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Dear Andy

**Proposed revised guidance on impact assessments**

British Energy welcomes the opportunity to comment on the issues raised in your consultation on the above dated 20<sup>th</sup> December 2007.

Generally speaking over the last three to four years Ofgem has made significant improvements in its effectiveness and working practices. This has predominantly been brought about by the adoption of the Better Regulation Principles including the carrying out of impact assessments. We have long advocated the adoption of such practices and believe on the whole Ofgem is moving in the right direction. However, it is vital that the production of impact assessments is not divorced from the policy making process. Such assessments should not be just a box ticking exercise but should be a fundamental part of consultation and policy making. There have been recent examples where there is an impression that policy is still being made and impact assessments then crafted to justify the policy decision. For example, the impact assessment published by Ofgem in respect of a number of BSC modifications seeking to introduce zonal losses was deeply flawed. The use of out-of date data plus an over reliance on independent analysis produced for a different purpose in coming to a decision which it knew would be highly contentious is inappropriate and does little to promote confidence in the regulatory regime.

Notwithstanding the above, we welcome the review by Ofgem of its existing guidance on impact assessments with a view to reflecting recent developments in best practice including any new guidance issued by other bodies including the Better Regulation Executive. Overall, we generally support the framework for consideration and completion of impact assessments as set out in the proposed revised guidance. However, the most important issue is not the guidance per se but the extent to which future assessments are consistent with such guidance.

We do have a number of specific comments on the proposed revised guidance and these are set out below.

**Chapter 2 – IAs produced under section 5A of the Utilities Act 2000**

On the whole the examples of those proposals which may, for each of the criteria set out in section 5A, indicate that a proposal is “important” appear appropriate. However, we note that in attempting to explain what proposals may fall within the criteria of having “significant impact” on persons engaged in licensed activities Ofgem indicate those that have “significant costs”. The continued use of the word “significant” is too subjective and we would urge more clarity in this area. For example, a

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proposal could have a significant impact if it increases costs on market participants above a certain percentage level.

In addition, in circumstances where Ofgem determines that a proposal is not important and therefore does not fall within section 5A Ofgem should communicate this decision at the earliest opportunity. It should then be prepared to revisit such a decision in the event that robust contrary representations are made by affected parties. This would introduce greater transparency and accountability to this decision making process.

### Chapter 3 – IAs outside the scope of section 5A of the Utilities Act 2000

We note that Ofgem may in certain circumstances still undertake impact assessments despite policy/proposals falling outside the scope of section 5A. We welcome this flexible approach which is consistent with best regulatory practice.

### Chapter 4 – The consultation process

Consulting interested parties is a vital part of the process of assessing the impact of proposals. We therefore welcome the increased use by Ofgem of informal consultations via seminars, workshops and bilateral meetings as a means of considering industry views early in the development process and a way of complimenting the normal written consultation process. We would encourage Ofgem to continue to adopt this approach as a means of increasing the transparency, consistency and accountability of regulatory policy development.

### Chapter 5 – Ofgem’s approach to measuring impacts, costs and benefits

We note that the Competition Commission (CC) in its decision on Modification 116 (CC 02-07) was particularly critical of the approach adopted by Ofgem in respect of the cost benefit analysis it undertook. This included both quantified and non-quantified benefits. On the quantifiable benefits, the consistency and rationality of explanations was criticised. On the non-quantifiable benefits the explanation and substantiation provided by Ofgem was deemed insufficient. Whilst we recognise that balancing qualitative benefits against quantified costs is sometimes difficult, it is clear that improvements need to be made in the approach adopted by Ofgem in order to ensure it meets best regulatory practice in this area and moves to more evidence-based decision making.

### Chapter 6 – What an Ofgem IA will cover

Generally speaking the areas set out in the guidance that an IA should cover appear appropriate. However, we would offer the following views on some of the areas:

*Options* – In nearly all circumstances there will be more than one option/proposal presented. It is important that any impact assessment fully assesses all of the options and does not just focus on the benefits of the favoured option. For example, the impact assessment<sup>1</sup> undertaken in respect of the zonal transmission losses proposals was considering a number of proposals, however, one of the options (P200) was barely considered. The assessment dismissed this proposal without any assessment of the direct or indirect impacts compared with the other proposals. For this reason the consultation process in this instance was flawed. As mentioned above it is imperative that this process is not simply a box ticking exercise and a means of justifying a preferred proposal. We consider the guidance should make it clear that all of the options will be fully and consistently assessed.

*Impacts on competition* - We consider that any consideration of the significant positive or negative impacts on competition in relevant markets should not be confined to national markets. An explicit assessment of the impact on competition in Europe (if any) should also be included. In the context of a competitive single European energy market, it would be neither appropriate nor efficient for there to be significantly different, more complex or more burdensome arrangements in the UK .

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<sup>1</sup> Zonal transmission losses – assessment of proposals to modify the Balancing and Settlement Code – 23<sup>rd</sup> February 2006 Ref: 32/07

*Managing the transition to a low carbon economy* - Explicit reference within this section is made to electricity generation from renewable sources and the potential impact proposals may have on such generation and likely positive/negative impact on greenhouse gas emissions. Whilst we accept the need for such assessment we consider such focus should be extended to all forms of low carbon generation including nuclear generation and carbon capture and storage. In addition, the analysis should cover new as well as existing low carbon generation.

#### Chapter 7 – Industry code and charging methodologies IAs

We note that Ofgem are currently expressing concern with the quality and depth of analysis provided to it through the code modification reports and suggest this is hindering GEMA's ability to make decisions in line with best regulatory practice. On the whole we do not see this as a major problem and note that Ofgem has only identified a small number of code modifications where it has raised concerns. However, Ofgem has commenced a review of industry code governance and it is important that any review should ascertain whether this is a widespread issue or one that is unique to certain modifications/codes. We recognise that in the event that Ofgem receives a report with insufficient modification assessment it may impact its ability to make regulatory decisions that meet the best practice guidelines. However, given Ofgem may attend all modification meetings (e.g. Panels, modification groups, issue groups etc) it would appear that this perceived defect could be mitigated at an early stage by more appropriate engagement by Ofgem at these meetings. It is vital that for Ofgem impact assessments (and ultimately final proposals) to be robust the analysis undertaken is fit for purpose. In circumstances where the analysis undertaken under the codes is not sufficient Ofgem should not overly rely on such analysis when making its decision on the merits of the proposals against its statutory objectives.

We note paragraph 4.8 and 7.8 make reference to the need to make timely decisions in order not to "jeopardise any industry code or charging methodology implementation dates". We fully concur with this view. However, we note that Ofgem recently in its assessment of the BSC modifications P198, P200, P203 and P204 is not adopting such an approach. Such changes in regulatory approach without any industry consultation or suitable justification is clearly inconsistent with the better regulation principles and increases regulatory uncertainty.

With respect to paragraph 7.10, we fail to see under what circumstances a non urgent proposal which is considered "important" under section 5A should not be subject to an impact assessment. More clarity should be provided within the guidance.

Paragraph 7.11 indicates that the standard procedure for impact assessments in respect of industry code and charging methodology modification proposals would consist of only one round of consultation. Whilst we acknowledge that this may be appropriate for 'normal' practice, we do consider that for modifications that are contentious and have a significant impact on industry participants the use of the 'minded to' phase, as recently used in the process of assessing the zonal losses modifications, would be more appropriate.

I trust you will find these comments helpful. I would be happy to clarify any aspect of our response with you should you wish.

Yours sincerely



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