



Should energy consumers and energy network users have the right to appeal Ofgem price control decisions? If so, what form should the appeals process take?

Final report

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Glossary

The following terms are used in this report:

Term	Description
DPCR	Distribution Price Control Review
CC	The Competition Commission
CAT	The Competition Appeals Tribunal
NATS	National Air Traffic Services Ltd
MTCs	Mobile termination charges
CAR	The Irish Commission for Aviation Regulation
DfT	Department for Transport
WACC	Weighted average cost of capital
The Act	The Communications Act 2003
MEUC	Major Energy Users Council
EIUG	Energy Intensive Users Group
BIS	Department of Business, Innovation and Skills
RAT	Regulatory Appeals Tribunal
Users	Network users

1 Executive Summary

1.1 As part of its review of the overall approach to energy network regulation, Ofgem has commissioned LECG to undertake a study looking at whether consumers and network users should have the right to appeal Ofgem price control decisions and what form such an appeal right could take. At present, price controls are set by a change to the licence of each network, with the agreement of the licensee (i.e. the network company). If the licensee does not agree, then the matter can be referred to the Competition Commission (the “CC”) by Ofgem. Other parties can only appeal via judicial review or, in theory, by lobbying the Secretary of State to use his or her power of veto.¹

1.2 The study investigates the advantages and disadvantages of introducing a right of appeal, on the substance of the regulatory settlement, for consumers and/or network users.² Where potential disadvantages are identified, it also investigates possible measures to mitigate those disadvantages. Finally, it addresses a range of more detailed implementation questions such as who exactly would have appeal rights, which body should hear the appeals, the scope of the appeals and how to promote well founded appeals and discourage frivolous appeals. This more detailed analysis is motivated in part by recognition that the design of the appeal mechanism will influence the benefits and costs of extending appeal rights.

1.2 Overview of advantages and disadvantages of appeal rights

1.3 The table below summarises our assessment of the advantages and disadvantages of appeal rights. The benefits we have identified are significant. Of the costs identified below, only the indirect costs appear to be potentially significant and we consider that they can be mitigated through careful design of the appeal process. On balance, we therefore favour extending appeal rights to consumers and users.

¹ S11 (4) of the Electricity Act 1989 and S23(5) of the Gas Act 1986 requires Ofgem to consult with the Secretary of State on licence changes and the Secretary of State has the power to reject the proposed licence change. This power is referred as to the Secretary of State veto.

² Ofgem is also considering the role of third party engagement in the price control process itself. Our review does not directly consider the role of third party engagement, although we do discuss the interaction between increased third party engagement and extended appeal rights.

Table 1: Summary of advantages and disadvantages of appeal rights

Criterion	Assessment
Positive	
Good regulatory process	Promote accountability of Ofgem to consumers and users Provide stronger incentives for consumers and users to engage in the price control process and for networks to engage with users and consumers Will lead to a more appropriate “balance of power” during price control process
Consumer benefits	Potential to improve the outcome of price control determination, which could have significant benefits for consumers.
Sustainability	Potentially help ensure that sustainability considerations are given appropriate weight in price control decisions.
Negative	
Direct costs	We would expect an increase in the number of appeals. This will result in additional costs for appellants, networks and Ofgem.
Indirect costs	Appeals may raise uncertainty for networks during appeal process and potentially more general uncertainty about the outcome of the price control process. However, provided the appeal is conducted in a reasonably short time period, the impact would appear to be modest. We do not believe that the appeal process will add to general uncertainty, provided the appeal body is of good standing.

Source: LECG

1.3 Good regulatory process

1.4 An appeals system strengthens the accountability of the regulator to its stakeholders. Appeal rights allow parties with a material interest in the outcome of the regulatory process to defend their interests in that process. Clearly, consumers and users have a strong interest in the outcomes of a price control review. Extending appeal rights would, therefore, increase the accountability of Ofgem to consumers and users.

1.5 Extending appeal rights to consumers and users would be consistent with encouraging greater network engagement with consumers and users. Appeal

rights will give consumers and users a stronger voice in the process. Networks will have an incentive to engage with consumers and users to ensure their proposals are understood and to address consumer and user concerns. Of course, increasing consumer and user engagement will require complementary measures to facilitate participation in the regulatory process, such as greater access to information and enhanced transparency of the price control process.

- 1.6 Extending appeal rights would also affect the ‘balance of power’ during a review in a way that would be likely to promote consumer interests. While price control reviews are fundamentally principle-based, there is inevitably an element of subjectivity in any decisions. Ofgem is required to make a judgement on a range of complex issues with conflicting interests. The current set of appeal rights could mean that at the margin there might sometimes be too little weight given to the interests of consumers and users in making decisions. Extending appeal rights could help correct this potential distortion.

1.3.1 Benefits to consumers

- 1.7 The extension of appeal rights will potentially improve the outcome of price control determinations. The possibility of appeal would incentivise high quality decisions and careful consideration of consumer and (where appropriate) user interests. It would also enable the appellate body to consider any concerns that users and consumers have about a decision, and to change decisions where appropriate.³
- 1.8 Price control determinations are high stakes decisions. A relatively small change to key parameters, such as the cost of capital or incentive arrangements, can result in a difference of several hundred million pounds worth of charges borne by consumers. Clearly, price control determinations have a significant impact on consumers, both in terms of charges and quality of service.
- 1.9 The benefit to consumers from lower charges or improved services may be limited if consumer appeal rights are not actually utilised. The threat of appeal may in itself provide some of these benefits, but if there is little prospect of the appeal right being utilised, then the threat of appeal will be weaker. In practice appeal rights might be under-utilised because of the inherent ‘free rider problem’:

³ Our study has reviewed both the economic literature on civil court appeals and the broader public policy discussion on regulatory appeals. The economic literature identifies a key benefit of an appeal right as providing parties with the opportunity to contest decisions that they believe are incorrect and so reduce harm by remedying incorrect decisions by lower courts. Costs are limited as only a small proportion of lower court decisions are appealed.

someone who appeals would generally incur a significant part of the cost of that appeal, while only enjoying a small proportion of the benefits from a successful outcome. For this reason, they may not take action, even where it is in the overall best interest of consumers.

1.10 This problem could be partly mitigated by having representative bodies act on consumers' behalf, by analogy to the current 'super-complaint' arrangements under UK competition law. However, this would be only a partial solution, since those bodies would also face challenges of capacity and resources. The latter issue could be addressed by additional funding for representative groups.

1.11 Extending appeal rights to system users might also help to mitigate these problems, as their interests may be aligned with consumers. Suppliers may be able to pass through network charges to customers, however, they will have some interest in avoiding price increase to their customers. Large suppliers have sufficient scale and sophistication to engage in the complex technical, economic and financial interests of price controls.

1.3.2 Sustainability

1.12 The link to sustainability is of particular importance in the context of the RPIX@20 review, for which the implications of decarbonising the GB energy system are a key driver. In general we do not believe that extending appeal rights is likely to harm sustainability. The effect is likely to be neutral, but there are some scenarios in which extended appeal rights could promote sustainability. For example, if a price control provided insufficient incentive for distribution networks to connect distributed generation, a distributed generator could appeal the determination on the grounds that Ofgem had not properly balanced its different statutory duties (including sustainability, as well as the balance of future and present consumer interests).

1.13 Equally, other consumer or suppliers may wish to appeal decisions on the grounds that the determination over-provided for sustainability and resulted in excessive charges. The effects of extending appeal rights on sustainability will depend ultimately depend on the outcomes of appeals. We believe that extending appeals rights will not inhibit the appropriate consideration of sustainability in price control determinations and is likely at least in some cases to promote it .

1.3.3 Direct costs

1.14 Extending appeal rights is likely to result in an increase in the number of appeals and this would directly increase the level of regulatory burden, imposing additional costs on Ofgem, the networks, the appellate body and the parties to the appeal. These costs would include additional resources such as legal expenses as well as additional management time.

1.15 However, we consider that these costs are likely to be small relative to the magnitude of the decisions being considered (i.e. an order of magnitude less than the benefits flowing from a relatively small improvement in decision-making). This is because even small changes in the terms of a price control can result in tens of millions of pounds of gains or losses for consumers. Clearly, the costs of an appeal are small in relation to this. As discussed below, we also propose that the appeal body should act as a gatekeeper to the appeal process to prevent frivolous appeals and avoid unnecessary costs.

1.3.4 Indirect costs

1.16 A more significant potential cost relates to an increase in the level of uncertainty and regulatory risk, at least during any appeal and potentially whilst the new arrangements were “bedding down”. The extension of appeal rights may be expected to increase the volume of appeals. An appeal may increase uncertainty about outcomes of the price control determination such as allowable charges until the appeal is resolved and in theory, this could delay investment decisions. In practice, this uncertainty will be limited by the duration of the appeal process, as investment will take place over the price control period. The network should be able to make any adjustments resulting from the outcome of the appeal in the remaining time left within the price control period, provided the appeal is decided in a reasonably short period (e.g. six to nine months).

1.4 Design and implementation of appeal rights

1.17 The table below summarises our recommendations in relation to the design of appeal rights, which are designed to mitigate the potential disadvantages of extending those rights to consumers and users⁴.

⁴ This study provides advice on regulatory policy. It does not intend to provide legal advice. We have not considered the legal instruments that would be needed to introduce the extension of appeal rights. We understand that Ofgem are considering the potential legal routes for implementing any changes in this area.

Table 2: Proposed approach to design of appeal rights

Issue	Proposed approach
Who hears appeals?	Competition Commission
Who has appeal rights?	Materially affected parties (most likely to be users of the network and representatives of end consumers)
Legal test	Adverse to public interest, giving due regard to Ofgem’s duties
Scope of appeal	The CC should generally review the price control decision as a whole and not just matters raised by parties
Discouraging frivolous appeals and reducing uncertainty	<p>Deadline for an appeal of 30 days after final price control determination</p> <p>CC to adopt four to six month period to hear an appeal and reach a decision</p> <p>Require permission from CC before an appeal can be lodged (gatekeeper to appeal process)</p> <p>CC to allocate costs of successful party to unsuccessful party (but with discretion).</p>
Role of CC	If it decided that an appeal is sustained, the CC should as far as possible re-determine the price control decision

Source: LECG

1.4.1 Appellate body

1.18 There is a strong case for the CC to be the appeal body. The CC is currently the appellate body for appeals by network companies and has a well-established expertise to consider price control issues. It has also successfully taken on the role of appellate body for energy network code modifications.

1.19 The alternatives to the CC would be to develop a new body to hear appeals or ask the Competition Appeals Tribunal (CAT) to hear appeals. However, the CAT currently refers price control matters in the communication sector to the CC and we see little merit in adding specific responsibilities to the CAT for price control in the energy sector.

1.20 There seems little value in creating a new body to hear price control, when the CC has a well-established expertise in this area. It is exposed to similar issues in hearing price control appeals in other sectors. This would also be a more costly option.

1.4.2 Who should have appeal rights?

1.21 We consider that the same approach should be adopted as used in the communications sector, for merger control and for energy network codes modifications. That is to allow a right of appeal to all materially affected parties. The CC should be responsible for determining whether a party is a materially affected party: in practice this would be likely to include most network users and most medium and large consumers, but probably not individual households. Consumer groups should represent the interests of small consumers, and we recommend that specific consumer representative groups be designated with appeal rights on behalf of consumers.

1.22 It would be possible for other parties to argue that they were materially affected parties, such as residents affected by network construction decisions (e.g. undergrounding). The onus would be these parties to demonstrate that they did have a material interest in the process.

1.23 An alternative approach would be to specify who could initiate appeals more formally (e.g. consumers, suppliers, generators, shippers etc). This approach would provide more certainty but could run the risk of unfairly excluding certain parties. Further, this approach would not be consistent with the approaches adopted in other sectors.

Legal test and grounds of appeal

1.24 When hearing an appeal, the legal test that CC would apply would be (as at present) to determine whether or not the matter appealed is adverse to the public interest, having regard to the Ofgem’s duties.

1.25 The CC would have to give permission for parties to appeal. We propose that to have their appeal heard an appellant (other than a network) should be required to demonstrate they have a *prima facie* case, i.e. that there is some reasonable basis for the CC to consider that the price control determination may be adverse to the public interest, giving due regard to Ofgem’s statutory duties.

1.4.3 Scope of appeal

1.26 Two issues arise under the rubric of “scope of appeal”:

- Whether the appeal should review the price control decision as a whole, or be limited to aspects raised by the appellants.
- Whether the appeal should be on the principles of the price control decision, all aspects (including methodology and conclusions) of the decision, or on whether Ofgem has followed a reasonable process to make the determination.

1.27 We recommend that the appeal should generally review the price control decision as a whole, consistent with the current approach taken by the CC in price control appeals. In general, we consider that decisions on particular issues in a price control are likely to need to take account of their relationship to other elements of the decision. Further, there is danger that if the appeal is limited to matters raised by parties, then parties would have an incentive to lodge an appeal on elements unfavourable to them, even where the decision as whole was satisfactory. This could result in a re-determination that is focused too narrowly or it could result in a series of limited appeals by various parties to protect their interests.

1.28 There may be a case for giving the CC discretion to consider individual matters raised in the appeal, if it is satisfied that a particular issue can be considered by itself without adversely affecting relevant parties. However, this does raise difficult issues about undercutting the balancing implicit between issues in price control determinations. We believe this matter is worth exploring further.

1.29 We consider that it would be impractical to restrict appeals to matters of principle only. This is because it is the impact of the principles on the outcome of the determination that will drive the decision or need to appeal, and that will usually lie within the discretion of Ofgem in applying the principles rather than in the principles themselves. In practice, it may therefore be difficult to distinguish between the principles and the rest of the determination and the development of a separate statement of principles may add an additional step to the price control determination process. We do not believe that appeal rights should be limited to process, as this point is already encompassed in the right to judicial review.

1.30 Finally we believe that the CC should have a strong bias against hearing new evidence or arguments that were not presented in the price control process. This will ensure that parties have strong incentives to engage appropriately with Ofgem during the price control process, and will deter any attempts at “regulatory arbitrage”.

1.4.4 Discouraging frivolous appeals.

1.31 The right to appeal should enhance the price control process, but it should not replace the current system with an “Ofgem-then-CC” determination (i.e. effectively a two-stage process). It is therefore important to build safeguards into the appeal process. We outline a number of features that we believe will support an efficient and effective appeals process, based on our review of appeal rights in other sectors.

Table 3: Discouraging frivolous appeals and mitigating the disadvantages of appeals

Feature	Explanation
Time to lodge an appeal	30 day period following end of price control to lodge a determination.
Time period to consider an appeal	Four to six months with limited period of extension.
Permission to hear appeal	Appeal party required to seek permission to appeal from CC and to demonstrate prima facie case for appeal.
Allocation of cost	CC to allocate costs against unsuccessful party.

Source: LECG

1.32 These features will help to mitigate the disadvantages discussed in Table 1. Limiting the time period to make and hear appeals will limit the period of uncertainty. Requiring permission to appeal should help to avoid unsound appeals. The potential for the CC to allocate costs against unsuccessful parties should encourage parties to consider the full cost of their decision to appeal and reduce the risk of excessive appeals. However, this could raise barriers against consumer groups appealing a decision. In this regard, we note that the CC has discretion about how it awards cost. There is some evidence that the CAT decisions on costs in relation to competition law appeals take account of parties’ ability to pay. Secondly, it is clear that funding of consumer groups would need to

be addressed to allow them to contemplate the use of appeals including their ability to meet other parties' cost should an appeal be unsuccessful.

1.4.5 Role of CC

1.33 There is question of the CC's role if it decided that an appeal should be sustained. It could remit the determination back to Ofgem or it could re-determine the price control itself. The CC's role in appeals has been extensively debated in the Communications sector. The CAT has ruled that the CC should as far as possible re-determine the matter, as this would reduce the time for determination and the attendant uncertainty around outcomes.⁵

1.34 Under the Electricity Act and the Gas Act, the CC is required to reach a conclusion on the matter referred and to propose any licence modification necessary to address any adverse effect that they have identified. Ofgem is then required to modify the licence to remedy the adverse effects identified by the CC. Ofgem are required to consult on the modification.

1.35 We propose that the role of the CC should be to re-determine the price control as far as possible, but that it should have the option of referring the decision to Ofgem, if it considers this is an appropriate course of action. This would avoid any delay arising from the CC reaching a decision on the appeal and then referring the matter back to Ofgem for re-determination and consultation to ensure that the re-determination addressed the CC's concerns with the original determination. Any further appeals would be to the courts and limited to points of law only or via judicial review.

1.5 Conclusion

1.36 We recommend that appeal rights are extended to consumers and users by enabling materially affected parties to appeal Ofgem price control determinations to the CC. We believe that this change will enhance the accountability of Ofgem to consumers and potentially improve the process and outcome of price control determinations. Extending appeal rights would be complementary to increased consumer engagement. It would be most valuable to introduce this change as part of the wider change to increase consumer and user engagement in the price control process. There is some risk that this change could result in an abuse of the appeal process or cause unnecessary delays to the price control

⁵ Hutchison 3G UK Limited v Office of Communications, Case 1083/3/3/07, 16 January 2009.

determination. We believe that these risks can be managed by a sensible design of the appeal process.

2 Introduction

2.1 Context of the review

2.1 This paper has been commissioned as an input to Ofgem's ongoing comprehensive review of the RPI-X framework that has been used to regulate transmission and distribution energy networks over the past 20 years.

2.2 There is increasing desire to ensure consumer participation in price control decision and to promote a transparent and legitimate decision process.

2.3 Like any regulator, Ofgem face a number of challenges in making price control decisions. These include:

- limited information such as on the current or future costs of network or demand by consumers;
- difficulty in assessing available information due to its complexity and/or the difficulty of weighing up conflicting evidence; and
- risk of 'regulatory capture', where the views and interests of the regulated companies come to dominate the regulatory process. This would result in a bias in weighing up the evidence.⁶

2.4 The energy sector is also facing a number of challenges and experiencing significant change, one of the key drivers for which is the move to a low carbon economy. Energy networks face increasing levels of uncertainty about the investment and deployment of new technology such as smart metering and smart networks. These changes may involve much greater interaction and participation by consumers such as with active demand management or microgenerators. It is also likely to add further complexity and uncertainty to price control determinations.

2.5 These challenges and changes raise the question about consumer involvement in the price control process and whether or not appeal rights should be extended to consumers and users. Ofgem is considering the nature of consumer engagement in the regulatory process in a separate paper; in this paper we consider the implications of extending the appeal rights.

⁶ Further information, see Ernesto Dal Bó, "Regulatory Capture: A Review", *Oxford Review of Economic Policy*, 22(2):203-225, 2006.

2.2 Terms of reference

- 2.6 Ofgem has commissioned LECG to undertake a study of whether consumers and network users should have the right to appeal Ofgem decisions on price control reviews. The study investigates the advantages and disadvantages of introducing a right of appeal to the regulatory settlement for network users and consumers. The second question is whether there are mitigating arrangements that could be put in place to limit the identified disadvantages. Finally, there are a range of questions about how to implement appeal rights such as who should hear the appeal and which parties should have appeal rights.
- 2.7 This report provides advice on regulatory principles, best practice and the design of regulation. It does not provide legal advice and the legal implications of this report or further work on this issue will be addressed by Ofgem.

2.3 Current appeal provisions

- 2.8 This section outlines the current provisions for appeal. There is, of course, a wider issue as to how consumers engage during the price control process. Here, we are focusing on engagement following a price control decision.
- 2.9 Under the Electricity Act 1989 and the Gas Act 1986, price controls are set by a change to the licence of each network. The change in licence condition is required to be agreed with the licensee (i.e. the network company). If the licensee does not agree, then the matter is referred to the CC by Ofgem. We denote this referral as a network appeal of an Ofgem decision.
- 2.10 S11 (4) of the Electricity Act 1989 and S23(5) of the Gas Act 1986 requires Ofgem to consult with the Secretary of State on licence changes and the Secretary of State has the power to reject the proposed licence change. This power is referred to as the Secretary of State 'veto' of licence modifications. We are not aware of the veto being invoked. Consumers, users or any other party are, however, able to seek the intervention of the Secretary of State, if they are not satisfied with the outcome of a price control. The process for doing so, and the grounds for intervention by the Secretary of State are unclear.
- 2.11 Finally, decisions of the regulator are subject to judicial review under administrative law. Those who are adversely affected by Ofgem's decision can apply to the Administrative Court for judicial review. Judicial review is available to networks, consumers and users and other affected parties as a residual remedy

for enforcing the legal duty of the regulator.⁷ Judicial review can be used to assess whether a regulator has acted within its legal powers and has followed a reasonable process. It does not reconsider the merits of a decision, except to the limited degree of checking against reasonableness.

2.4 Structure of report

2.12 In section 3, we outline our approach and our assessment framework for assessing the advantages and disadvantages of extending appeal rights to consumers and users. In section 4, we outline the approach to appeals in other sectors with emphasis on recent changes in the UK to extend appeal rights to a broader range of parties. In section 5, we set out our in-principle assessment of the merits of extending appeal rights to consumers and users. In section 6, we discuss the design and implementation of appeal rights in practice. In the appendix, we summarise the economic literature on the analysis of appeal rights. The insights from the literature are used to inform our assessment.

⁷ House of Lords, “The regulatory state: ensuring its accountability”, 2003/04.

3 Assessment framework

3.1 Introduction

3.1 This section sets out our framework for evaluating the advantages and disadvantages of extending appeal rights to consumers and network users, Our assessment framework is summarised in the table below.

Table 4: LECG’s assessment framework

Criteria	Definition
Positive criteria	
Good regulatory process	The impacts on the regulatory process, with particular reference to the principles of better regulation, the incentives for consumer engagement and the balance of power between parties.
Consumer benefits	The potential impact on prices and quality of service to consumers from improving outcomes of price control decisions, consistent with Ofgem’s primary objective of protecting consumer interest
Sustainability	Consider impact on sustainability from extending appeal rights such as move to low carbon energy
Negative criteria	
Direct costs	The additional costs to Ofgem and stakeholders from extending appeal rights
Indirect costs	Indirect impact of extending appeal rights such as increasing uncertainty for networks. Incorrect appeal decisions

Source: LECG

3.16 We now discuss the criteria in more detail.

3.2 Good regulatory process

3.17 In assessing the impact of extending appeal rights on the regulatory process, we have focused on the Government's principles of better regulation. These require regulation to be:⁸

- transparent – regulators should be open and keep regulations simple and user friendly;
- accountable – regulators should be able to justify decisions and be subject to public scrutiny;
- proportionate – regulators should only intervene where necessary;
- consistent – Government rules and standards must be joined up and implemented fairly; and
- targeted – regulation should be focused on the problem.

3.18 In addition to the principles of better regulation, we consider the incentives for consumer engagement as a result of the extension of appeal rights and the impact on the balance of powers between parties. The broader issues considered under this heading provide the reason for the term “good regulatory process” rather using the term “better regulation”.

3.3 Consumer benefits

3.19 Ofgem's primary statutory objective is to protect the interests of current and future consumers.⁹ Price control decisions are a key determinant of the price and value of network services for consumers. Consumers have a direct interest in price and quality of service provided by networks. Appeals have the potential to change price and quality outcomes for consumers. It is, therefore, important to consider the potential implications for consumer outcomes from extending appeal rights.

3.4 Sustainability

3.20 Extending appeal rights will enable consumers and users to appeal a price control, if they considered that the determination did not meet Ofgem's duties. Ofgem has a secondary duty to contribute to sustainable development. It will be important to consider the impact of extending appeal rights on sustainability.

⁸ Department of Business Innovation and Skills website

<http://www.berr.gov.uk/whatwedo/bre/index.html/index.html>, viewed on 12 August 2009.

⁹ Ofgem website, <http://www.ofgem.gov.uk/About%20us/Authority/Pages/TheAuthority.aspx>, viewed on 12 August 2009.

These impacts could arise from users such as distributed generators lodging appeals or consumers with an interest in sustainability issues appealing price control determinations that they felt do not adequately address sustainability issues.

3.5 Direct costs

3.21 Extending appeal rights will impose additional costs on a number of parties, if an increase in the number of appeals takes place. These costs include the legal and other costs of lodging and responding to an appeal and the costs of an appeal body to hear the appeal. There are also costs such as increased management time devoted to appeal issues.

3.6 Indirect costs

3.22 Indirect costs are the less visible costs that arise from extending appeal rights. A key indirect cost is the additional uncertainty for networks and other stakeholders during the appeal process and potentially around outcomes in a regime with extended appeal rights.

4 Experience in other sectors and countries

4.1 Introduction

4.1 In this chapter we outline recent developments in consumer and user appeal rights in other regulated sectors in the UK and briefly discuss developments outside the UK. While there are significant differences between the energy sector and the sectors discussed in this section, the debates that took place in other sectors, and the outcomes of those debates can provide insights into the issues, advantages and disadvantages of extending appeal rights. We review these developments as an input into our assessment of extending appeal rights.

4.2 We discuss the following examples of price control appeals in the UK:

- communications – price controls with broad definition of appeal parties;
- aviation – extensive discussion of the parties that should have appeal rights for a price control; and
- water, rail and air traffic – price control appeals framework similar to current arrangements in the energy sector.

4.3 We also discuss examples of appeals outside of price controls which are relevant to our study. These include:

- energy sector modification appeal rights – an example inside of the energy sector of recent extension to appeal rights;
- competition law framework – an example of the extension of appeal rights for competition law decisions; and
- super-complaints – we discuss the use of super-complaints as a means of representing consumers under competition law.

4.4 The table below provides a summary of the key points in relation to the UK appeal regimes.

Table 5: Key points of UK appeal regimes

Sector	Key points
Communications	<p>The Communications Act 2003 provides for appeals on the merits of Ofcom determinations including price control decisions. Appeals are made to the CAT, who then refers any determination of price control to the CC.</p> <p>There has been one reference from the CAT since the introduction of the appeal rights. The CC made significant changes to the Ofcom price control determination in this case.</p> <p>The appeal process has taken considerable time to work through for the one reference from the CAT to the CC regarding a price control decision</p>
Airports	<p>There has been considerable discussion regarding the extension of appeal rights in the aviation sector to consumers and users.</p> <p>The CC has favoured extending appeal rights while the CAA is opposed.</p> <p>An expert review panel has proposed that appeal rights be extended but only for the principles of a price control decision.</p>
Competition	<p>Appeal rights for merger control decisions were reformed in 2002 and allow interested parties to appeal to the CAT on the merits of a decision.</p> <p>The CAT has in many cases upheld OFT decisions.</p>
Energy sector code modifications	<p>Appeal rights for Ofgem decisions on energy sector code decisions include materially affected parties.</p> <p>Tight time lines are set for the decision to appeal and the hearing of the appeal and determination by the CC.</p>
Water	<p>The water sector parallel the current arrangements in the energy sector with price control determinations by licence modifications. The regulated firms have the right to reject licence modification and the regulator then refers the determination to the CC.</p>
Rail	<p>The rail sector parallels the current arrangements in the energy sector with price control determinations by licence modifications. The regulated firms have the right to reject licence modification and the regulator then refers the determination to the CC</p>
Air traffic control	<p>The air traffic control arrangements parallel the current arrangements in the energy sector with price control determinations by licence modifications. The regulated firm has the right to reject the licence modification and the regulator then refers the determination to the CC</p>

Source: LECG

4.2 Ofcom

4.5 In this section, we discuss the introduction of broad appeal rights of price control decisions in the communications sector, outline how the appeal process works and discuss the evidence of the use of the appeal rights. We then summarise our key insights from the extension of appeal rights in the communications sector.

4.2.1 Introduction of broad appeal rights

4.6 The Communications Act 2003 (“the Act”) introduced a new regulatory framework in the communications sector. The main provisions of the Act were to transfer the powers and functions of the various regulatory bodies that were regulating the communications sector to one body, Ofcom, and to set out the duties of this new regulator. The Act provided regulatory powers to Ofcom concerning licensing, allocation of radio communication spectrum, digitalisation; and merger control. It also provided for the establishment of a Consumer Panel and procedures for appealing decisions relating to networks and services (including price control determinations)..¹⁰

4.7 There was little discussion of the extension of appeal rights as part of the Communications Act. The broader appeal rights under the Communications Act reflected a European Directive which allows appeals to an independent tribunal and appeals on the merits of a case. The EC Communications Regulatory Framework Directive states that:

*Member States shall ensure that effective mechanisms exist at national level under which any user or undertaking providing electronic communications networks and/or services who is affected by a decision of a national regulatory authority has the right of appeal against the decision to an appeal body that is independent of the parties involved.*¹¹

4.8 The House of Lords suggest that the origins of the European Directive related to Article 6 of the European Convention on Human Rights.¹² Article 6 provides for a fair hearing by an independent and impartial tribunal established by law.¹³

4.9 As part of the implementation of the 2002 EU telecommunications directives, the existing regime of licensing of telecommunications operators was abolished.

¹⁰ Explanatory notes of the Communications Act 2003

¹¹ Directive 2002/21/EC, 7 March 2002.

¹² House of Lords, “The regulatory state: ensuring its accountability, May 2004.”

¹³ Council of Europe, European Convention of Human Rights.

Ofcom could impose price controls on operators to protect consumers, who are determined to have Significant Market Power in a relevant market.

4.2.2 Procedure

- 4.10 The Act lays out who is permitted to appeal Ofcom decisions, and what the route of appeal is. In summary, appeal rights are granted against Ofcom decisions¹⁴ to communications providers and persons making associated facilities available, as well as any other person whom the decision affects¹⁵. The appeals bodies are the CAT and the CC.
- 4.11 The CAT is the general appellate body, all appeals are made to the CAT, but price control appeals must be referred by the CAT to the CC for determination. This is consistent with the functions of the two bodies. The CAT is an independent judicial body created to hear appeals against decisions under the Competition Act 1998 and Articles 81 and 82 of EC law. The CC inherited powers of the former Monopoly and Mergers Commission and has the function of conducting market investigations under the Enterprise Act and as a reference and appeal body for price control determinations in a range of regulated industries.¹⁶
- 4.12 Under S193(5) of the Communications Act 2003, the notification of appeal against Ofcom's price control determination must be given as soon as practicable after the making of the notified determination. It is not clear to what extent this is a constraint. It would appear to provide considerable uncertainty about the length of the period in which an appeal could be made.
- 4.13 The CC guidelines give the following timelines for undertaking appeals:¹⁷
- regulatory references other than Ofcom price control references - six months but with one extension of up to six months; and
 - Ofcom price control references - four months, but subject to any directions given by the CAT.

¹⁴ These decision include price control determinations, but also enforcement of competition law.

¹⁵ S192, Communications Act 2003

¹⁶ Richard Whish, "Competition Law", 6th edition, 2009.

¹⁷ Competition Commission, "General Advice and Information", March 2006

4.2.3 Experience with appeal rights

4.14 The table below summarises Ofcom price control decisions and whether appeals have been lodged with the CAT and referred to the CC. Appeals of Ofcom price controls

Ofcom price controls	Date	Appeal lodged with CAT	Reference to Competition Commission
Leased lines	2004	No	No
	2009	Yes	Reference pending
Mobile termination rates	2004	Yes – for competition assessment only	No, price control issue were not raised.
	2007	Yes	Yes
Network charge control	2005	No	No
	2009	No	No
Local Loop Unbundling/Metallic Path Facility (MPF)	2005	No	No
	2009	Yes	Reference pending
Wholesale line rental	2006	No	No
	2009	Yes	Reference pending

Source: LECG and Ofcom

4.15 There has been one appeal of an Ofcom price control decision which has resulted in a CC decision. There are two recent cases where parties have lodged appeal with the CAT, but the CAT is yet to decide whether to refer the matter to the CC. The table below does not include other non-price control appeals, such as on spectrum and mobile number portability. In regard to the 2004 mobile termination price control, we note that H3G appealed to the CAT, but this was on the grounds of Ofcom’s competition assessment rather than the price control itself and the matter was determined by the CAT.

4.16 The reference to the CC concerned the price control of mobile termination charges (“MTCs”). In July 2007, Ofcom issued determinations in disputes between BT and each of the five mobile network operators (O2, Hutchinson 3G, T-Mobile, Vodafone, and Orange) concerning MTCs. Four appeals were launched to the CAT against these decisions, by BT, T-Mobile, Hutchinson 3G and a group of fixed network operators.

4.17 The CAT found that Ofcom had made a number of errors of law in the way it went about determining the disputes. It also found that the appeals were well founded in terms of the core issues. The CAT then referred the price control issues to the CC for determination. The CC made significant changes to the Ofcom decision and reduced the charges for call termination by up to 27%. This suggests that the outcome of the appeal had significant benefits for consumers, if the reduction in wholesale charges flows into retail prices.

4.18 In the mobile termination case, Ofcom issued its price control determination on 27 March 2007. The CAT referred the case to the CC on 18 March 2008 with a deadline of 31 October 2008 to make a determination. The CC requested two extensions and delivered its final determination on 16 January 2009.

4.19 We note that appeals have not been raised from operators or service providers to the CAT and not from consumers or representative groups. In theory, consumers are able to appeal, in practice, we do not observe any expectation that consumers or representative groups would utilise the appeal provisions.

4.2.4 Key insights

4.20 There has not been a comprehensive evaluation of the benefits or the effectiveness of the appeal process in the communications sector and it is in relatively early days with the extended appeal regime given the infrequent number of price control determinations. However, we make the following observations based on the available evidence.

- Extension of appeal rights was introduced as part of a broader package of measures in the communications sector. The rationale for extending appeal rights was to ensure consistency with EC Directives and human rights law.
- Appeal rights have been exercised by parties other than the regulated network, but only one Ofcom price control determination has been referred to the CC for review. A number of Ofcom price control determinations have not been appealed. This suggests that extension of appeal rights need not result in excessive number of appeals, although, it is probably still too early to draw definitive conclusions.
- In theory consumers are entitled to appeal, but in practice, consumers and representatives of consumers have not used the appeal process.

Consumer representatives are not designated to act on behalf of consumers.

- In the procedure for lodging appeals there appears to be significant uncertainty about the period in which an appeal can be made.
- The procedure of the CAT deciding whether to refer the matter to the CC has added significant additional time to the appeal process in the only price control appeal heard so far.
- The CC made significant changes to the mobile termination price control in the case of the one appeal heard by the CC. Mobile termination rates were significantly reduced from Ofcom's determination.

4.3 Aviation

4.21 In this section, we discuss the debate in the aviation sector about the nature of appeal rights for price controls and for determination of controls. First, we discuss the current price control appeal process and then we discuss the debated appeal rights for: (i) determination of whether an airport should be price controlled; and (ii) licence modifications to implement price control.

4.3.1 Current determination and price control appeal process

4.22 The CAA regulates four different areas of the aviation sector in the UK: safety, air space, consumer protection and economic regulation of airports and NATS.¹⁸ In 2008 the government commissioned two reviews of the CAA's role: a strategic review of the CAA and an in-depth study of the economic regulation of airports by an expert panel led by Professor Martin Cave.

4.23 Under the current statutory framework, the CAA is required to set price controls for airports which have been designated by the Secretary of State. The CAA makes recommendations to the Secretary of State about which airports to designate. The Secretary of State's decisions about which airports are subject to price control regulation was subject to judicial review under Part IV of the Airports Act 1986.¹⁹ The price control determinations by the CAA are automatically referred to the CC.

¹⁸ Formerly, National Air Traffic Services.

¹⁹ DfT, "Reforming the framework for the economic regulation of UK airports", March 2009.

4.3.2 Determination of control

4.24 The Department for Transport (“DfT”) proposes to replace the current designation of airports for regulation with a licence based regime.²⁰ The licence would contain differing levels of obligation for the airport depending on the market power and size of the airport. The highest level of obligation is referred to as Tier 1. The DfT considers that decisions on whether an airport is to be Tier 1 airport should be appealable. This is because these decisions can have far ranging impact on a broad range of parties such as airlines and consumers,

4.25 The DfT concluded that all parties with a material interest (i.e. the licensee, airlines, specified consumer groups and other airport operators) should be given appeal rights. To prevent long-running cases the DfT proposes a change in legislation to provide a reasonable timeframe for such appeals to take place. The DfT believes the CAT would be best placed to act as the appellate body, as the determination of whether a price control should be imposed involves an assessment of competition. In order to prevent frivolous claims, the CAT would also have to grant permission for appeal. As the CAT can also award costs against unsuccessful appellants, this would act as a deterrent against appeals with a low probability of success.

4.3.3 Licence modification

4.26 The DfT is considering three options to allow appeals against a decision to modify a licence, including decisions on price controls and service quality:

- option 1 – all parties with a material interest would have equivalent rights of appeal to those granted to the licensee;
- option 2 – all parties with a material interest would have the right of appeal, but these would not be equivalent to the licensee’s, as only certain higher-level principles behind the decision could be appealed; and
- option 3 – no other parties would have right of appeal for licence modifications.

4.27 The DfT noted the divergence of view among the authorities on the appeal rights for licence modifications.

²⁰ DfT, see above.

- 4.28 The CAA considers that extending rights of appeal to airlines and other consumer groups would improve accountability but suggest that to do so risks every modification being appealed, thereby overwhelming and slowing down the system. For these reasons the CAA does not favour extension to airlines of merits based appeal rights on licence modification decisions.
- 4.29 The CC has taken a different view. They suggest that limiting appeal rights to the licensee, the ‘traditional model’, might not be appropriate in the aviation sector. To enhance regulatory accountability they have recommended that the right to challenge the merits of CAA decisions on licence modifications, such as the level of the price cap, should be extended beyond the licensee to other parties with a sufficient interest such as airlines.²¹
- 4.30 The DfT’s Expert Panel considers that all parties should have a right to appeal an airport operator’s statement of charging principles (discussed below), with the price control itself subject only to appeal by the airport operator. The Panel believe that opening up merits based appeals more broadly than this would result in the system being overwhelmed and slowed down by appeals, with the unintended consequence of the CC becoming the *de facto* sectoral regulator.²² The concern may in part be a reflection of a desire to move away from the current regulatory process which involves automatic reference of price control decision to the CC.
- 4.31 The Expert Panel believed that a statement of charging principles should explain how regulated charges are to be set. A statement should be prepared ahead of each price review, and the airport would have a duty to keep it under review. The CAA would be required to approve such statements to ensure they reflect desirable principles, such as cost-reflectiveness and efficiency of provision. The CAA’s decision to approve or reject the statement would then be subject to appeal on its merits by the licensee, airlines, and passenger representatives.
- 4.32 The DfT proposed a second way distinct from, but not necessarily exclusive of, the Panel’s proposal that would provide other parties with some access to appeal the merits of CAA pricing decisions on licence modifications whilst not permitting merits-based challenges on every aspect of licence modification. This would be

²¹ Competition Commission, “BAA airports market investigation, A report on the supply of airport services by BAA in the UK”, March 2009.

²² Independent Panel on Airport Regulation, “Report of the independent panel on airport regulation”, 27 January 2009.

facilitated by obliging the CAA to publish alongside its price control decision for Tier 1 airports a principled explanation of the basis upon which the price control decision was reached. The explanation would cover the fundamentals of the price control methodology – including whether it is based on a RAB, and whether it is single or dual till. It would not, however, deal with the technical calculations and assumptions that were made beneath these fundamentals, such as assumptions around the licensee’s weighted average cost of capital (“WACC”). The DfT recognised that it might be difficult to agree an appropriate level of detail that would be covered by such a statement of principles. They considered that it is likely to be necessary to specify in legislation the minimum that would need to be covered in a statement.

- 4.33 The DfT has not yet reached a conclusion on which parties should have the appeal rights for licence modifications.

4.3.4 Key insights

- 4.34 There is considerable debate in the aviation sector on the appropriate framework for price control appeals. There is support for broadening the scope for appeals against price control determinations beyond airports, however, there is concern that such a change could result in the CC being the *de facto* regulator. The CC has an unusually prominent role in the current price control process, as determinations are automatically referred to the CC. A proposed compromise to extend appeal rights but manage the risk of excessive appeals is to restrict appeals by interested parties to the principles of the price control determination.

4.4 Other regulated sectors in the UK

- 4.35 The water, NATS and rail regulatory regimes contain detailed provisions for the modification of licence conditions and appeals against certain proposals. The procedures have a number of standardised features summarised below.
- 4.36 Each regime allows for the modification of a licence condition by agreement between the regulator and the licence holder.
- 4.37 The regulator is typically able to seek to modify particular licenses to address matters which, in the regulator’s view, adversely affect the public interest. This procedure is effectively invoked as an appeal mechanism when the regulator and company cannot agree on a licence condition change. This procedure requires the regulator to refer the matter to the CC who will recommend modifications to

the licence if the CC agrees that the public interest is adversely affected. If the CC finds that no matter operates against the public interest, its decision is final, and no change would be made to the licence condition. If the CC agrees that certain matters operate against the public interest, the regulator will then propose modifications which the regulator believes are appropriate to address the concern. If the CC agrees, then these modifications will be implemented. If the CC does not agree with the regulator's proposed modifications, then it can impose its own modifications. This procedure involves interested parties (including all licence holders and the Secretary of State) being notified of the reference initially and at various stages of the process.

4.4.1 Key insights

4.38 Practice in these sectors reflects the current approach to price control appeals in the energy sector. It provides the regulated firm with the opportunity to contest price control determinations, consistent with their critical interest in the process. There is no opportunity for other parties to contest the process. This appears to reflect thinking at the early stage of utility regulation with less consideration given to participation by other parties or consumers.

4.5 OFT

4.39 In this section, we discuss the major changes to appeal rights as part of the reform of competition law in 2002. We also discuss the creation of consumer representatives with powers to make super-complaints as an example of the designation of representative bodies to act on behalf of consumers with regard to competition law.

4.5.1 Appeal rights for competition law decisions

4.40 Prior to passage of the Enterprise Act 2002, merger decisions were made by the Secretary of State of Trade and Industry rather than the OFT or the CC. Appeal rights were limited to judicial review.

4.41 Under the Enterprise Act, the OFT conducts the preliminary analysis of mergers and refers to the CC any cases that raise serious competition concerns for more detailed analysis. The Competition Act provides for an appeal to the CAT on

merits of decisions by the OFT and CC. The powers of the CAT are extensive, considerably wider than a court exercising judicial review.²³

4.42 The rationale for the extended right and grounds of appeal under the new competition law regime was that the powers available to the OFT and sectoral regulators are considerable and that to balance these powers and ensure compliance with the Human Rights Act 1998, full right of appeal, not merely the possibility of judicial review, should be available.²⁴ The CAT's decision can only be appealed on points of law to the Court of Appeal.

4.43 There have been a number of appeals by interested parties, including competitors, and occasionally customers or suppliers. Examples of each are shown below:

- competitor – Celesio A.G. v. OFT;²⁵
- customer –;²⁶ and,
- supplier – Bettercare v. OFT.²⁷

4.44 Review of the CAT's decision shows that the CAT has upheld many of OFT's infringement decisions both as to substance and level of the penalty.²⁸

4.5.2 Consumer representation

4.45 Section 11 of the Enterprise Act provides for super-complaints to be made to the OFT and to the sectoral regulators including Ofgem. Super-complaints allow a designated consumer body to make a complaint to the OFT or a sectoral regulator about features of a market which appear to be significantly harming consumers. The OFT or sectoral regulator must publish a fast track report of action it intends to take within 90 days. The 90 day period may be extended by the Secretary of State. The super-complaint may lead to a market study by the OFT or the regulator or a reference to the CC. Designated consumer groups were given the power to represent consumers as it was considered that individual

²³ Richard Whish, *Competition Law*, sixth edition, 2008, page 433.

²⁴ Richard Whish, see above, page 426.

²⁵ CAT, case number 1059/4/1/06.

²⁶ CAT, case number 1107/4/10/08. Bloomberg News.

²⁷ CAT, case number 1059/4/1/06.

²⁸ Whish, see above, page 427.

consumers lack the experience or knowledge to complain effectively, but that a designated consumer body should have the resources and ability.²⁹

4.46 Consumer bodies are designated by the Secretary of State. Designations are made once a year in October and applications for designation are submitted each year to Department of Business, Innovation and Skills (“BIS”). Six bodies have been designated including the Consumer’s Association (trading as Which?).³⁰

4.47 The criteria for designation as a super-complainant include: independence, competence and experience in representing consumers and capability to put a complaint together.³¹

4.5.3 Key insights

4.48 Changes to competition law introduced a new set of institutions to administer competition law and enabled a broad range of interested parties to appeal decisions to the CAT. This appeared to be motivated by the need to provide a check on increased powers of new institutions.

4.49 The process for super-complaints provides a potentially useful template for designating consumer groups to act on behalf of consumers which may be useful in a regulatory appeals process.

4.6 Energy sector codes

4.50 In this section, we discuss the appeal system for modifications to the Energy sector industry codes. We first discuss the approach to appeals for energy sector code modifications and then the rationale for the expansion of appeal rights. We then discuss the process and experience with appeals.

4.6.1 Approach

4.51 The Energy Code Modification appeal system was created under the Energy Act 2004. The gas and electricity industries have in force various codes that govern matters such as use of the system, connection, energy balancing, supply point administration and security of supply. A party to a code can seek its modification by putting forward a code modification for consideration within the industry and by a code panel. There is also provision for certain consumer representatives to

²⁹ Whish, see above, page 442.

³⁰ Department of Business, Innovation and Skills website, <http://www.berr.gov.uk/whatwedo/consumers/enforcement/super-complaints/page17902.html>, viewed on 1 September 2009.

raise modifications, although they are not a party to the code. After consultation within the industry and consideration by expert groups, the code panel makes a recommendation to Ofgem as to whether the proposal should be accepted or rejected. Ofgem then decides whether or not to accept the recommendation. Prior to the 2004 Act, Ofgem decisions were subject to appeal by judicial review only.

4.6.2 Rationale

4.52 The Government wished to promote regulatory accountability while avoiding the creation of a second-tier regulator. The Government concluded that an appeal mechanism was the appropriate way to improve the accountability and transparency of the code modification process, but that such a mechanism must minimize regulatory uncertainty and delay and so be tightly constrained³². The role of the CC is limited to considering cases where Ofgem has rejected the views of the majority members of the relevant industry code panel body.³³

4.6.3 Process

4.53 The Act introduced a merits-based review of Ofgem’s decision by the CC.³⁴ Under S173 of the Energy Act, an appeal against a decision may be brought under this section only by (i) a person whose interests are materially affected by it; or (ii) a body who represents such persons. The Act requires the CC to decide whether Ofgem’s decision is right or wrong. In reaching its decision, the CC will not carry out an investigation, or hold what is effectively a re-run of the process by which Ofgem reached its decision. Instead, the CC will review Ofgem’s decision.

4.54 The CC must reach a decision within a short period of time—in most cases, it will give its decision on the appeal within the period of 12 weeks beginning with the day on which Ofgem made its decision on the relevant code modification recommendation.³⁵

4.6.4 Experience

4.55 There has been one appeal heard by the CC in relation to the energy code: E.ON UK plc v GEMA (UNC116).³⁶ In this case, the CC partly allowed E.ON’s appeal in relation to proposed reform of gas industry offtake arrangements and quashed

³¹ BIS, “Guidance for bodies seeking designation as super-complainants”, March 2009.

³² DTI, “Gas and Electricity Codes: Strengthening the transparency and accountability of the gas and electricity industry code modification process: Government Response”, November 2003.

³³ Competition Commission, “Guide to Appeals in Energy Code Modification Cases”, July 2005.

³⁴ Technically, it is GEMA rather than Ofgem.

³⁵ Competition Commission, “Introduction to the Competition Commission’s energy code modification appeal jurisdiction”, September 2005.

Ofgem's decision.³⁷ E.ON appealed on 30 April 2007, the CC granted E.ON permission to appeal on 11 May 2007 and published its decision on 10 July 2007.

4.6.5 Key insights

4.56 The extension of appeal rights for energy sector code modifications is consistent with developments we have observed in other sectors. It also highlights the use of safeguards to prevent excessive use of appeals to the point that the CC would become the *de facto* regulator. While the changes are still relatively recent, they appear to be successful in striking a balance between providing a check on the regulatory decision process and avoiding excessive cost and duplication of decision making.

4.7 Other jurisdictions

4.57 We have not undertaken a comprehensive review of regulatory practice in terms of appeals against price control determinations in other jurisdictions. It is not clear that direct inferences can be made from other jurisdictions, as differences in the legal system, regulatory arrangements and legal structure will impact on the role of the regulator and appeal rights. However, we are aware that there are a number of other jurisdictions where appeals are allowed against regulators' price control decisions for energy networks such as the Netherlands and Italy and for airport price controls in Ireland.

4.58 We are not aware of any active use of appeal rights by consumers or users in these jurisdictions, except for Irish airports (which we discuss below). It is therefore difficult to infer whether these rights are effective or that consumers' views and interests are well represented in the process. In our discussion with the staff of the Dutch regulator, they noted that consumer groups were actively involved and influential in the price control determination, but that appeal rights had not been used by consumer groups. There was no evidence of excessive or frivolous appeals.³⁸

4.59 Irish airport regulation allows for appeal of Airport price control decisions to a Minister, who may establish an Appeal Panel to hear the decision under S40 of the Aviation Regulation Act 2001. The Minister may establish an appeal panel to hear the appeal. The Minister may refuse to establish a panel, but must provide

³⁶ Utilita Electricity Limited lodged and later withdrew an appeal before it could be heard.

³⁷ *E.ON UK Plc and GEMA and British Gas Trading Limited*, Decision and order of the Competition Commission, CC02/07.

reasons in writing. An appeal panel can either confirm the price control determination or refer to back to the regulator for re-determination.

- 4.60 In August 2001, the Irish Commission for Aviation Regulation (“CAR”), the sector regulator, set a price control for airport charges (at Dublin, Cork and Shannon). Aer Lingus, with Ryanair and others, appealed against the determination in October 2001. In January 2001, the Appeal Board ruled that the CAR’s determination should be reviewed, on a number of grounds appealed by Aer Lingus including inadequate use of benchmarking results to set efficiency targets for the airports, excessive depreciation allowances, errors in the construction of price control formulae and an apparent loophole that would allow the airport operator to ‘game’ the control by altering cargo charges.³⁹

4.8 Conclusions

- 4.61 The current provisions for appeal rights for GB energy networks are consistent with the approach to appeals traditionally employed in other price controls in the UK. However, in recent years, this approach has been subject to review and change as part of wider regulatory reform in the communication and aviation sectors and for competition law. Appeal rights in the communications sector have been broadened to allow any affected party to appeal Ofcom price control (and other) determinations. The Enterprise Act 2002 introduced a new appeal process and allows any affected party to appeal decisions by the OFT and CC. There is an ongoing debate in the aviation sector as to whether appeal rights for price control determinations should be extended to consumers and users.
- 4.62 In the energy sector itself, the energy code appeal process allows affected parties to appeal Ofgem decisions. In other countries, there is provision for consumers and users to have appeal rights, however, there appears to be little active use of these processes.
- 4.63 The recent developments in appeal rights have focussed on extending appeal rights from the regulated networks to other affected parties. The moves appear to be motivated by new EU legislation, the desire to counter-balance the powers of the regulatory body, and the need to ensure consistency with human rights law. The extension of appeal rights appears to be successful – there is no evidence of

³⁸ Correspondence with Nederlandse Mededingingsautoriteit (NMa) / Energiekamer, 6 August 2009.

pressure to roll back appeal rights. However, there is little evidence of consumer involvement in the appeal process outside competition law. Instead, appeal rights are utilised by industry parties.

- 4.64 In the aviation sector, there has been significant debate and the issue of appeal rights is still unresolved, although this may be motivated by the CC's unusually full role in the current airport price control.
- 4.65 The CAT and CC have overturned decisions of regulators and the OFT, although the evidence from the experience with competition law where there is a larger number of appeals suggests that the CAT confirms most of the OFT/CC decisions.
- 4.66 The experience with regulation suggests that appeal rights can be successfully extended to parties other than the regulated network and that extended appeal rights can enhance the regulatory process. Experience to date does not support the idea that extending appeal rights leads to significantly greater consumer participation in the price control process. Benefits to consumers would appear to rely on the actions of other participants in the sector rather than consumers themselves.

³⁹ Commission for Aviation Regulation, "Decision of the Commission further to a referral by the Aviation Appeal Panel of the Commission's Decision in relation to its Determination of the 26 August 2001 on the Maximum level of airport charges", 9 February 2002.

5 Overall assessment

5.1 In this chapter we outline our overall assessment of the pros and cons of allowing appeal rights for users and consumers based on our assessment framework. We firstly set out a summary of our view and then discuss each of the key points in more detail.

5.1 Overview

5.2 The table below provides an overview of our assessment of the pros and cons of extending appeal rights to consumers and users.

Table 6: Pros and cons of extending appeal rights to consumers and users

Criteria	Assessment
Positive	
Good regulatory process	<p>Promote accountability of Ofgem to consumers and users</p> <p>Provide stronger incentives for consumers and users to engage in price control process and for networks to engage with consumers and users</p> <p>A more equal 'balance of power' during price control process</p>
Consumer benefits	Potential to improve outcome of price control determination which could have significant benefits for consumers
Sustainability	Help ensure that sustainability considerations are given appropriate weight in price control decisions
Negative	
Direct costs	We would expect an increase in the number of appeals. This will result in additional costs for

	appellants, networks and Ofgem
Indirect costs	Appeals will raise uncertainty for networks during appeal process and potentially about price control outcomes Appeal decision may be incorrect

Source: LECG

5.2 Good regulatory process

5.20 In assessing the impact of extending appeal rights on good regulatory process, we consider the principles of better regulation, the impact on the incentives for consumer engagement and the balance of power between the parties.

5.21 In the table below we summarise our assessment of the impact of extending appeal rights on the principles of better regulation. We then discuss in more detail the impact on the accountability, transparency and targeted, which we believe is most relevant to our assessment.

Table 7: Impact assessment of extending appeal rights

Principle	Effect of extending appeal rights
Accountability	Promote accountability of Ofgem to consumers and users
Proportionality	Strikes right balance between enhancing role of consumers without providing for overall symmetry between users, consumers and networks.
Consistency	Ensure consistency of standing to appeal between networks, users and consumers
Transparency	No substantive impact except for enhanced incentives for consumer engagement
Targeted	Provided positive benefits of appeal exceed additional costs

Source: LECG

5.2.1 Accountability

5.22 An appeal system strengthens the accountability of the regulator to its stakeholders. It requires the Ofgem to give a reasoned argument in response to arguments and evidence put forward by interested parties. In regard to aviation price controls, the DfT noted:

The most important mechanism for ensuring regulatory accountability is ensuring there is appropriate provision for affected stakeholders to challenge the CAA's decisions to an independent body.⁴⁰

- 5.23 The effectiveness of the appeal system in providing accountability will be affected by the criteria that determine which parties have standing to appeal. The appeal body may be able to consider the interests of all relevant parties against Ofgem's objectives. However, if users and consumers do not have the right to appeal it may not have the opportunity to do so. Users and consumers have a strong interest in network charges and service quality. Therefore, there is an argument on grounds of regulatory principle that networks and users should all have rights of appeal.
- 5.24 Ofgem's statutory objectives do not provide for a substantive duty owed by the regulator to users. It could be argued that as Ofgem does not have primary statutory duty towards users and so mechanisms to promote accountability to users are unnecessary. However, it is users (as suppliers) whose customers will be affected by a network's service charges and quality. One means of giving effect to consumer interest will be providing users with a right of appeal. There is some concern that suppliers do not have sufficiently strong interest in acting on behalf of consumers, as we discuss further in Section 6. However, they are well placed in terms of understanding of the issues. Further there are some issues such as efficient interaction between networks and suppliers that consumers are beneficiaries of but do not participate in. The absence of a statutory duty toward users does not necessarily detract from the case for giving users a right of appeal.
- 5.25 It could be argued that Ofgem acts to protect the interests of consumers and therefore an appeal right is not required.⁴¹ If Ofgem effectively acts on behalf of consumers, then they will have no need for rights of appeal. However, this argument would apply to the interests of networks in terms of financeability as well. An appeal process recognises that checks on the decision process are required and that the decision maker may not always make perfect decisions. Ofgem has to balance a number of duties when making regulatory settlements and an appeal process should allow for a check on the full range of duties. It will

⁴⁰ Department for Transport, "Reforming the framework for the economic regulation of UK airports", March 2009.

limit the benefit of the appeal system if some parties with important interests cannot defend them.

5.2.2 Proportionality

- 5.26 In this context the proportionality test asks whether extending appeal rights to consumers and users is an excessive intervention relative to the outcome it achieves (even if the outcome is a desirable one). The counter-claim would be that price controls are of fundamental importance to networks, so that networks should have an appeal right, but that they are of less importance to consumers and users and therefore the extension of appeal rights to those groups is a disproportionate regulatory intervention.
- 5.27 We recognise that price controls affect the interests of networks more fundamentally than they affect the interests of most and perhaps all consumers and users. For example, if prices are set too low then a network's financial viability is at risk. It is therefore arguably proportionate that networks should have a more central role in the price control process than do consumers or users (this argument should however be seen in the context of Ofgem's principal statutory duty to promote the interests of consumers).
- 5.28 However, our recommendations would not (and are not intended to) create a position of symmetry between networks, users and consumers. Networks' overall position in the price control process is—rightly—quite different from that of other parties in terms of the level of engagement with Ofgem throughout the process. Moreover, even if one focuses on appeals only, it is clear that appeals would always be a more potent tool in the hands of a network than in the hands of a consumer or user, for reasons discussed earlier (the “free rider problem”). Finally, our proposals for implementation (discussed in Section 6) entail a set of hurdles for non-network appeals that create a further difference between network and non-network appeal rights.
- 5.29 Finally, we note that the extension of appeal rights to consumers and users is not necessarily a zero-sum game. By enhancing the role of consumers and users it may lead to a more robust process with higher levels of accountability and legitimacy, to the benefit to all parties, including networks.

⁴¹ For example of this argument, see CE Electric UK Funding Company, “Response to Ofgem's consultation paper”, April 2009.

5.2.3 Consistency

5.30 We note that while users and consumers do not currently have standing to appeal price control decisions to the CC, this does not prevent interested persons from challenging a licence modification by way of judicial review in the High Court or by appeal to the Secretary of State for a veto. This could raise a question as to whether further appeal rights are needed by consumers and users. Although, neither mechanism has been used in the twenty years of Ofgem price controls, this might simply reflect the quality of Ofgem decisions.

5.31 However, the current approach would imply that Ofgem's decision could be open to challenge by one person whose interest is materially affected in the CC and by another person whose interest is materially affected in judicial review proceedings or before the Secretary of State, at the same time. This does not appear to be a sensible approach or consistent with good practice. We note that an extending the right of appeal for consumers and users may raise questions about the continued relevance of the Secretary of State veto.

5.32 An extension of appeal rights to consumers and users is consistent with the direction of the reform of appeal rights under competition law, in the communications sector and the energy code appeals process, as described in section 4.

5.2.4 Targeted

5.33 The question of whether or not extending appeal rights is targeted, is really a question as to whether there are significant benefits from extending appeal rights and that these benefits are greater than the costs. This in turn implies a consideration of alternatives to extending appeal rights as a means of achieving the desired outcomes. The extension of appeal rights may mean that the price control determination process is extended. However, provided there are real net benefits from the extension of appeals, then it would be appropriate to consider the extension as targeted regulation.

5.34 The issue of targeted regulation raises the question as to whether there might be alternative means of achieving the same benefits as extending appeal rights at a lower cost. There are number of potential avenues for improving the quality of Ofgem decision making and interaction with consumers, however, there appears to be little direct substitute for appeal rights. Increasing consumer engagement will help, but it is also a complementary measure to appeal rights than a substitute

for it. Many of the alternative measures to protect against regulatory capture such as independent GEMA members and publication of minutes are already in place. Extending appeal rights therefore appears to be consistent with targeted regulation.

5.2.5 Incentives for consumer engagement

5.35 Appeal rights strengthen consumers' and users' voices in the price control process and so will provide greater incentive for them to participate in the determination process.⁴² The ability of consumers and users to effectively utilise a right of appeal will depend on how well informed they are about the issues in a price control. Increasing consumer and user engagement will facilitate effective use of appeal rights.

5.36 Extending appeal rights enhances the incentives for networks to engage with users and consumers. In doing so, networks will gain a greater appreciation for consumer and user interests and therefore will be able to take account of these interests in their proposals to Ofgem. Engagement will enable networks to persuade consumers and users about the merits of their proposals. This may assist with reducing the likelihood of an appeal.

5.37 Consumer engagement and the right of appeal are mutually reinforcing and the full benefits of an appeal process will be dependent at least in part on greater consumer engagement.

5.2.6 Balance of powers

5.38 The extension of appeal rights will affect the 'balance of power' between networks, consumers and users. Extending the right of appeal to consumers and users will result in a more equal balance of power between network, consumers and users. This will tend to result, all being things equal, in Ofgem giving more weight to consumer interests in their decision.

5.39 The shift in the balance of powers could raise risks around undermining the recovery of network costs and so deterring investment. However, this risk appears to be modest, given that Ofgem has a statutory duty to ensure financeability and that the price control framework with revenues set to recover expected efficient costs including an appropriate return on investments, is well

⁴² We discuss the impact of appeals on incentives of parties in more detail in the Appendix., section A7.4.

established. Furthermore networks would retain the right to appeal decisions and could use this to overturn Ofgem decisions that were too weighted towards consumers' short-term interests. On balance, given the safeguard to protect networks, we believe the overall impact is likely to be positive.

5.3 Consumer benefits

5.40 In the appendix, we discuss the economic literature on appeal rights in the civil courts and its potential relevance to appeals against price control determinations. In summary, rights to appeal have two major affects – they allow parties to appeal decisions that they believe are incorrect and they impact on the incentives of other parties. Extending appeal rights to consumers and users will enable them to appeal decisions that they believe do not take appropriate account of their interests. Extending appeal rights will affect the incentives of parties in the price control process. It will place greater onus on Ofgem to appropriately consider the interests of consumers and incentivise networks to engage with consumers and users and consumers to engage in the price control

5.41 Both the impact on Ofgem, networks, consumers and users' incentives during the price control process and the ability to appeal perceived errors will benefit consumers. In particular, consumer and user appeals potentially remedy mistakes that adversely impact on consumers and users, such as allowing excessive returns or an excessive level of capital and/or operating expenditure. The appeal could also relate to the requirement for additional investment, although the network is also likely to have an incentive to appeal on this issue.

5.42 The potential benefits to consumers from such appeals could be large. Price control decisions have significant potential benefits for consumers and therefore, relatively small changes in to the outcome to decisions have a large effect on consumers. Small changes to parameters such as the cost of capital could generate a difference in charges of over tens of millions of pounds annually⁴³. Ofgem has commented in the review of DPCR4 it was too easy for networks to

⁴³ For example, Ofgem notes that 0.25% increase in the cost of capital for DPCR5 would result in a 0.5% increase in network charges. The effect of £100m change in allowance for pension deficit recovery is 0.2% increase in charges. Total distribution charges are currently approximately £3.6b per annum. Hence a 0.25% change in the cost of capital would result in an additional £36m charges for consumers each year. See Ofgem, "Initial Proposal: Electricity Distribution Price Control Review".

outperform both the losses incentive mechanism and because it impacted on overall performance, the price control as a whole.⁴⁴

- 5.43 Consumers' and users' interests differ between different types of consumers, e.g. household versus commercial and different types of users e.g. distributed generation versus grid connected generation. It is possible that a successful appeal could alter the balance of benefits between consumers and users i.e. benefit some consumers at the expense of other. We do not think that this point changes the merit of an appeal mechanism, although it is important to be aware of this issue.

5.4 Sustainability

- 5.44 Many of the points discussed above also have relevance for sustainability. However, a particular concern with energy networks is their role in the transition to a low carbon economy. There is a question as to whether the extension of appeal rights has an impact on this objective. Some industry participants have argued that consumers' interests are not well aligned with the long term investments required to achieve a low carbon energy sector. Others have suggested that consumers and users are poorly placed to decide on the magnitude and types of investment required to meet climate change objectives. We now consider these points.
- 5.45 We accept that while there may be some tension between the interests of some consumers and users and the transition to a low carbon energy supply, the same is not true of all consumers and users. Generators are users of the electricity grid, while most suppliers have interests in generation as well as retail. In the case of distributed generation, both consumers and suppliers may be interested in connecting to the network. It is therefore the case, that some consumers and users will have different interests from other consumers and users that are nonetheless consistent with Ofgem's statutory duties and so participation need not diminish the consideration of climate change and sustainability in the regulatory process.
- 5.46 Any appeal will be considered in the context of Ofgem's objectives, which do provide explicit consideration of the interests of sustainability. Therefore, appeals

⁴⁴ There is a question about to what extent that reductions in network cost will be passed onto consumers. This will partly depend on the extent of competition in the retail market. Provided the market is reasonably competitive, we would expect that some of the benefits will be passed through

will be considered with due importance given to sustainability objectives and the appeal process will not place an undue focus on short-term consumer interest.

5.47 There is some merit to the point that consumers and users may not be well informed about the appropriate timing and scale of investment. However, this could be partly addressed by networks providing more information to users and consumers. We anticipate that this would take place under any move to greater consumer engagement in the regulatory process. Finally, we think that to the extent that consumers and users are less informed about the details of the capital investment programme, they are less likely to appeal decisions or to appeal successfully on these grounds.

5.48 The link to sustainability is of particular importance in the context of the RPIX@20 review, for which the implications of decarbonising the GB energy system are a key driver. In general we do not believe that extending appeal rights is likely to harm sustainability. The effect is likely to be neutral, but there are some scenarios in which extended appeal rights could promote sustainability..

5.5 Direct costs

5.49 We expect the extension of appeal rights will result in additional appeals and therefore an increase cost to Ofgem, networks and appeal parties. The level of cost will depend on the number (and intensity) of appeals. This is difficult to forecast with any degree of certainty.

5.50 The costs for each party could be significant requiring legal and expert advice as well as considerable management time and internal firm resources. Nonetheless, we would expect that the direct cost of an appeal process is likely to be relatively modest in relation to the size of the regulatory decision and the consumer welfare gains.⁴⁵

5.51 Parties will have an incentive to appeal only for decisions when they are reasonably confident of over-turning a decision, otherwise they face the risk of incurring their own and other parties costs without the prospect of likely benefits. This should help to focus appeals on the appropriate regulatory decision.

to consumers.

⁴⁵ As discussed in the previous section, consumer benefits could potentially be in the order of tens of millions of pounds.

- 5.52 Appeals will be more likely where the appellant may benefit significantly from overturning a decision. Consumer groups will not directly benefit from a successful appeal (aside from potentially recovering their own cost). They have relatively limited resources and may struggle to fund the irregular and uncertain costs of an appeal. This has the potential to limit their potential use of an appeal process, unless the resourcing of consumer groups is addressed in the design of the appeal process.
- 5.53 Users will have incentive to appeal where there are significant benefits to themselves. These benefits may not always align with consumer interest such as where generator appeals a price control decision to delay investment programme that would affect ability of competition to expand. This may mean that more appeals could be made than would be desirable. We discuss how this could be managed in section 6.

5.6 Indirect cost

- 5.54 Indirect costs are the broader costs to the sector from extending appeal rights. We now discuss two indirect costs: uncertainty and incorrect appeal decisions.

5.6.1 Uncertainty

- 5.55 A key indirect cost is potential increase in uncertainty associated with additional appeal activity and the impact this may have on network business planning. If an appeal is lodged, then the network will face a period of uncertainty about outcomes until the appeal is determined. For example, uncertainty around the level of allowable capex may cause networks to delay capital expenditure planning. As some capital expenditure has significant lead times, there could be a concern that this may potentially lead to delays to investment or increase the risk of investment and potentially the cost of capital.⁴⁶ It is also true that the network faces this uncertainty under regulatory arrangements, if it rejects a licence modification and Ofgem refers the matter to the CC. However, in that case, it at least takes the decision whether or not to reject a licence modification.
- 5.56 Provided the appeal process takes place in six to nine months, the impact of an appeal on the level of uncertainty for a five-year price control should be modest. Investment will be planned over the five-year price control period, so that even if the appeal did result in a lower level of allowed capital investment, this will be

much greater than the firm is likely to invest in the first six to nine months of a price control. The regulated network will be able to adjust plans in light of the outcome of the appeal over the remaining time of the determination. This issue would be more serious if the appeal was to take a significant portion of the price control. It is therefore important to ensure that safeguards are in place to promote the efficient consideration of appeals. We discuss this issue in Section 6.

5.57 There is also a more general concern that extending appeal rights could increase general uncertainty for networks as it will be unclear what the outcome from the extension of appeal rights to consumers and users will be for some considerable time. If this uncertainty was perceived as significant then this could arguably raise networks' cost of capital.⁴⁷ However, provided that parties have confidence in the appeal body, then the additional uncertainty would appear to be limited. It is unclear why an appeal body would be less regarded to the financeability of networks than Ofgem. The experience with appeals in the communications sector provides some precedent and this should reduce uncertainty.⁴⁸ Further, concerns can be addressed by ensuring that the appeal body is respected and will carefully balance the interests of networks and consumers.

5.6.2 Incorrect appeal decisions

5.58 Our analysis has assumed that the overturning of Ofgem's decision on appeal is an improvement to price control decision making. There is a possibility that the appeal body could either: (i) incorrectly dismiss an appeal that should have been allowed; or (ii) overturn a correct Ofgem decision. The costs of (i) are to reduce the benefits of an appeal process without any offsetting cost reductions. The cost of (ii) would typically reduce returns to the network, potentially to a level below cost. This could have significant costs if it reduced the quality of outputs or delayed investment by networks.

5.59 A further possible outcome is that the appeal body and Ofgem might reasonably differ over the determination of the price control, given the complexity of the issues and the uncertainty about the appropriate treatment of issues. In this case, an appeal might change the outcome but not result in an improved or worse

⁴⁶ We note that a delayed investment is not necessarily a bad outcome. If the appeal body finds that investment should not go ahead then delay would be in the consumer interest.

⁴⁷ Although that uncertainty is a diversifiable risk that in principle should have this effect, according to finance theory.

⁴⁸ Although, experience with the appeal mechanism is limited to six years and the energy sector may face different issues.

decision. The appeal process would therefore increase costs without any offsetting benefits.

- 5.60 The selection of an appropriate appeal body will help limit the risk of poor quality appeal decisions. This will help to prevent excessive appeals and will help to deter appeals against reasonable decisions.

5.7 Conclusions

- 5.61 We consider that there are strong arguments for the extension of appeal rights to consumers and users. First, there is an important set of arguments based on the principles of better regulation. In particular extending appeal rights to all those with a legitimate interest in the process would enhance accountability. While we acknowledge that there are concerns about the appeal authority substituting for the regulator these would appear to be best addressed by appropriate design of the appeal process. The provision of appropriate safeguards would also avoid an excessive or disproportionate shift of focus towards consumers and users, bearing in mind that it is networks whose interests are most fundamentally at stake in a price control.

- 5.62 Second, there are further arguments around the potential to provide additional guarantees around the quality of the price control process. Consumers and users have strong interests in the outcome of the price control process. Relatively small changes to price control decisions could have significant implications for consumers. While the extension of appeals is likely to increase the administrative cost and regulatory burden, the additional costs appear to be much smaller than the benefits to consumers that the additional safeguards would provide, and can be managed by good design of the appeal process.

- 5.63 Finally, we think that sustainability in both in terms of climate change and social objectives can be enhanced rather than diminished by extending appeal rights, as consumers and users have interests in sustainability and these interests will be reflected in use of the appeals process... In any case, provided the appeals relate to Ofgem's duties they seem unlikely to hinder the consideration of sustainability.

- 5.64 We have considered the arguments and accepted the in-principle case for extending appeal rights to consumers and users, we now turn to the design of appeal arrangements.

6 Design and implementation of appeal rights

- 6.1 In this chapter, we consider a number of issues regarding the implementation of appeal rights. These issues include: which party should have appeal rights; the grounds for making an appeal; the appellate body; how to encourage well founded and discourage spurious appeals; the scope of appeals; and whether there should be time limits on the right to make an appeal. The design of the appeals process is important to ensuring that the regulatory burden of the appeal process is manageable. A summary of our approach is set out in the table below. We then discuss each of the points in more detail.

Table 8: Proposed approach to design of appeal rights

Issue	Proposed approach
Who should hear appeals	Competition Commission
Who should have appeal rights	Materially affected parties (most likely to be users of the network and representatives of end consumers)
Grounds for appeal	Adverse to public interest, giving due regard to Ofgem duties
Scope of appeal	The CC should generally review the price control decision as a whole and not just matters raised by parties
Discouraging frivolous appeals and reducing uncertainty	<p>Deadline for an appeal of 30 days after final price control determination</p> <p>CC to adopt four to six month period to hear an appeal and reach a decision</p> <p>Require permission from CC before an appeal can be lodged</p> <p>CC to allocate cost of successful party to unsuccessful party</p>
Secretary of State veto	Able to be removed.
Sector issues	Appeal rights should be extended for gas and electricity transmission and distribution networks.
Role of CC	If it decided that an appeal is sustained, the CC should as far as possible re-determine the price control decision

Source: LECG

6.2 Who should have appeal rights?

6.2 There are a range of parties that may be affected by price control determinations including consumers (domestic, commercial and major energy users) and users of networks such as suppliers, other generators and gas shippers.

6.3 There are a number of issues to consider when designating which party might have appeal rights. These include the interest of the party in price control determinations, their resources and ability to engage with price control determinations and their access to information.

6.2.2 Consumers

- 6.4 Domestic and commercial consumers have a strong collective interest in network price control determinations, as they will ultimately bear much of the cost and experience the impact of the quality of service delivery. Individually, however, they are poorly placed to consider price control issues. They have limited resources and energy is a relatively small proportion of total costs for many (but not all) consumers. Network price controls raise complex technical, economic and financial issues, which are difficult and undesirable for consumers to directly engage with by themselves.
- 6.5 In addition to the question as to the feasibility and desirability of individual consumers engaging in the price control, there is a free rider problem that may inhibit participation by individual consumers. Individual consumers may rationally choose to rely on the efforts of other consumers, as they will benefit from those efforts without incurring costs. This means that individual consumers are likely to exert too little effort in the appeals process. Consumer representative bodies provide a partial means of addressing the free rider problem (although they themselves suffer from the problem).
- 6.6 The interests of domestic and commercial consumers are represented by a number of organisations such as Consumer Focus. Large users are represented by bodies such as the Major Energy Users Council (“MEUC”) and Energy Intensive Users Group (“EIUG”). Representative groups enable the dedication of resources to issues such as price controls, although they still face significant challenges in participating in the price control process due to the specialist industry and regulatory nature of many of the issues. However, they also raise the issue of how a representative group can determine consumer preferences and when it would be in consumer interests to appeal a price control determination. Consumer representatives will also suffer from the asymmetric nature of relevant information which is most likely to be held by the network or by Ofgem, such as the costs of equipment or investment needed to meet demand. Representative groups may also have to trade off the interests of consumers where these differ between consumers. No group represents the interests of future consumer per se. The limitations due to asymmetric information can be addressed, in part of an effective consumer engagement process. The issue of trade offs between interest can be addressed by interaction between the consumer group and consumers and potentially by different groups representing different types of consumers.

6.2.3 Users

- 6.7 Suppliers, as retailers of energy, are responsible for the payment of most network charges and their customers are impacted by network quality. While much of these costs will ultimately be passed through to consumers, it is likely that suppliers will experience some impact from changes in network charges due to market frictions and imperfection. There is also a question of timing of the ability to pass through price changes, as suppliers may have customers on fixed price contracts. Therefore, suppliers' interests will, to some extent, be aligned with users. Large suppliers have sufficient scale and sophistication to engage in the complex technical, economic and financial interests of price controls.
- 6.8 The interests of most major suppliers may also be complicated by their ownership interests in distribution networks. This may undermine their incentives to take action against networks. However, one major supplier, Centrica does not own networks, RWE does not own networks in the UK and a third supplier, EDF, is in the process of selling its distribution networks. Suppliers also have significant interests in electricity generation, which we discuss below.
- 6.9 Grid connected generators have interests in the costs of electricity transmission as they bear some of the costs.⁴⁹ They also have interests in the availability of transmission capacity to connect generation and in the quality of service. In some cases, generators may have an interest in blocking or delaying capacity expansion because they benefit from grid constraints. They have interests in the access to transmission capacity by competing generators and access to distribution networks by distributed generation. Distributed generation has an interest in capacity and reliability of distribution networks. The costs of transmission for generators are likely to be passed through to suppliers to some extent, in a similar fashion to suppliers.
- 6.10 Generators', producers', interconnectors' and shippers' interests in transmission and distribution networks will be different from consumers' interests. To the extent that they are the beneficiaries of improved capacity and quality without paying the full cost of the investments, then they will tend to favour investment over containing cost. However, it is also true that generator interests may be aligned with consumer interest, for example, where incremental investment provides

⁴⁹ At least in the short run. Economic theory suggests that in the long run the incidence of these costs will be mainly on consumers, since demand is much less elastic than supply. We note that generators pay proportionally less transmission charges than suppliers.

improved service quality and this improvement is valued by consumers. Further, generators' and shippers' interests may be affected by their interest as suppliers or owners of distribution.

6.2.4 Other parties

6.11 There is a question as to whether parties other than consumers and users should have appeal rights. Our recommendations already include giving appeal rights to consumer representative groups, and it might be argued that this should include groups that represent the interests of specific subsets of consumers, such as the fuel poor, and/or that groups that represent other "public interest" causes (e.g., environmental protection).

6.12 Our proposed definition does not rule out other parties becoming appellants, although they would have to demonstrate to the appeal body that they are materially affected by the price control decision and that they had *prima facie* case that they are adversely affected by matter in the public interest with regard to Ofgem's duties. As for all parties, we would expect that the CC would not in general allow such parties to raise new issues in their appeal and therefore, that they would have engaged on the relevant issues during the determination process.

6.2.5 Conclusion

6.13 In summary, individual consumers do have a legitimate interest in price control determinations but are poorly placed in terms of both resources and information to engage with complex price control determinations. Consumer representatives are better resourced to represent consumers but face the challenge of understanding consumer preferences sufficiently well to know when an appeal is warranted. Users of distribution networks may have the resources to engage with price control determination, but their interests may not always be well aligned with consumers.

6.14 We recommend extending appeal rights to a broad scope of materially affected parties with constraints on the use of appeals. In similar fashion to the Communications Act, appeal could be open to any materially affected party, with the onus on the appellant to demonstrate that they are affected by the price control decision.⁵⁰ Appellants could be required to demonstrate a *prima facie* case

⁵⁰ As with current price control appeals, the appeal body would have discretion to reject appeals on the grounds that the issues raised by the appellant had not been raised in the price control.

that Ofgem had failed to meet its statutory objectives in taking its price control decision. This would help to ensure that appeals are directed towards protecting consumer interests. We recommend that consumer groups are designated to act on behalf of consumers. The definition of affected parties would still allow individual consumers to take action, although we would not expect this to happen except in exceptional circumstances. The appeal body would be expected to take account of the desirability of hearing appeals from an individual, should an application for an appeal be made.

6.3 Who should hear the appeal?

- 6.15 The CC is the body that hears appeals from networks about price control reviews. We believe that there are compelling reasons for having the CC hear appeals from other affected parties, if the right of appeal were to be extended in this way.
- 6.16 It would create a conflict if a second body was designated to hear appeals from consumers and users while the CC still heard appeals from networks. This would create the risk that the CC would hear an appeal from a network at the same time as a consumer or user appeal was heard by a second body and the risk of different decisions on the same issues by different appeal bodies. The creation or designation of a second appeal body does not appear to be a workable or sensible option.
- 6.17 There is also precedent from the communications sector and for the energy market codes for the CC to hear appeals from affected parties. The CC is also familiar with price control issues from its current role in the airport price control process. The CC is a specialist body with the expertise to consider price control issues and the determination of prices. It would be appropriate for the CC to continue to hear appeals in the event that appeal rights are extended to consumers and users.
- 6.18 There may be a question about the suitability of the CC to decide on the environmental or security of supply issues implicit in the determination of an energy price control. A decision may require the exercise of judgement about the allowance of expenditure by networks designed to protect the environment or promote security of supply at a cost of users and consumers. However, the CC is already required to determine such issues under current energy price control appeal processes albeit for networks only. Secondly, the CC is required to reach a view on environmental and security of supply issues arising from appeals

against price controls in other sectors such as water and rail. The composition of the CC with a broad range of academic and professional skills, gives it the necessary capacity to consider such issues.

6.19 It would be expensive to establish a further body to hear appeals, given the high degree of expertise required to make a determination. There may be a question as to whether all regulatory matters should be heard by a specialist regulatory tribunal. The House of Lords constitution select committee recommended that a Regulatory Appeals Tribunal (“RAT”) should be set up to cover regulatory decisions that do not fall within the jurisdiction of the CC and the CAT.⁵¹ This idea has some merit, however, it would require wider reform in other sectors as it is intended to be multi-sectoral. Appeal mechanisms in other sectors are outside the scope of this report, but if there is a wider consideration, then it would be appropriate to consider whether the establishment of a RAT is appropriate. In the absence of such a change, the CC remains the centre for expertise in the review of price control decisions. An alternative to the establishment of a RAT would be to establish a specialist division of panel member within the CC to hear price control appeals. This idea is attractive, particularly, if there is an increasing volume of appeals across a range of sectors.

6.20 There is a question as to whether the appeal should first be referred to the CAT, who in turn would have the power to refer the matter to the CC, as is the case in the communications sector. However, the arrangement in the communications sector is necessary as appeals can be referred on both price control and other issues (such as competition cases). The CAT refers price control issues to the CC. There does not appear to be a need to refer price control matters to the CAT for reference to the CC in the case of energy network price controls, because the subject is restricted to price controls. It would be more efficient to refer matters directly to the CC.

6.4 Role of CC

6.21 There is question of the CC’s role if it decided that an appeal should be sustained. It could remit the determination back to Ofgem or it could re-determine the price control itself. The CC’s role in appeals has been extensively debated in the Communications sector. The CAT has ruled that the CC should as far as possible

⁵¹ House of Lords, “The Regulatory State: Ensuring its Accountability”, 6 May 2004.

re-determine the matter, as this would reduce the time for determination and the attendant uncertainty around outcomes.⁵²

- 6.22 Under the Electricity Act and the Gas Act, the CC is required to reach a conclusion on the matter referred and to propose any licence modification necessary to address any adverse effect that they have identified. Ofgem is then required to modify the licence to remedy the adverse effects identified by the CC. Ofgem are required to consult on the modification.
- 6.23 We propose that the role of the CC should be to re-determine the price control as far as possible, but that it should have the option of referring the decision to Ofgem, if it considers this is an appropriate course of action. This would avoid any delay arising from the CC reaching a decision on the appeal and then referring the matter back to Ofgem for re-determination and consultation to ensure that the re-determination addressed the CC's concerns with the original determination.

6.5 Grounds for appeal

- 6.24 The grounds of any appeal raised would be related to the basis on which materially affected parties were seeking to appeal the Ofgem decisions. Currently, Ofgem may refer any matter to the CC to consider whether it is adverse to the public interest. The CC must have regard to Ofgem's duties.
- 6.25 The grounds for appeal for energy code modifications is that Ofgem has failed to have proper regard to its duties and objectives or that the decision is an error of law or fact. In the communications sector, the legislation requirements are procedural. The grounds of appeal must be set out in sufficient detail by the appellant to indicate whether the appellant believes the decision was wrong in law or fact or whether the appeal is against the exercise of discretion by Ofcom (S192(6) Communications Act).
- 6.26 We propose that consumers and users would have to demonstrate they have a material interest in the price control determination and they should be required to demonstrate they have prima facie grounds for appeal. The CC would determine whether or not the matter appealed is adverse to the public interest, having regard to Ofgem's duties, as at present.

⁵² Hutchison 3G UK Limited v Office of Communications, Case 1083/3/3/07, 16 January 2009.

6.6 Scope of appeal

- 6.27 A key choice in the grounds for appeal is whether to adopt broad-based grounds such as in the Communications Act 2003, which provides for appeals on merit, or whether to take the approach discussed in the aviation sector of restricting appeals to matters of principle. Under the latter approach, Ofgem would be required to adopt or approve a statement of principles around the price control and appeals would be restricted to matters in that statement. A related question is whether the scope of an appeal should be limited to a specific issue cited in the application or whether it should permit an investigation of all aspects of the settlement, in line with the current arrangements.
- 6.28 The benefit of allowing appeals on specific points is that it reduces the issues and therefore the time and cost of considering appeals. It also may fit with the range of interest of consumers and users, as they may not be interested in all aspects of the decision.
- 6.29 However, allowing appeals on specific issues would undo a key element of Ofgem's determination: decisions are taken as a whole. In considering any element of a decision, there are likely to be trade offs and ultimately, Ofgem makes a judgement as to whether the determination meets its objectives as a whole. There is a danger in revisiting a part of any decision that interactions with other elements of the decision will not be appreciated.
- 6.30 There is a risk that if the appeal is limited to matters raised by parties, then parties would have an incentive to lodge an appeal on elements unfavourable to them, even where the decision as whole was satisfactory. This could result in re-determination that is focused too narrowly or it could result in a series of limited appeals by various parties to protect their interests.,
- 6.31 The practice of the CC in considering appeals for price controls is to consider all aspects of a case rather than specific issues. We believe that such an approach is generally appropriate for appeals against Ofgem's price control decisions and will assist in ensuring that the appeal takes all relevant points into account. . There may be a case for giving the CC discretion to consider individual matters raised in the appeal, if it is satisfied that a particular issue can be considered by itself without adversely affecting relevant parties. The CC could be required to consult with Ofgem and the network as to whether it should consider a narrow appeal to ensure that it understands the implications for the parties. Single issue

appeals do raise difficult issues about undercutting the balancing implicit between issues in price control determinations. We believe this matter is worth exploring further.

6.32 We favour a broad based approach based on a merits review of Ofgem decisions. Developing a statement of pricing principles would add an additional element to price control processes and it is difficult to draw the line between issues which should be addressed in the statement of principles and those in the determination itself, without the statement being too general or high-level to add value. In any case, affected parties are likely to want to consider the impact of the stance taken by Ofgem on prices themselves. Consumers or users may object to Ofgem’s position in principle but prefer not to appeal a decision as the impact of the disputed issue on the determination is minimal.

6.33 We accept that consumers and users may find it difficult to reach views on the merits of some issues where the network has access to detailed information necessary to inform decisions such as the required capital investment in a price control period. We draw two conclusions from this point. First, it will be important for Ofgem to facilitate the provision of information by networks to affected parties – this will also be consistent with any broader adoption of consumer engagement. Secondly, the appeals process needs to be designed to discourage ill-informed or frivolous appeals. We will discuss this point below. Finally, we believe that there is value in being able to draw on the precedent for the use of merits based appeals for communications sector and competition issues faced by the CC.

6.7 Should Ofgem or the appeal body be able to refuse an appeal hearing?

6.34 A potential concern with extending appeal rights is that there may be frivolous or low value appeals. A related concern is that the CC may effectively replace Ofgem as the regulator, if it reviews all or most regulatory decisions. The economic analysis of civil law notes that appeals are the exception rather than the norm of the legal process— most decisions are not appealed.⁵³

6.35 We believe that it would be appropriate for somebody to have the right to reject appeals at an initial stage. This will help to deter frivolous or low value appeals and if such appeals are made, prevent them from going forward to the CC.

⁵³ For further discussion, see section A7.2 of the appendix.

- 6.36 We now discuss the choice of the appropriate body to make the decision. Ofgem will be well placed in terms of its understanding of the issues after reaching its price control determination, whereas the CC will be coming fresh to the issue. However, Ofgem may not be independent from the decision, as it is its decision which is subject to appeal and more importantly, will not be perceived to be independent. This may undermine the value of a right of appeal. Further, the CC has the power to reject appeals under the Communications Act and for the energy network codes, so there is precedent for the CC to take this decision.
- 6.37 We also believe that the CC has a strong bias against hearing new evidence or arguments that were not presented in the price control process. In deciding whether or not to hear an appeal, it should consider whether or not the party has raised the appeal issues in the price control determination with Ofgem. This helps to safeguard the role of Ofgem in the price control process and ensures that the appeal process is not used as alternative to engaging with Ofgem.
- 6.38 On balance, given the independence of the CC and the precedent in the communications and energy sector, we consider that the CC should be given the right to reject appeals.

6.8 Allocation of costs

- 6.39 There is a question as to whether further measures are required to encourage well founded appeals and discourage spurious appeals. One potential measure is the allocation of costs arising from unsuccessful appeals. The CC has power to award costs against the unsuccessful party for appeals and for its own costs for appeals under the energy sector code.⁵⁴ This approach helps align the incentives of the parties with efficient outcomes, as they potentially incur their own costs and the costs they impose on other parties. This should encourage parties only to pursue well founded claims. On the other hand, the risk to a party of losing an appeal and being required to cover CC and other party costs may deter parties with limited resources such as consumer groups from appealing Ofgem decisions. The latter issue is probably best addressed by appropriate funding of consumer groups. We note that the CC can exercise discretion in the award of costs and may take account of the circumstances of the appellant in considering the issue of costs.

⁵⁴ Competition Commission, "Explanatory Notes on sections 173 to 177 and Schedule 22 of the Energy Act".

6.40 The CC's policy on cost for energy network code appeals is that it will normally award order an unsuccessful party to pay the costs of the successful party.⁵⁵ The CAT's policy on the award of costs is more open. The CAT does not apply the conventional rule in civil litigation that costs follow the event. It has, however, awarded costs against parties where it has perceived the appellant has raised points without merit or unnecessarily complicated a case.⁵⁶ The CAT has considered taking account of the size of a business in its decision to award costs. It has refrained from awarding costs against small to medium sized businesses in some cases, where it was concerned that the threat of having to pay the OFT's cost could deter action.⁵⁷

6.41 We believe that the CC should have a policy of awarding costs against unsuccessful parties, without fettering their discretion to take account of the circumstance of the parties. Although this risks deterring some genuine appeals, the benefit in terms of discouraging low value appeals is significant. Funding of consumer groups can be addressed by other means.

6.9 Time limits

6.42 There is a question as to whether the rights of parties to issue an appeal should be limited to a particular period of time. There is also a question as to whether other affected parties should be able to join the process, following notice of an appeal. The current price control process allows around one month for pre-consultation on a licence change and one month for consultation on the licence change. The precedent in other CC processes is mixed. The energy sector code has a tightly constrained timeline for appeals. This timeline allows three weeks for an appeal to be lodged, two weeks for the CC to make its decision on whether to hear the appeal, one week for Ofgem to comment and a further six weeks for the CC to make the decision.

6.43 Under S193(5) of the Communications Act 2003, the notification of appeal against Ofcom's price control determination must be given as soon as practicable after the making of the notified determination. The CC guideline for Ofcom price control references is four months, but subject to any directions given by the CAT.

⁵⁵ Competition Commission, "Guide to Appeals in Energy Code Modification Cases", July 2005

⁵⁶ Richard Whish, *Competition Law*, Sixth Edition, 2008, page 435.

⁵⁷ Richard Whish, see above, p434.

- 6.44 One of the concerns about the appeal process is the potential uncertainty for the networks over whether or not the price control determination will be appealed and if appealed, the uncertainty around the outcome. This would suggest that the time period for appeals should be limited and that a CC determination be made as soon as practical.
- 6.45 The nature of the price control determination process is that there are a number of rounds of consultation before the final determination. The parties should therefore be well aware of the issues. It does not seem unreasonable that a decision on whether or not to appeal should take place in a limited period such as the one month that Ofgem currently allows the networks for licence modification for a price control. If an appeal is lodged, it would appear reasonable to allow other parties a limited period such as two weeks to seek to join the appeal process.
- 6.46 The time period for the CC to investigate is probably best determined by the CC, but a timeline of four months, with an extension of two months consistent with guidelines for Ofcom price control determinations would appear to be appropriate. This would enhance the accountability of the CC for delivering in the desired timescales.

6.10 Secretary of State veto

- 6.47 If appeal rights are extended to consumers and users, we believe that the provision allowing the Secretary of State to veto Ofgem's decision should be reconsidered. We are not aware of the original rationale for this provision, it may have been more appropriate at an early stage of the development of independent regulators. The right raises the risk of political intervention into the price control determination and may undermine the independence of the regulator. We are not aware of the veto being used or even the veto being sought by consumers and users. It is open to question the practical constraint of the veto or the process that would be followed by the Secretary of State were he or she to consider a veto.
- 6.48 We believe that a right of appeal to the CC should adequately protect the interests of networks, consumers and users and therefore the Secretary of State could be removed from the process.

6.11 Sector specific issues

- 6.49 Much of our discussion has treated energy networks generically rather than analysing the individual characteristics of gas and electricity transmission and distribution networks within. This is appropriate as many of the pros and cons will apply to all sectors. We now discuss the relevance differences between the networks.
- 6.50 Electricity and gas transmission connect with distribution networks and directly connected customers. Directly connected customers will generally be large industrial users and will be more able to engage with transmission operators in the price control process than domestic or commercial customers. Distribution networks are potentially an affected party for transmission and high pressure gas pipeline transport. However, they do not bear the costs of transmission and therefore do not have a direct interest in the price control, although they will be affected by service quality. National Grid as an owner of electricity and gas transmission does not have ownership interests in generation, shipping or supply. This may facilitate its engagement with all users and avoid any perception of conflict of interests. Although, Scottish Power and Scottish and Southern do have transmission, distribution and supply interests.
- 6.51 There is likely to be significant investment required in electricity transmission networks to meet demand to connect renewable energy resources. This has the potential to heighten potential conflict between consumer interest in low cost electricity supply and climate change goals. To the extent that Ofgem price control decisions are making trade offs between these interests, there may be additional value in an appeals process enhancing accountability to consumers.
- 6.52 Electricity and gas distribution networks connect many small domestic and commercial customers. Many suppliers have an ownership interest in distribution networks and therefore may be conflicted or perceived to be conflicted from acting on behalf of consumers. Potential role changes from innovations such as smart metering and distributed generation are likely to place additional pressures on electricity distribution networks.
- 6.53 Overall, we think that extending the right to consumer and users to appeal price control decisions will be valuable for all energy networks. Consumer appeals are likely to have the most relevance for electricity transmission and distribution

networks due to the potential major investment requirements and potential for distribution networks to have a local system operator role.

7 Appendix: Economic analysis of appeals

7.1 Introduction

7.1 In the appendix we consider the economic analysis of appeals in the civil law legal process and how this might be applied to the issue of extending appeal rights to consumers and users for price control decisions.

7.2 Insights from the law and economics literature

7.2 'Law and economics' i.e. the economic analysis of the law, analyses both substantive legal issues and legal process. Formal analysis of the civil law legal process identifies the key advantages and disadvantages of appeal rights in the civil legal process. These advantages and disadvantages (or costs and benefits) are likely to have relevance to considering the appropriate appeal rights for price control determinations.

7.3 There are, however, some key differences between the role of courts and Ofgem that must be kept in mind. Civil law courts adjudicate disputes between parties about property, tort and contractual issues. Ofgem is a specialist regulatory body with a set of statutory duties. We discuss the implications of these differences below.

7.2.1 Benefits and costs of appeals

7.4 The economic analysis of appeals in the civil legal process assumes that the objective of the legal process is to maximise net social benefits.⁵⁸ It identifies the key benefits and costs of appeals as:

- the benefits of reducing errors of lower court decision including the harm to parties from the error of the lower court decision and the incentives on other parties not part of the legal process; and
- the associated costs: the direct costs of the appeal process including legal advisors and experts of the parties and the cost of the appeal court such as judicial salaries, court staff and overhead costs.

7.2.2 Keeping appeal costs down

7.5 The law and economics literature suggests that hierarchical court systems enable the highest judges to monitor the performance of lower judges and correct their

⁵⁸ Robert Cooter and Thomas Ulen, *Law and Economics*, 5th Edition, Pearson, 2007, page 417.

mistakes at low cost (compared to the cost of having high level judges make all decisions). The system of appeals keeps monitoring costs low because litigants typically appeal when the lower court makes a mistake. This is because the expected value of appealing is high when the higher court is likely to reverse the decision of the lower court and the appeal court is more likely to reverse a decision when the lower court when it make an error.⁵⁹

7.2.3 Precedent

7.6 In addition to correcting mistakes, the law and economics literature identifies a further benefit from the appeals process: the development of legal precedent. When an appeal court decides a matter of law, the precedent may affect many people other than parties to the dispute.

7.2.4 Relevance civil court literature to the price control process

7.7 There are some key differences as well as similarities between the civil legal process and the price control process. Ofgem is a regulator and is required to make detailed and complex decisions about the level of prices for networks rather than determining whether a party has complied with the law. Ofgem has an investigative role and not solely an adjudicative role. Ofgem has a statutory objective to acts on behalf of consumers. Ofgem also has an adjudicative role in the sense that it needs to reach a final determination of issues in accordance with its statutory objectives. Ofgem considers price controls issues on a five-yearly basis and therefore has an opportunity to revisit decisions in future price controls.

7.8 In contrast, a civil court acts as an independent body to adjudicate between parties with a dispute and decides whether the law has been breached. In general, civil courts do not determine prices, although they may determine the level of compensation to be paid by a party. Appeals for court decisions may be on matters of substance – “fact and law”, or limited to a point of law only, depending on the jurisdiction and the nature of the appeal court. Courts consider matters on a one-off basis.

7.9 There are a number of mechanisms in Ofgem’s price control process to reduce the scope for incorrect decision. First, there are several rounds of consultation with stakeholders including representatives of consumers and users as well as

⁵⁹ Cooter and Ulen, see above, page 467.

networks as Ofgem develops its price control proposals.⁶⁰ Ofgem also has a Consumer Panel with 100 consumers in five locations across Great Britain to provide consumer feedback on energy and regulatory issues. Finally, the decisions are taken by the Authority, which has a majority of non executive members, ensuring an independent check on decisions.

7.10 However, despite the significance differences in the role and function of Ofgem and the civil courts, there is a parallel between the benefits and costs of an appeal mechanism for civil courts and Ofgem. In both cases, an appeal mechanism can reverse an incorrect decision. Both courts and Ofgem are likely to have an incentive to avoid successful appeals against their decision and so having an appeal mechanism may influence their decision making process.⁶¹ Appeals could, therefore, provide incentives for better quality decision making for both Ofgem and lower civil courts.

7.11 Finally, we note that price control determinations are complex decisions and that there may be more than one 'right' answer. It is therefore possible for two bodies to differ on the appropriate decision and yet both determinations may represent a reasonable decision based on the available evidence.

⁶⁰ Although there are concerns that few consumers and users respond to consultations and that there responses are limited.

⁶¹ For example, see evidence by former regulators that the threat of judicial review affected their decision making process in House of Lords, "The regulatory state: ensuring its accountability", 6 May 2004.

A7.1 Economic analysis: Benefits and costs of appeals

- 7.12 We now consider how the economic analysis of the benefits and costs of appeals in the civil law process described above could apply to Ofgem price control decisions.
- 7.13 The equivalent administrative costs of extending appeals rights for Ofgem price control decisions are the costs to Ofgem of defending their decision, legal advisors and experts for the appellant and any other represented party and the costs of the appeal body such as member fees, staff and overhead costs.
- 7.14 The equivalent social benefits of improvements to Ofgem decisions needs to account of the existing appeal rights of networks. As networks already have appeal rights, we can leave aside the social benefits relating to improving outcomes by Ofgem in relation to networks such as from setting prices too low to allow recovery of cost. The extension of appeal rights to consumers and network users will not increase these benefits. In theory, there could be question as to whether the extension of appeal rights could increase the risk that price control decisions do not ensure that networks are financeable. However, unless the appellate body is believed to be less reliable or objective than Ofgem, there is no reason to expect that there is increased financeability risk for networks.
- 7.15 The social benefits of extending appeals would be the reduced probability that a price control would not set prices too high or incentive the delivery of an inappropriate service quality – this could be either too high (and therefore costs greater than benefits) or too low (costs of low quality to consumer greater than additional cost of improving quality to network).⁶² It could also be in regard to Ofgem making too much or insufficient provision for environmental or security of supply concerns in its price control determination.
- 7.16 The precedent value of appeals on Ofgem decisions is likely to be more limited than for appeal courts. This is because there are a large number of court decisions affected by the precedent from appeal cases. Further, it is likely impact on the behaviour and decisions of parties not before the courts, but in similar context. Nonetheless, decisions by an appeal body are likely to have relevance for

other economic regulators and for future Ofgem decisions. This particularly true for generic price control parameters are likely to have a direct implication for other sectors such as the cost of capital. A number of commentators have noted the value of precedent about price control decisions under the current regulatory framework.⁶³

A7.2 Incentives and risk in Ofgem’s decision process

7.17 The above discusses the benefits of appeals in terms of correcting incorrect decisions by lower courts and Ofgem rather than the incentive effects, the law and economics literature also considers the incentive effects of appeal rights. The incentive effects are likely to differ between court litigation and Ofgem price control determinations. The focus on incentives for civil court decisions is on the impact on other parties in similar position who may change their behaviour in light of a decision. For example, to improve safety procedure in light of the finding of liability of a firm in a similar position. The incentives impacts of appeals for price control decisions relate to the behaviour of the parties in the price control, as we now discuss.

7.18 It is reasonable to expect that extending the right of appeal would affect Ofgem’s behaviour⁶⁴. Under the current appeal rights, Ofgem has incentives to give more weight to avoiding the risk of incorrect decision against the interests of networks, at the expense of the interests of consumers. Under appeal rights for networks, users and consumers, Ofgem’s incentives would shift toward balancing the risks of appeal between the parties. We consider this issue further in chapter six.

7.19 The introduction of appeal rights may affect the incentives for networks, user and consumer involvement in the appeal process. In light of an extended scope for appeal, networks may have greater incentive to understand consumer and user preference and to explain their positions to consumers and users in order to minimise the risk of appeal or at least successful appeal. This incentive may assist with scope for broader consumer engagement, although extending appeal

⁶² From a strict economic perspective, the social benefit of lower prices is the value of the product that is not purchased due to the high price but would have been purchased at competitive prices (or deadweight loss). In effect, this assumes that the consumer loss is mainly off-set by gains to the networks. However, Ofgem’s objectives are to protect the interests of current and future consumers. This suggests that it may reasonable to consider the loss of consumer welfare and not to offset this loss with gains to networks, provided the gains are not necessary for financeability.

⁶³ David Newbery, “The relationship between regulation and competition policy for network utilities”, June 2005.

rights by themselves may be insufficient to promote greater engagement. It will be unlikely that individual consumers will want to participate in the process (unless they are large energy user) and they will require representation by consumer groups.

- 7.20 Likewise, consumers and users may be incentivised to more fully participate in the price control process by the ability to launch an appeal against the outcomes. They will be more confident that their voices will be heard in the process and this may encourage greater engagement.

A7.3 Conclusion

- 7.21 In this appendix, we have outlined the law and economic analysis of appeal rights. Appeal rights have two major affects – they allow parties to appeal decisions that they believe are incorrect and they impact on the incentives for other parties. Extending appeal rights to consumers and users will enable them to appeal decisions that they believe do not take appropriate account of the interests of consumers. This is likely to improve the outcome of decisions.

- 7.22 Importantly, extending appeal rights will change the dynamics of the price control process. It will place greater onus on Ofgem to appropriately consider the interests of consumers and incentivise networks to engage with consumers and users and consumers to engage in the price control process. These effects should improve the process for making decisions.

⁶⁴ As discussed above, the risk of judicial review has affected the regulatory process, it therefore is reasonable to believe that the risk of appeal on merits would also influence the decision making process.

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