Ofgem<sup>6</sup> in August 2003 despite a recommendation from the BSC Panel to reject. If – for the sake of argument and leaving aside the benefits of implementation – P98 had been successfully appealed, then the industry would have avoided significant expenditure. According to Ofgem’s decision letter, the revised implementation costs amounted to £0.75-1.3 million while the ongoing costs were in the order of £175-540k per year. These sums have a net present value (NPV) of £3.2-9.0 million assuming a 3.5% discount rate over a twenty-year period and that all the implementation costs are incurred in “year zero”.

### Costs

- 3.3 The direct costs of both options (i) and (ii) have been estimated by the CC as:

CC’s initial set-up costs<sup>7</sup> = up to £10k

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<sup>6</sup> [www.elxon.co.uk/docs/ta/modifications/modsprops/hP098/Decision\\_Letter\\_Final.pdf](http://www.elxon.co.uk/docs/ta/modifications/modsprops/hP098/Decision_Letter_Final.pdf)

<sup>7</sup> Possible costs of appointment of two new members at the CC.

CC costs per appeal = £75k

Estimates of the number of appeals CC would hear on an average basis range from five to ten per year. This is equivalent to a NPV of £5.3-10.7 million assuming a 3.5% discount rate over twenty years. In any individual year there could be a greater or lesser number of appeals. It is thought likely that a higher number of appeals may be brought when the system is first introduced. These costs exclude the applicants and Ofgem's costs, which could significantly exceed the CC's costs but are difficult to quantify. These costs would be met by the parties to the appeal as directed by the CC in accordance with the general principle that the "loser" pays the costs of an appeal. As Ofgem is funded by the industry, all costs, except where the appellant is not successful, will be met by the industry (and ultimately therefore by consumers of electricity and gas).

- 3.4 However, the direct and indirect costs of option (ii) are likely to be substantially greater. Not excluding those decisions where delay caused by an appeal could have an adverse material impact on the security of energy supply would be especially costly given that continuous gas/electricity supplies are essential inputs to virtually every modern economic activity in Britain. The relationship between the volume of energy undelivered and the level of resultant economic losses is very complex, but even a short supply interruption can have cost implications in the order of millions of pounds depending on its location.
- 3.5 By not excluding proposed modifications where the relevant code panel (or alternatively the majority of consultation respondents) agrees with Ofgem's decision, a flow of vexatious appeals could result in an attempt to frustrate the progress of certain code modifications that would disadvantage the participant even though it is generally accepted that they would benefit society as a whole. Such behaviour would increase the regulatory uncertainty of the modification process and significantly increase its costs, which would ultimately be borne by consumers in the form of higher prices than would otherwise be the case.
- 3.6 Consequently, the net benefit from option (i) should exceed that of option (ii) by a large margin.

## **4 Equity and Fairness**

- 4.1 There is no evidence that either of the options set out above would disproportionately impact on any particular social or racial group. In particular, all consumers benefit equally from the security of energy supply.

## **5 Small Firms' Impact Test**

- 5.1 None of the options impact directly on small firms because small firms are not parties to the energy industry codes. The Small Business Service have therefore confirmed that there is no requirement to carry out stage one of the Small Firms' Impact Test.

## **6 Competition Assessment**

- 6.1 Only option (ii) would impact on the degree of competition within the gas and electricity markets. This is because the regulatory uncertainty created by a broader

right of appeal would tend to raise barriers to entry in the industries and to militate against the profitability of smaller energy firms. This would reinforce the position of well-capitalised large firms, which are better able to withstand market risk.

- 6.2 The tightly defined right of appeal in option (i) should avoid any additional regulatory uncertainty.

## **7 Enforcement and Sanctions**

- 7.1 The CC is the relevant authority under both options.

## **8 Consultation**

- 8.1 The DTI commenced a public consultation on the accountability of the code modification process on 30 April 2003. The consultation ended on 20 June 2003; and the DTI's conclusions document was published on 7 November 2003. This document constitutes the public consultation on the licence changes needed to implement the funding mechanism for appeals. Details of a further DTI consultation on the draft Order designating which industry codes are subject to appeal, and which types of decisions will be excluded from appeals, can be found at:

[www.dti.gov.uk/energy/consultations](http://www.dti.gov.uk/energy/consultations)

## **9 Monitoring and Review**

- 9.1 The efficacy of the legislation will be reviewed in three years.

## **10 Summary and Recommendation**

- 10.1 Following a public consultation in 2003, the Government concluded that the introduction of an appropriate formal appeals mechanism for Ofgem decisions on gas and electricity code modification would increase the accountability of Ofgem decisions. The proposed changes would impact on every firm in the gas and electricity markets that is a party to the Transco Network Code, Balancing and Settlement Code and Connection and Use of System Code. The biggest firm is National Grid Transco, which is a party to all three codes.
- 10.2 The principal benefit of this policy is to minimise the risk of sub-optimal decision-making. The total direct costs of a statutory appeals mechanism are estimated to be £5.3-10.7 million in net present value terms assuming a 3.5% discount rate over twenty years. In addition, there are likely to be significant costs incurred by appellants and Ofgem. The indirect costs are difficult to quantify but are unlikely to be significant given the tightly constrained right of appeal and compressed process designed to avoid any material increase in regulatory uncertainty.
- 10.3 With respect to the exclusion of code modifications that impact on the security of energy supply or where Ofgem disagrees with the opinion of the relevant panel (or alternatively the majority of respondents to consultations on the modification), it is very likely that excluding such modifications from the formal right of appeal would result in a significantly higher overall net benefit than not excluding them.