

Regulating Energy Networks for the Future: RPI-X@20**Emerging Thinking – Third party right to challenge our final price control decisions****Document type:** Consultation Paper**Ref:** 14/10**Date of publication:** January 29th 2010**Deadline for response:** April 9th 2010**Target audience:** Consumers and their representatives, those with sustainable development interests, energy transmission and distribution companies, generators and offshore producers, suppliers, shippers, Government, investors, academics and other interested parties.**Overview:**

RPI-X@20 is Ofgem's detailed review of energy network regulation.

Our recently published Emerging Thinking paper (Ref 05/10) sets out, for consultation, a potential new regulatory framework for the energy networks. In that paper, we briefly considered whether and how a third party right of challenge might sit in any new framework. Taking the ongoing debate on this issue into account, the present consultation paper explores in more detail the potential advantages and disadvantages of giving third parties a merits-based right of challenge, to complement existing Judicial Review provisions. To spur the debate further we also set out a potential design option of such a right of challenge.

We welcome views on all aspects of this issue, alongside views on the Emerging Thinking consultation.

Contact name and details: Hannah Nixon, Partner, RPI-X@20 and Regulatory Finance**Tel:** 020 7901 7165**Email:** RPI-X20@ofgem.gov.uk**Team:** RPI-X@20 and Regulatory Finance

Context

RPI-X@20 is Ofgem's detailed review of how we regulate energy network companies. We are looking to the future on behalf of existing and future consumers, asking whether the existing 'RPI-X' frameworks will remain fit for purpose.

We recently published our Emerging Thinking consultation paper. This set out, for consultation, a potential new regulatory framework for energy network companies. If implemented, the new regulatory framework would encourage energy network companies to meet the challenges and opportunities of delivering a sustainable, low carbon energy sector whilst continuing to facilitate competition in energy supply. There is considerable uncertainty about how best to meet these challenges whilst maintaining value for money for existing and future consumers.

Under any new arrangements, there would be greater emphasis on energy network companies understanding what the demands on network services would be from existing consumers, and anticipating what is needed for future consumers. As now, Ofgem would, in any regulatory framework, balance the needs of existing and future consumers, based on the best information available. In the Emerging Thinking consultation paper, we underline that enhanced engagement with stakeholders by network companies and by Ofgem may improve the transparency, quality and legitimacy of decision-making.

We have adopted and will maintain an open and consultative approach to the review. During the course of our engagement with interested parties there has been much discussion and debate on whether the transparency, quality and legitimacy of decision-making (both Ofgem's and that of network companies) would be further enhanced if third parties had a right to challenge the merits of our final price control decisions. The issues have been discussed at our workshops and were considered by the Consumers Working Group. A number of parties have submitted written papers to us, both for and against such a right. We also commissioned a paper from LECG on the issues. In the course of discussions it has been noted that such a right already exists in other sectors (e.g. communications in GB, and airports in Ireland and Australia). We also note that the Department for Transport has recently introduced such a right in the context of GB airport regulation.

In the context of this wider debate, and developments in other sectors, the present paper sets out for consultation the potential introduction of a third party merits-based right to challenge our final price control proposals. It is issued in parallel with our main Emerging Thinking consultation paper to ensure that any such new right of challenge is considered in the round with other aspects of the framework. Given the significance of the issues covered, we have allowed interested parties a reasonable time period to review the material published. We welcome responses to this consultation, alongside our other Emerging Thinking papers, by April 9th 2010.

Associated documents

See Appendix 2 for details of associated documents

Table of contents

1. Introduction	1
What do we mean by third party right of challenge?	3
A complement to Judicial Review	4
Structure of this paper and next steps	5
2. Potential advantages and disadvantages of a third party right of challenge	6
Potential advantages	7
Potential disadvantages	9
3. Options for introducing a third party right of challenge.....	12
Using existing legislation.....	12
A change in legislation.....	13
A two-track approach	14
4. Issues to consider in designing a right of challenge	15
Overview of issues to consider.....	15
Who would decide whether a challenge is warranted?	17
Who could challenge our final price control decisions?	18
On what grounds could challenges be made?.....	21
What aspect of the price control decision could be challenged?	22
What would the outcome of a challenge be?	25
What would the timescales of any challenge be?	26
Who would pay costs of a challenge?.....	27
When would the price control licence condition be modified?	28
5. A potential design for debate.....	29
Features of the potential design	30
Gatekeeper	30
Who could appeal and grounds for appeal.....	30
Scope and nature of appeal	30
Outcome of the Competition Commission reference	31
Timescales.....	31
Awarding of costs	31
Implementation of price control licence modification	31
Appendices	32
Appendix 1 - Consultation response and questions	33
Appendix 2 - Associated documents	35
Appendix 3 – The Authority’s powers and duties.....	38
Appendix 4 - Glossary.....	40
Appendix 5 - Feedback questionnaire	41

1. Introduction

Chapter Summary

→ We describe what a merits-based third party right of challenge might involve and set out the structure of the remainder of the paper.

1.1. RPI-X@20 is Ofgem's review of how we regulate Britain's energy networks. We are looking to the future on behalf of energy consumers to design a regulatory framework that meets their needs, particularly those relating to delivery of a sustainable energy sector.

1.2. Our recently published Emerging Thinking paper sets out for consultation our ideas on a potential new regulatory framework for energy network companies¹. If implemented, the new framework would be designed to encourage energy network companies to focus on the long term, play a fuller role in facilitating delivery of a sustainable energy sector, and deliver value for money for existing and future consumers.

1.3. We think that energy network companies need to focus, on an ongoing basis, on the needs of existing consumers and anticipate what is needed for future consumers of network services. We recognise that the current regulatory framework already contains important features to ensure that Ofgem and network companies focus on the needs of existing and future consumers:

- a regulatory framework focused on rewarding companies, through a profit incentive, for meeting consumer needs (as specified in existing licence conditions and outputs);
- involvement of third parties and their representatives in price control reviews;
- a need for Ofgem to act on behalf of consumers and to explain our decisions in a transparent way; and
- a right to challenge the decisions of the Authority through Judicial Review.

1.4. However, as set out in our February 'Principles, Process and Issues' paper and our 'Emerging Thinking' consultation paper, we have heard concerns from a number of interested parties that the existing features of the framework may not go far enough to ensure that network companies focus on the needs of the consumers of their network services.

1.5. In a new regulatory framework we would retain and build on the features of the current regime. We would, through a potential new regulatory framework, continue to encourage network companies to effectively engage with consumers, network users and other stakeholders. Evidence of this engagement would be presented in the business plan and would influence our assessment of plans. We would complement network company engagement with stakeholders, with Ofgem engagement with stakeholders. This would be consistent with our principal duty to

¹ The consultation paper can be found on our website:
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/emerging%20thinking.pdf>

protect the interests of existing and future consumers and the associated need to understand the interests of these consumers. Our ideas on enhanced engagement are discussed in the main Emerging Thinking consultation paper and in our 'Enhanced Engagement' supporting paper². We recognise that there are particular issues associated with understanding better the needs of future consumers. The general move to encourage network companies to focus on the long term and on delivery of a sustainable energy sector will help, but we will ultimately retain responsibility for considering how best to balance the impact of price controls, and associated output decisions, on existing and future consumers.

1.6. In our Emerging Thinking consultation paper we raised the question of whether a full merits-based third party right of challenge could complement enhanced engagement, potentially improve or contribute to the quality and legitimacy of our decision-making and potentially improve or contribute to the decisions made by network companies. In RPI-X@20 we are focusing on the question of whether the right should be introduced in relation to price control licence modifications only.

1.7. The present paper sets out for consultation our emerging thinking on the potential advantages and disadvantages of a merits-based third party right of challenge on price control licence modifications, particularly in the context of the potential new regulatory framework. The design of a merits-based third party right of challenge will affect the balance of advantages and disadvantages. We therefore also set out the issues that would need to be considered in designing such a right and describe one potential design intended to spur the debate.

1.8. Any right of challenge for third parties would be introduced to complement the existing provisions. We welcome the views of interested parties on whether the existing provisions provide sufficient safeguards to ensure that energy network companies and Ofgem are focused on the needs of existing and future consumers, and to ensure the quality and legitimacy of decision-making in any future regulatory framework. In particular, we welcome views on whether we should introduce such a third party merits-based right of challenge on price control licence modifications and views on the principles and practicalities associated with the potential introduction of such a right, whether under existing powers or under a tailor-made right of challenge in future primary legislation.

1.9. There has been much debate on this issue in the course of RPI-X@20. The discussion in this paper builds on a number of contributions that have already been made to the debate, including responses to the February 2009 'Principles, Process and Issues' consultation and papers by LECG (for Ofgem), Stephen Littlechild (for Ofgem), CEPA (for Centrica) and John France (CE Electric)³. Similar debates have also been taking place in the context of airport regulation. These current debates

² Links for all papers referenced in this paper can be found in Appendix 2.

³ These papers can be found in the 'Role of consumers and government' section of our web forum: <http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Pages/rocag.aspx>

should be considered in the context of ongoing discussion, since the privatisations of the 1980s and 1990s, on how best to ensure the accountability of regulators⁴.

1.10. Our recommendations on the issue will be made to the Authority, alongside other aspects of the regulatory framework, in summer 2010. If we decide, following consultation, to pursue this idea further, our ideas on the design and implementation of the third party right of challenge on price control licence modifications would be developed to reflect responses to this consultation. We would also discuss whether we could or should introduce the right under existing legislation or whether the right would need to be introduced by the Government under primary legislation. More generally, we will have regard to legislative changes including proposed changes to the Authority's duties under the fifth session Energy Bill and implementation of the European Union third package.

What do we mean by third party right of challenge?

1.11. We describe here what a potential merits-based right of challenge might involve. The description does not reflect a presumption that such a right should be introduced. It is intended to provide context to the discussion.

1.12. If introduced, a new third party right of challenge would involve allowing third parties the right to challenge the merits of our final price control proposals. Any warranted challenge would be considered by the Competition Commission. Under existing legislation, the challenge would involve a third party making a request to the Authority to make a price control licence modification reference to the Competition Commission. With a change in legislation the process of how a challenge would be made and the manner in which the Competition Commission would undertake an investigation may be different. The creation of a broader right of challenge could complement what amounts to the pre-existing right of licensees to reject price control final proposals, thereby triggering a price control licence modification reference to the Competition Commission by the Authority.

1.13. It is argued by some that such a right of challenge could, if effectively designed, enhance the new regulatory framework set out in our Emerging Thinking consultation paper. In particular, it could be one of the ways in which network companies and stakeholders would be encouraged to take more responsibility for engaging on price control issues in a more meaningful and productive way. On the other hand, there are risks that such a mechanism may prompt unwarranted challenges that unnecessarily raise regulatory uncertainty and lead to delays in the implementation of price control, potentially delaying needed investment.

1.14. We discuss in Chapter 2 the advantages and disadvantages of such a right of challenge. We also consider in Chapters 3 and 4, as it affects the balance of these advantages and disadvantages, how such a right might be designed if introduced. This includes a discussion on who the right would be open to and on the safeguards

⁴ See for example, the 2004 House of Lords Constitution Committee Sixth Report on 'The regulatory state: ensuring its accountability': <http://www.publications.parliament.uk/pa/ld200304/ldselect/ldconst/68/6802.htm>

that would need to be considered, amongst other matters, to prevent frivolous or vexatious references being made, and those with limited merit. We present one potential design option in Chapter 5 to spur the debate further. In this potential design option, the Competition Commission would review the merits of the challenge and make a recommendation on the final price control.

A complement to Judicial Review

1.15. The right would, if introduced, complement the existing right for third parties and licensed network companies to challenge our price control decisions through Judicial Review (JR).

1.16. A JR challenge examines the way in which a decision was made, including whether a decision was reasonable and whether account was taken of all relevant fact and representations made, but does not look at the rights or wrongs (i.e. the merits) of decisions reached. The case is reviewed by an Administrative Court Judge and, if the challenge is upheld, the most likely outcome is that the matter is sent back to Ofgem to reconsider its decision in light of the Court's judgement. The JR route does not allow for another party (e.g. the Competition Commission) to make recommendations to us on the substance of the price control decision. At present there is no route for parties, other than the network companies, to challenge the merits of our decisions⁵.

1.17. Whilst we consider JR to be effective, the focus on the process of our decision-making may not affect the behaviour of network companies. A challenge route could be developed to allow an independent expert body, such as the Competition Commission, to examine the merits of our decisions. There are also other features of JR challenges that may be relevant in considering whether to create a merits-based right of challenge and the design of that right. For example, the JR process can be lengthy, both because of the time taken for the case to be heard by a Court and, where the Authority is unsuccessful, the time taken for the decision to be reconsidered by Ofgem. The JR process may be as long or longer than a Competition Commission reference, although we recognise that urgent cases can be expedited by the Courts and price control decisions may well fall into this category.

1.18. The potential also currently exists for the Secretary of State to exercise the right to veto proposed licence changes. This extends to proposals relating to price controls. The Secretary of State takes account of our principal objective and general duties when considering the basis for veto. During RPI-X@20, it has been suggested that if third parties had significant concerns about the proposed regulatory settlement they could lobby the Secretary of State to use this power. However, there is limited clarity over the process that the Secretary of State would adopt in using this power and the grounds under which it might be used. To date it is not a route that has been used. We will also consider further any implications for this right

⁵ In the event that the Authority was unsuccessful in a JR challenge, there may be a further opportunity for third parties to influence the decision in the event that a further round of consultation was necessary in light of the Court's judgement.

of veto arising out of implementation of the third package, which will be consulted on by Government.

1.19. For our summer 2010 recommendations we will consider further, taking account of responses to this consultation, whether a third party merits-based challenge of price control licence modification would provide a complement to JR and a Secretary of State veto, as well as additional benefits for stakeholders and ultimately end consumers. In particular, we will consider whether there is added value in having a process for third parties focused on the rights and wrongs of our decisions, rather than the process itself, and from having a potentially tighter timescale for the challenge process, subject to statutory constraints.

1.20. If we decide to take forward the idea, we will also consider further how best to design the right to complement existing routes of challenge. We will consider the impact on the wider regulatory framework and, in particular, the drive to encourage energy network companies to play a fuller role in facilitating delivery of a sustainable energy sector and to deliver value for money for existing and future consumers. We are mindful of the need to consider legal issues, including proposed changes to the Authority's duties under the fifth session Energy Bill and implementation of the European Union third package. We will continue to discuss our developing thinking with Government, other regulators (including the Competition Commission) and other interested parties to ensure we understand the wide range of views.

Structure of this paper and next steps

1.21. This paper sets out, for consultation:

- the potential advantages and disadvantages of a third party right of challenge (Chapter 2);
- legislative options for introducing a third party right of challenge (Chapter 3);
- ideas on the issues that would need to be considered when designing such a right (Chapter 4); and
- a potential design option for a third party right of challenge (Chapter 5).

1.22. Given the significance of this policy decision, we would welcome views from a wide range of interested parties on the merits of introducing a third party right of challenge. We would also welcome views on how best to implement and design such a right if it were to be introduced.

2. Potential advantages and disadvantages of a third party right of challenge

Chapter Summary

→ We describe the potential advantages and disadvantages associated with a merits-based third party right of challenge on our final price control decisions.

→ **Question 1:** Do you have views on the potential advantages and disadvantages of a third party merits-based right of challenge? Are there any factors that we have not identified or considered?

→ **Question 2:** Taking account of our ideas on the wider regulatory framework, set out in our recently published Emerging Thinking consultation paper, particularly the role of enhanced engagement by network companies and Ofgem, do you think the advantages outweigh the disadvantages, or vice versa?

→ **Question 3:** To what extent could the design of the right of challenge, and how it is implemented (whether through existing or primary legislation), mitigate the potential disadvantages?

2.1. We set out here our emerging thinking on the potential advantages and disadvantages associated with introducing a third party merits-based right to challenge our final price control decisions (price control licence modifications). Our assessment builds on the discussions on this issue that have taken place to date as part of RPI-X@20⁶. We see potential for such a right to enhance the effectiveness of the new regulatory framework presented in our main Emerging Thinking consultation document but recognise that there are also potential risks to delivery of our desired outcomes if this right is introduced. We welcome views on the balance of the advantages and the disadvantages, both in principle and for specific potential options for implementing and designing the right of challenge.

2.2. When making recommendations to Authority in summer 2010, we will consider further, taking account of responses to this consultation, whether the advantages are likely to outweigh the disadvantages. This will include considering, amongst other things, the potential impact on uncertainty, risk and hence the cost of capital. We recognise that this will depend in large part on how the right is designed.

2.3. Implementation of a merits-based right of challenge for third parties will only be considered for our summer 2010 recommendations if we are confident that the advantages outweigh the disadvantages in the context of wider proposals on a new regulatory framework. Despite the interactions discussed in this paper if, following consultation, we decide not to introduce a third party right of challenge, all other aspects of the new regulatory framework set out in our Emerging Thinking document would remain viable.

⁶ As noted earlier, see in particular papers from LECG, Stephen Littlechild, CEPA and John France on our web forum.

Potential advantages

2.4. Table 1 highlights a number of potential advantages associated with the introduction of a merits-based third party right of challenge on our final price control decisions. We welcome views on these potential advantages, including whether there are other potential advantages not captured here.

Table 1: Potential advantages of a third party right of challenge

Reason	Rationale
Improves effectiveness of new regulatory framework	In the new regulatory framework, which we are consulting on, we want energy network companies and stakeholders to take more responsibility for engaging on how best to deliver desired outputs in a meaningful and productive way. A third party right of challenge may provide an additional incentive to do this. This could improve the perceived legitimacy of a new regulatory framework.
Better regulation	May improve accountability, transparency and legitimacy of Ofgem's decisions ⁷ .
Improved regulatory decisions	Allows for another independent body to review decisions where there is concern that they are not aligned with consumer interests.
Complement enhanced engagement	Network companies may have increased incentives to engage with third parties when planning and delivering. Third parties may also have greater incentive to engage with network companies and us. Network companies could be expected to attempt to limit the risk of a challenge by effectively engaging with stakeholders on an ongoing basis.
Increase 'consumer' focus	Network companies and Ofgem may have additional incentives to consider consumer needs throughout the price control review.
Alignment of regulatory policy	The move would be consistent with the trend towards greater accountability in regulation of communications and airport sectors.

2.5. The debate and discussion on third party right of challenge in RPI-X@20 has arisen in the context of wider discussions on how best to ensure that network companies and Ofgem focus on the needs of existing and future consumers and how best to improve the legitimacy of decision-making on price control related issues. The main argument made in favour of introducing a third party right of challenge is that a stronger 'right of appeal' could encourage network companies and other stakeholders to take more responsibility for engaging on price control issues in a meaningful and productive way and thereby improve the perceived legitimacy of the regulatory regime.

- The right could potentially, if effectively designed, provide additional incentives on network companies to consider how best to deliver desired outputs efficiently for the longer term. More generally, it may also encourage network companies to focus on the needs of their consumers (including network users) on an ongoing basis. The network companies could be expected to try to avoid the risk of a challenge by

⁷ We highlighted several principles of best regulatory best practice that we would need to take account of in designing a desirable regulatory process in "RPI-X@20 - Working paper 1: What should a future regulatory framework for energy networks deliver?" available from: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Networks/rpix20/forum/do>

adequately reflecting the views of stakeholders in their business plans or providing robust reasons as to why their needs could not be addressed.

- In parallel, the right of challenge could encourage stakeholders to engage more effectively with network companies and Ofgem. For example, the right could potentially be designed to ensure that only those that demonstrate that they effectively engaged in the price review process would be able to challenge the merits of a price control decision. Third parties could be incentivised to develop well-justified and credible positions during enhanced engagement as there would be routes available to them to challenge the settlement if their views were not effectively addressed as part of the settlement. While JR could be used to challenge a decision if we had not taken account of representations made, as noted above, it could only result in the matter being remitted to us to reconsider our decision⁸.

2.6. There is also an argument that the right of challenge could improve the effectiveness of the overall regulatory framework, by improving the quality, accountability and legitimacy of Ofgem's decision-making. This is likely to be increasingly important in the future as we are likely to be making more decisions about increasing costs when there is uncertainty about what is the best way for network companies to deliver efficiently over the long term.

2.7. An additional, somewhat circular, argument is that if the right of challenge were to help make other aspects of the new regulatory framework, and our decisions on the price controls, work more effectively the number of appeals could be limited. This is because concerns would, in principle, have been taken into account by Ofgem and network companies earlier in the process.

2.8. There are a number of potential benefits, as set out in Table 1, including a possible increase in Ofgem's accountability and greater transparency with respect to our final proposals. These benefits are generally consistent with 'better regulation' principles and may become increasingly important as we will potentially be making more price control decisions that reflect an element of judgement in terms of assessing the evidence provided and reaching a position on the best way to progress issues. This is likely to be increasingly important in the future. Historically, with the emphasis on securing cost reductions for consumers through improved efficiency, the priority has rightly been on ensuring that the affected companies have an effective route to challenge to protect their commercial interests. Looking ahead, the focus is likely to be on delivery of a sustainable energy sector and we may be making more decisions about increases in costs (and hence network charges) in circumstances where there is uncertainty about what is the best way for network companies to deliver efficiently over the long term. In this context, third parties may have more legitimate concerns in the future about the outcomes of price control reviews, notably increased costs that they are being asked to pay or the extent to which outputs are being delivered, than they would have done in the past. This is why there may be a stronger case than previously for a merits-based third party right of challenge.

⁸ We note that, in the context of JR challenges, there may be a further opportunity for third parties to influence the Authority's decision in the event that a further round of consultation was necessary in light of the Court's judgement.

2.9. Allowing the potential for an independent body to review the rights and wrongs of our decisions, including these judgements, adds an extra cross-check in appropriate cases and, more generally, would encourage us and other parties engaged in the price review process to continue to consider all aspects of evidence carefully when making these judgements. These reasons are consistent with those put forward by other parties when introducing a third party right of challenge (or right of appeal) in other sectors⁹.

2.10. It is also possible that the merits-based option combined with other aspects of the regulatory framework (particularly enhanced engagement) could reduce the risk of JR challenges, as well as merits-based challenges themselves. This is because it could encourage network companies and other stakeholders to try to avoid appeals by understanding and taking account of each others' interests in the price control review.

Potential disadvantages

2.11. We recognise that there are also real and potential downsides associated with a merits-based third party right of challenge on our final price control decisions, relating to the risks associated with its implementation and application in practice. These are highlighted in Table 2 below. We welcome views on whether there are other potential disadvantages not captured here and on the overall assessment of the proposed process.

⁹ See the LECG and Littlechild reports on our web forum for a discussion of the sectors where third party right of appeal has been introduced. The Department for Transport's decision to introduce such a right in relation to airport price controls can be found on their website:
<http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationairports/decisiondocument/>

Table 2: Potential disadvantages of a third party right of challenge

Reason	Rationale
Overall impact on regulatory predictability and uncertainty	Allowing third parties a right of challenge could lead to a perception that the regulatory process will be less predictable and there could be more uncertainty about regulatory decisions. This uncertainty could potentially have an impact on delivery of outputs and on the financing of needed investment. Some parties have suggested that this is particularly concerning in a time when the energy sector needs to undertake significant investment.
Increased burden and costs associated with large number of challenges	Allowing third parties to challenge our final price control decisions could lead to a large number of requests for a modification reference to the Competition Commission. Where a reference is made, this will lead to an increase in resource and time costs of all parties involved in the price review process, including the Competition Commission. Even where a modification is not made there will be increased costs on the party responsible for reviewing the merits of all challenges. It may also increase the bureaucracy and complexity of regulation.
Increased burden and uncertainty associated with unwarranted challenges	There is a potential risk that some third parties will lodge challenges that are unwarranted, potentially to disrupt or delay implementation of a price control.
Delay and uncertainty associated with implementation of the price control	An increased probability of challenge could mean that there is greater uncertainty about when a price control will be implemented and what that price control will include. This could potentially delay needed investment.
Reputation risk for Ofgem and the Authority as the final price control decision-maker	The Competition Commission may be viewed as the final decision-maker on price control matters if there is an expectation of a number of significant references. This would mean that the Authority's role as the decision-maker on price controls could potentially be undermined. It may also mean that, knowing that third parties have a right of challenge, we would somehow feel less responsible for pressing to achieve the maximum for consumers.
Concerns about the legitimacy of the challenge process and risk of JR challenge	If poorly defined and designed, there is potential for the legitimacy of the challenge process itself to be questioned. For example, there may be concerns about the design allowing too many unwarranted challenges or about decisions not being made in a transparent way. This could lead to Judicial Review challenges of the process around third party merits-based challenges.
Overcomplicated process	There is a potential concern that introducing an additional right of challenge could overcomplicate the regulatory process. This could potentially be contrary to the principle of Better Regulation and of our ambition in the RPI-X@20 project to simplify the regulatory framework where appropriate.
Risk of regulatory capture by interest groups that might challenge decisions	There may be a risk that Ofgem focuses undue attention on the needs of certain interest groups in an attempt to limit the risk of appeal by these groups. This could potentially distort decision-making. The risks are similar to the risks of a regulator being 'captured' by a regulated business that are discussed extensively in the regulatory literature.

2.12. The main concerns relate to the potential for such a mechanism to increase uncertainty and the potential impact of this on investment and financing, particularly at a time where the energy sector is poised to deliver large investment projects. There is a related concern that there would be a large number of challenges, particularly unwarranted ones. This could increase the burden on all parties involved in the price control process and potentially increase the complexity of the regulatory framework. The number of challenges is likely to be large if there is little downside to third parties making a challenge. The potential downsides of the mechanism would increase the lower the threshold is for cases actually being considered by the Competition Commission. This issue is discussed further in Chapter 5.

2.13. A third party right of challenge that is used extensively could also increase uncertainty around the timing of price control implementation and about what is included in a final price control. This may lead to greater risk in the energy network sectors more widely and have potential implications for the cost of capital. It may also cause network companies to delay investment, potentially putting timely delivery of outputs at risk. This uncertainty would be higher the longer any challenge process took. This would therefore be a particular concern if the challenge process was imprecisely formulated and lengthy, and if the price control was not implemented until after a challenge had been dealt with (even if the network company accepted proposed price control licence modification). The risks would be present if there is a perception that the existence of the right of challenge increases uncertainty, although if over time it becomes clear that the right is not used extensively this may reduce.

2.14. In Chapters 3 and 4 we set out the issues that would need to be considered when designing and implementing a merits-based third party right of challenge. We think that an appropriate design could go some way to addressing the concerns highlighted. We therefore need to consider further, in our assessment of the case for introducing such a right of challenge, how the balance of advantages and disadvantages looks for particular design and implementation options. Our potential design option in Chapter 5 provides one model for consideration. We welcome views on other design options.

3. Options for introducing a third party right of challenge

Chapter Summary

→ We describe how a third party right of challenge could potentially be introduced by us using existing legislation or by Government through a change in legislation. As noted earlier, this discussion does not reflect a presumption that a right would be introduced but informs the decision on whether to introduce such a right.

→ **Question 1:** Do you have views on whether it is preferable for us to implement a third party merits-based right of challenge using existing legislation or for Government to introduce a right through a change in legislation?

3.1. Were we to decide that it would be in the interests of existing and future consumers to introduce a third party merits-based right of challenge of our price control final proposals, we could either introduce it using existing legislation or approach Government to seek a tailor made right of challenge through a change in legislation. The route that is considered most feasible and/or preferable may have implications for the detailed design of the mechanism. We will continue to discuss with Government when and whether opportunities for legislative change for such a right might arise if this approach is considered preferable.

3.2. We welcome the views of interested parties on how best to introduce a merits-based third party right of challenge on our final price control decisions. As emphasised earlier, this discussion of how best to implement such a right does not reflect a presumption that such a right should be introduced. The discussion is intended to inform the decision on whether to introduce such a right and to allow us to understand better views on how such a right might be introduced were we to take the idea forward.

Using existing legislation

3.3. We think that we could introduce a merits-based challenge mechanism relating to the price control licence condition for third parties using powers contained within existing legislation. Under s12 of the Electricity Act 1989 and s24 of the Gas Act 1986 we can make a modification reference to the Competition Commission asking them to investigate and report on whether particular matters operate, or may be expected to operate, against the public interest and if so whether these adverse effects could be remedied or prevented by licence modification. When considering public interest, the Competition Commission must have regard to, but is not limited to, our principal objective and general duties¹⁰.

3.4. To date this power has been associated with references that would be made if a licensee did not accept a proposed licence modification. However, it is open to us to

¹⁰ The Energy Act 2004 introduced a right for market participants to appeal our decisions on proposed changes to industry codes to the Competition Commission, subject to that decision being eligible for this right. These appeals are outside the scope of the right of challenge being considered in RPI-X@20 which is focused on price control licence modifications only.

make a reference following a concern raised by a third party (a non-licensee) where we have concerns that something operated or may be expected to operate against the public interest. This is consistent with how we might respond if a network company (the licensee) did not accept proposed price control licence conditions. In RPI-X@20 we are focusing on the use of this power for price control licence modifications only.

3.5. We could use these powers to introduce a third party right of challenge at the next round of price reviews without the need to wait to introduce the mechanism via primary legislation. In designing the right, we could seek to address some of the concerns and potential risks that have been identified within the constraints of existing legislative framework. For example, when considering the potential design set out in Chapter 5, we will consider further what could be fully reflected with existing legislation.

3.6. We recognise that there may be constraints on some aspects of the design of a right of challenge, discussed further in Chapter 4, when implemented through existing legislation. These may include, for example, what party could be the gatekeeper, and whether and how costs of a Competition Commission investigation might be awarded. We will consider further what options are feasible under existing legislation.

A change in legislation

3.7. The alternative would be to ask Government to introduce a third party right of challenge via primary legislation. This would be consistent with the route taken to introduce a third party right of appeal in the telecoms sector¹¹ and the approach set out by the Department for Transport for the implementation of a third party right of appeal in airports. There are also powers in existing energy legislation that could be used as a template for creating a third party right of challenge on the merits, such as the powers in the Energy Act 2004 in respect of Energy Code Modification Appeals (sections 173-177 and Schedule 22).

3.8. Implementing a third party right of challenge using primary legislation could allow the mechanism to be designed without reference to existing provisions and provide greater freedom to determine the design of the process. However, it is not clear whether and when Government might wish to introduce such a right in primary legislation. We will discuss opportunities with Government if we decide to recommend introducing such a right via primary legislation.

¹¹ Further details regarding the third party right of appeal in communications regulation are included in the LECG report 'Should energy consumers and energy network users have the right to appeal Ofgem price control decisions?' available from:
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Networks/rpix20/forum/rocag>

A two-track approach

3.9. If we were to pursue the idea of a merits-based third party right of challenge, we could, if possible and sensible to do so, introduce any right of challenge using our existing powers in the first instance and at a later stage look to Government to enshrine the right of challenge within primary legislation when the opportunity arises. This may enable consumers to reap the potential advantages sooner, reinforcing the need for network companies and stakeholders to engage more effectively in the new regulatory framework.

3.10. It may also allow us to design the right to ensure that the potential disadvantages are managed as far as possible, using our detailed knowledge of the sector, the regulatory framework and the needs of investors. Were we to have introduced the mechanism using existing powers, this could provide Government with a steer on the design of primary legislation, reflecting experiences to that point. There would also be 'lessons learned' from using the right in practice that could be taken into account when Government was designing primary legislation.

4. Issues to consider in designing a right of challenge

Chapter Summary

→ We set out the issues that would need to be considered if we were to design and implement a third party merits-based right of challenge. We discuss potential options to consider in relation to the design. As noted earlier, this discussion does not reflect a presumption that a right would be introduced but informs the decision on whether to introduce such a right.

→ **Question 1:** Do you have views on the issues that need to be considered when designing a third party merits-based right of challenge?

→ **Question 2:** Do you have any comments on the options that could be considered in relation to each aspect of the design of the right?

4.1. We set out in Chapter 2 the potential advantages and disadvantages associated with a third party right to challenge our final price control decisions. In many ways the 'devil is in the detail' and we recognise the importance of ensuring that any right, if introduced, provides genuine opportunity to challenge whilst minimising the risk of unwarranted and lengthy challenges. The scale of benefits and costs of such a right would depend on how it was designed. The decision on whether to introduce a third party right of challenge of price control licence modifications is therefore linked to how it might work in practice.

4.2. We discuss here the design issues that need to be considered if such a right were to be implemented. We also describe potential options that could be considered for each aspect of the design.

4.3. We will consider further how best to design a third party merits-based right of challenge if the Authority so decided in light of the consultation and having had regard to legal and other issues.

4.4. We welcome views on a third party merits-based right of challenge. The discussion here does not reflect a presumption that such a right should be introduced. Rather it will inform the decision on whether to introduce such a right and to allow us to understand better views on how to design such a right, were we to take the idea forward.

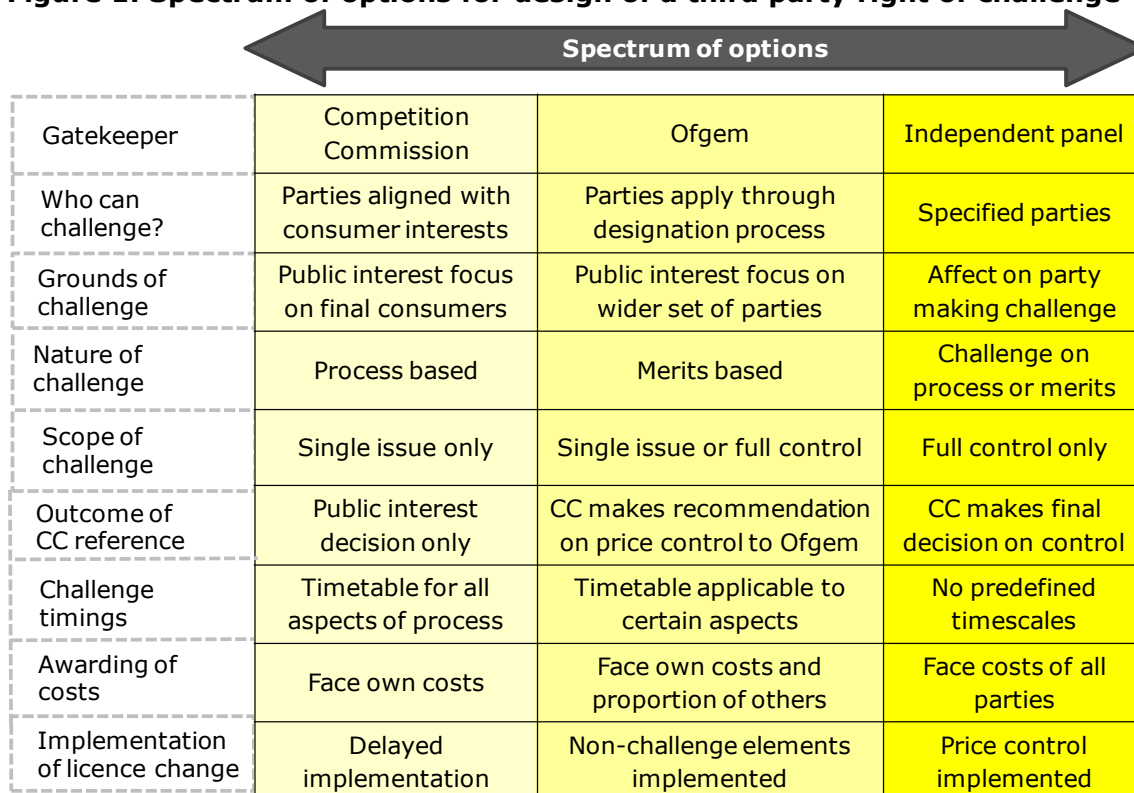
Overview of issues to consider

4.5. We set out in Figure 1 the key issues that need to be considered when designing a third party right of challenge. Specifically, we would need to consider:

- Who decides whether the challenge is warranted (who is the 'gatekeeper')?
- Who can challenge our final price control decisions?
- On what grounds can challenges be made?
- What aspect of the price control decision can be challenged?
- What would be the potential outcome from a Competition Commission reference?

- What would the timescales associated with any challenge be?
- Who would pay costs of a challenge?
- When would the price control licence condition be modified?

Figure 1: Spectrum of options for design of a third party right of challenge



	Competition Commission	Ofgem	Independent panel
Gatekeeper	Competition Commission	Ofgem	Independent panel
Who can challenge?	Parties aligned with consumer interests	Parties apply through designation process	Specified parties
Grounds of challenge	Public interest focus on final consumers	Public interest focus on wider set of parties	Affect on party making challenge
Nature of challenge	Process based	Merits based	Challenge on process or merits
Scope of challenge	Single issue only	Single issue or full control	Full control only
Outcome of CC reference	Public interest decision only	CC makes recommendation on price control to Ofgem	CC makes final decision on control
Challenge timings	Timetable for all aspects of process	Timetable applicable to certain aspects	No predefined timescales
Awarding of costs	Face own costs	Face own costs and proportion of others	Face costs of all parties
Implementation of licence change	Delayed implementation	Non-challenge elements implemented	Price control implemented

4.6. For each aspect of the design there is a spectrum of answers and hence a number of different designs that could be considered. We discuss below options for each of the design aspects illustrated in Figure 1. We expect that the issues would be broadly the same whether the right is implemented through existing or new legislation, although the feasibility of different options for each aspect of the design may be different. There may be constraints on how sophisticated some aspects of the scheme can be under existing powers, for example in relation to awarding costs and the timing of challenges (which would be subject to existing statutory constraints). This may have knock-on implications for how other aspects of the scheme would be designed to ensure the potential disadvantages are managed effectively.

4.7. We will need to consider all of these issues further if we decide to introduce a third party merits-based right of challenge.

Who would decide whether a challenge is warranted?

4.8. A key issue to determine is whether and how a gatekeeper might determine whether challenges initiated by third parties should be referred for a full investigation to the Competition Commission. As set out in Figure 1, the gatekeeper could be Ofgem, the Competition Commission itself (in a pre-investigation phase) or an independent panel.

Role of the gatekeeper

4.9. The gatekeeper would carry out an initial assessment of any challenges raised to ensure that cases referred to the Competition Commission were based on robust grounds and met other criteria laid out in the design of the right of challenge. An appropriate gatekeeper could therefore help to reduce the risk of unwarranted challenges proceeding to full Competition Commission investigation and thereby potentially disincentivise third parties from making such challenges in the first place.

4.10. A set of criteria would be needed that any challenge would be expected to comply with to be seriously considered for a full Competition Commission reference. These criteria could be set by Ofgem, by the gatekeeper (if not Ofgem) or could be set out in legislation. The criteria would be published, alongside guidance from the gatekeeper on how it would take decisions. To ensure transparency in relation to the challenge mechanism, the gatekeeper would publish decisions on any challenges raised and the outcome of those cases. This would allow the gatekeeper to demonstrate that it had complied with the published criteria in assessing any challenges. The development of such criteria could be challenging, notably in avoiding overcomplicating the regulatory process.

4.11. If introduced, the right of challenge could potentially be designed, as discussed below, to specify the time that the gatekeeper has to make decisions about whether or not to make or allow a reference for a full Competition Commission investigation. The gatekeeper would need to demonstrate that any such timetable had been adhered to and, if not, explain why extra time was needed. Any decisions by the gatekeeper on whether to allow a challenge would themselves be subject to judicial review. Care would be needed in the design of this stage of the process to avoid unnecessary and time consuming JR challenges. Again, we would need to consider how best to do this without unduly overcomplicating the regulatory process.

Potential options on who would be the gatekeeper

4.12. There are a number of parties that could be appointed to perform the role of the gatekeeper. The potential advantages and disadvantages associated with each are set out below in Table 3.

4.13. If implemented under existing legislation, we would need to be the gatekeeper for any challenges lodged as we are the party with the power to make a reference to the Competition Commission. This could raise concerns about whether we were

sufficiently objective to take decisions on a third party request to the Authority to make a modification reference. This would place increased importance on the development of robust and objective guidelines for the way we would take decisions on potential referral to the Competition Commission and would require that we commit to publishing clear and transparent decisions on challenges raised.

4.14. Decisions on whether to make a reference would be open to judicial review which also provides some safeguard. Furthermore, the introduction of a right of challenge, and decisions on an appropriate gatekeeper, would not preclude other parties, for example Parliamentary Select Committees or the National Audit Office, from continuing to undertake occasional reviews of Ofgem including potentially our decisions on third party challenges.

Table 3: Assessment of potential gatekeeper parties

Gatekeeper	Advantages	Disadvantages
Ofgem	<ul style="list-style-type: none"> ▪ Good understanding of issues and sector ▪ Acts as the gatekeeper for modification references now ▪ Does not require legislative change 	<ul style="list-style-type: none"> ▪ Concerns about independence ▪ Risk of capture by third parties ▪ Increased regulatory burden
Competition Commission	<ul style="list-style-type: none"> ▪ Independent party ▪ Precedent - de facto gatekeeper for appeals in communications and airports 	<ul style="list-style-type: none"> ▪ Additional resource may be needed to get CC up to speed but if a reference is made to the CC, this would ensure a prior understanding of the issues. ▪ Likely to require legislative change
Independent panel	<ul style="list-style-type: none"> ▪ May allow for more focused and streamlined approach ▪ Expertise could be assured through choice of panel members 	<ul style="list-style-type: none"> ▪ Absence of precedence or 'standing' ▪ Adds extra layer to process, increasing bureaucracy. ▪ May be difficult to recruit parties that are 'independent'. ▪ May require legislative change

Who could challenge our final price control decisions?

4.15. There are a range of parties that could be impacted by the outcome of the final regulatory settlement and may therefore have an interest in challenging our decision if a merits-based right of challenge was introduced. These are set out in our supporting paper on enhanced engagement and include:

- domestic consumers;
- small and medium enterprises (SMEs);
- industrial and commercial consumers (I&C);
- representatives of each of these groups of consumers;

- network users (suppliers, generators and shippers);
- network companies (including independent networks);
- investors and their representatives;
- special interest groups¹²; and
- other regulators (including the Health and Safety Executive).

4.16. We note that a right to challenge the final regulatory settlement could in principle be given to all of these parties on the basis that they may be unduly impacted by the outcome of the regulatory settlement. However, if eligibility to appeal was extended to a broad range of parties this could potentially increase the risks associated with a rise in unwarranted challenges. We consider here options on how to limit the range of parties that are able to challenge our price control decisions, if we decide to introduce such a right.

Options for defining the parties allowed to make a challenge

4.17. There may be merit in developing guidance on the parties that would be eligible to initiate a challenge. The aim would be to balance the benefits associated with allowing a broad range of third parties whose interests are aligned with those of consumers the right to challenge with the need to reduce the risk of unwarranted challenges. If the right of challenge were being introduced through legislation then this would make explicit the criteria for parties to be entitled to make a challenge.

4.18. There are three potential options for identifying the parties that would be allowed to make a challenge. The ability to pursue these options will vary depending on whether a right is introduced under existing legislation or a change in legislation. For example, a designation process is likely to require a change in legislation.

- Named parties could be specified upfront that would be allowed make a challenge. For example, the Department for Transport has specified that Passenger Focus would have the right to appeal airport price control decisions.
- A designation process could be introduced, similar to that which is used for 'supercomplainants' under the Enterprise Act 2002, which allows third parties to apply to have a designated status which enables them to make a challenge. The list of parties that are designated would change over time, with applications being considered when they are made.
- A broad range of parties could be allowed to have the right, for example any 'affected party', but the ability to challenge could be limited to those that could demonstrate that their interests are aligned with those of end consumers and that could demonstrate that they effectively engaged with Ofgem and network companies in the price control review process. This would provide parties with an incentive to participate in the enhanced engagement process and could facilitate more constructive discussions in these forums. It would also ensure that challenges were based on an informed understanding of the price control process.

¹² This might include, for example, groups with an interest in energy network issues in a specific locality, groups with an interest in vulnerable customers, or groups with an interest in sustainable development issues.

4.19. If we decide to introduce such a third party merits-based right of challenge, we will consider further, for our summer 2010 recommendations, which approach is likely to be most effective at balancing the need for challenge to be credible and the need to limit the disadvantages associated with numerous, unwarranted, challenges. We also need to consider which approach is most feasible depending on whether a right is introduced using existing legislation or a change in legislation.

Emerging thinking on parties that might be able to challenge

4.20. Our emerging thinking on the parties that may be able to challenge the final regulatory settlement, if such a right was introduced, is set out below. We will need to consider these issues further if we decide to introduce a third party merits-based right of challenge. We will also need to consider whether, under existing legislation and new legislation, it is feasible and appropriate to limit the groups that have a right of challenge.

Consumers and their representatives

4.21. There may be a rationale for end consumers having the right to challenge our final price control proposals. This would be aligned with our principal objective to protect the interests of existing and future consumers. However, there are questions about whether it is appropriate for individual consumers to have this right and we welcome views on this, including whether the issues to consider are different for domestic, SME and I&C consumers.

4.22. The issues that need to be considered include whether consumers have sufficient levels of expertise on price control arrangements and access to resources to launch a challenge. There are also issues relating to the number of consumers that would be able to challenge, and hence the potential number of challenges.

4.23. We will also consider whether consumer representatives (e.g. Consumer Focus), rather than individual consumers, should be given the right of challenge as a proxy for end consumers. Consumer representatives may be able to develop their price control expertise during the enhanced engagement process and, where they have a good understanding of consumer views, they may be able to effectively represent these in any challenge.

Network users

4.24. During the RPI-X@20 review there has been much discussion about whether or not network users should have a right of challenge. One argument is that network users are consumers of network services and, as such, they should be able to challenge the final proposed regulatory settlement. Network users generally have expertise on price control arrangements and would therefore have a good understanding of the implications of the final regulatory settlement. They also understand the commercial conditions in the industry and this could inform their view on the appropriateness of the proposed regulatory settlement. In addition, network users may have better access to resources required to support any challenge.

4.25. An alternative argument is that network users' interests are not aligned with those of final consumers and they may have incentives to 'game' the system and to delay the price control by initiating unwarranted challenges. This incentive could be particularly strong if the network users see no real downside to making a challenge.

4.26. We will consider further, if we decide to introduce a third party right of challenge, whether and how best to allow network users to have such a right, taking account of what is feasible in the design of the right under existing legislation and what might be feasible with a change in legislation.

Special interest groups

4.27. We will also consider whether special interest groups (e.g. environmental groups, groups representing particular vulnerable consumers) should be have a right of challenge, if such a right is introduced.

4.28. As with other groups of consumers there are a number of issues to consider. These groups may be affected by the outcome of a final regulatory settlement and may have engaged throughout the review. However there may be a risk of unwarranted challenges if a group sees a right of appeal as a way of delaying a particular activity by a network company. This may increase the potential number of challenges. We will need to consider whether there are options for reducing the number of challenges, for example by limiting the grounds for making a challenge to issues that could not be addressed elsewhere (e.g. planning process or general charging approval processes).

4.29. When considering the case for giving rights to these groups we will consider interactions with the decision on the scope of the right of challenge (discussed below). If the challenge can only be made to the price control as a package there may be less case for providing a right of challenge to special interest groups who may typically only be interested in a single issue or a limited aspect of the control.

On what grounds could challenges be made?

4.30. As discussed in Chapter 3, if we decide to introduce a third party merits-based right of challenge we would need to consider whether to implement the right through existing legislation or through a change in legislation. Under our existing powers we can make a reference to the Competition Commission asking them to investigate and report on whether particular matters operate, or may be expected to operate, against the public interest. Under these provisions, when the Competition Commission is considering whether any particular matter operates or may be expected to operate against the public interest, it must have regard to the matters covered by the Authority's duties. As such the key issue that they would be looking at, as they do now on price control references, is whether or not the particular matter is in the interests of existing and future consumers and is consistent with our wider statutory duties including European obligations.

4.31. The grounds for mounting a challenge would therefore need to be that there are legitimate concerns that our final proposals, the entire package or some elements of it, may be expected to operate against the consumer interest.

4.32. If the third party right of challenge were implemented using primary legislation, this would allow more freedom to determine the grounds on which a challenge could be lodged. However, we expect that a similar public interest or consumer interest rationale for a challenge would also be incorporated in a change in legislation. Clearly it is important to ensure a coherent framework, so that in reporting on any appeal the Competition Commission applies the same criteria as we have to in taking the initial decision and hence, as currently, there would need to be a clear link with the Authority's duties.

What aspect of the price control decision could be challenged?

4.33. We set out here the options to consider on both the nature and scope of a third party right of challenge, if we were to introduce such a right.

Nature of challenge

4.34. There are three broad forms that a potential challenge could take:

- **Process based:** This involves a challenge of the process followed in reaching a decision rather than the merits of the conclusions reached.
- **Merits based:** This would involve a challenge of the rationale upon which the decision was founded.
- **Process based or merits based:** This would allow the possibility that either of the approaches outlined above could be followed.

4.35. We note that a process based mechanism, in the form of JR, already exists to allow third parties to challenge the process followed in developing the final proposed price control.

4.36. The introduction of a merits based mechanism would extend existing provisions and allow third parties to challenge the basis on which decisions were taken. This approach may be complementary to our proposed enhanced engagement process as it would allow parties to initiate a challenge if they had raised an issue during the process of engagement which they did not feel had been adequately assessed.

Scope of challenge

4.37. If we decide to introduce a right of challenge we will need to consider, as part of the design, what the scope of a challenge could be and what the scope of a reference to the Competition Commission could be. We also need to consider, as part of the scope, what information any Competition Commission investigation would be

based on. We recognise that the potential scope may depend on whether the right is introduced through existing legislation or through a change in legislation.

Scope of the Competition Commission reference

4.38. The scope of the Competition Commission investigation could focus on:

- a single issue or specific aspect of the price control;
- the price control settlement in its entirety; or
- there could be scope for the Competition Commission to determine whether it is appropriate to focus on all of the price control settlement or specific aspects of it.

4.39. Under existing legislation, The Authority makes a reference to the Competition Commission setting out what the scope of the investigation is expected to be. The Authority may at any time by notice to the Competition Commission vary a reference by adding to the matters specified in the reference or by excluding from the reference so specified. The scope is linked to the 'matters' that we have considered, following a challenge from a third party, are expected to operate against the public interest.

4.40. If a right of challenge were introduced through a change in legislation, it would be important to consider how the scope of a Competition Commission reference would be set. There are a number of options to consider. For example, the gatekeeper could be given discretion to set the scope of the reference and the investigation; the legislation could specify explicitly what the scope of any reference or investigation would be; or the Competition Commission could have discretion to decide what the scope of the reference is.

4.41. An approach focused on a single issue is likely to be less resource intensive in terms of time and cost. However, it has been argued that it may not be possible to assess effectively one aspect of a regulatory settlement in isolation as the price control should be considered as a package of measures. Single issue investigations are therefore only likely to be feasible if the issue was considered separable from the rest of the package and such an approach may need to be agreed by us, the affected network company and the party making the challenge. If agreement could not be reached, the whole package may be included in a reference. In addition, there may be incentives for parties to launch a challenge of a specific aspect of the regulatory settlement even though, on balance, they are satisfied with the proposals. This could increase the risk of a large number of challenges.

4.42. With an approach focused on the package any recommended changes to the regulatory settlement would be considered in the context of the package as a whole. It would therefore allow the decisions that Ofgem had taken to be considered on balance. However, this approach could be more costly and time consuming given the potential breadth of focus. In addition, it may be more difficult to identify the 'winners' and 'losers' of the process, particularly if more than one party raised a

challenge, and this could make apportioning costs, if this were to be part of the design, difficult.

4.43. There may be merit in being flexible and making decisions on a case-by-case basis on whether it is appropriate to look at a single issue or the whole price control package.

Information used in a Competition Commission reference

4.44. When designing a third party right of challenge there is also a need to consider what information the Competition Commission would use in its investigation. Two main options can be considered in principle:

- the investigation only makes use of the information that was available to Ofgem at the time that it made its final price control decision and that is included in any reference; or
- the investigation makes use of up-to-date information, with affected and interested parties making submissions of evidence.

4.45. Under existing legislation, the Competition Commission is required to 'investigate and report' on a matter and uses the latter approach in licence modification references. The Competition Commission determines the extent to which new analysis, research and information is needed for its investigation. If a third party right of challenge were introduced through a change in legislation it would be important to consider whether this approach remained appropriate. Interactions with other aspects of the design of the right would be important to consider here. For example, if the challenge is on the process, it may not be necessary or appropriate to use new information. Furthermore, the impact on the timing of the investigation may also need to be considered. Collecting and analysing new information may add to the length of time that the investigation takes.

Scope of third party challenge

4.46. The scope of the third party challenge could be fixed to be the same as the scope of the Competition Commission reference. For example, if a reference can be made on the whole price control package only, then may it be appropriate for third parties to have to challenge the package rather than individual elements. This would ensure continuity across all aspects of the challenge and would ensure that the party making the challenge understood all aspects of the price control rather than being focused on their issue of concern only.

4.47. Alternatively, it could be possible to allow parties the right to challenge individual issues but to make it clear that the reference could involve investigation of all aspects of the control. Third parties would need to consider the potential risks associated with a wider reference relative to the potential benefits of ensuring that their issue of concern is addressed. This approach may allow the gatekeeper and the Competition Commission to better understand what the specific areas of concern are, but would not necessarily limit the scope of a reference. It may also limit the number

of single-issue appeals, relative to a case where single-issue references were common place, given the potential risks associated with a wide reference. For example, a third party may get an outcome in its favour on the issue of concern but experience downside from other aspects of the price control decision.

What would the outcome of a challenge be?

4.48. When considering how a challenge would work in practice we also need to understand what the outcome of a Competition Commission reference would be. We have identified three main options. The extent to which these could apply in practice depends on whether any right of challenge were introduced through existing legislation or through a change in legislation.

- No view on price control from the Competition Commission: The Competition Commission could review whether a matter was, or was expected, to operate against the public interest and where it found a matter for concern refer the matter back to Ofgem to decide what, if any, price control licence modification was needed.
- Recommendation on price control from the Competition Commission: The Competition Commission could review whether a matter was, or was expected, to operate against the public interest and where it found a matter for concern make a recommendation on what an appropriate price control licence modification would be. This recommendation could reflect the view of Ofgem, the view of the party making the challenge or a different 'Competition Commission' view. There would be an expectation that Ofgem would implement the recommendation.
- Decision on price control from the Competition Commission: The Competition Commission could review whether a matter was, or was expected, to operate against the public interest and where it found a matter for concern make a decision on what an appropriate price control licence modification would be. Ofgem would be legally obliged to implement that licence modification, subject to further challenge (judicial review) of the Competition Commission decision by network companies or third parties¹³.

4.49. Under existing legislation, the Competition Commission makes a recommendation to Ofgem on the price control licence modification and this is the Competition Commission view on an appropriate price control modification rather than a decision on whether Ofgem or the party making the challenge is 'right'. We will consider further whether this approach would remain appropriate if the right was introduced through a change of legislation. We are mindful, in this context, to consider the need for a consistent approach for references made when a network company does not accept a licence condition and for references made following a challenge by a third party.

¹³ Under existing legislation the Competition Commission provides a Report to the Authority with a recommendation where they make a finding of effects adverse to the public interest. However, there is scope for a further stage of iteration as the Authority looks to implement the Competition Commission's recommendations where the Competition Commission can veto some or all of the changes proposed by the Authority if they do not align with the Competition Commission's recommendations.

What would the timescales of any challenge be?

4.50. A number of concerns have been raised that a third party right of challenge would be lengthy and therefore increase uncertainty of the timing and nature of price controls. The total timescale of any challenge, if introduced, would be affected by the time taken to undertake different parts of the challenge process including:

- the time between publication of final price control proposals and a deadline by which challenges have to be lodged;
- the time the gatekeeper has to make a decision about whether to refer the challenge to the Competition Commission;
- the time the Competition Commission has to make a recommendation; and
- the time that Ofgem has to implement a final (post-challenge) price control licence change.

4.51. As outlined above in Figure 1, the challenge could, at one end of the spectrum, be strictly defined while at the other there could be no predefined timings. There are also obvious interactions here with the issue of when the price control modification would be introduced which is considered below.

4.52. If the right of challenge was introduced using existing legislation, this would mean that we would be bound by the statutory timetables that have already been determined. Under existing powers, the Authority may specify a time limit of up to six months within which the Competition Commission must report following a reference being made. The Authority may extend this by up to six months if following representations from the Competition Commission, the Authority is satisfied that the report cannot be made within the initial six month period. There are no other time limits on other stages in the process but in order to subsequently implement any modification reflecting the Competition Commission's findings Ofgem must first carry out a statutory consultation (minimum of 28 days) and then give the Competition Commission four weeks to veto some or all of the particular changes if they do not consider them consistent with their report.

4.53. Under primary legislation, there would be freedom to determine what the appropriate timings for each phase of the challenge process should be. Decisions on other elements of the design could also have an impact on the timing. For example, if the Competition Commission only looked at existing evidence rather than having a requirement to 'investigate', the timings could be shorter.

4.54. If there were no predefined timings, this might provide greater flexibility in the process followed but would also be likely to lead to greater uncertainty over when the final outcome of the price control would be known. This approach could also potentially lead to delays in the development of the final price control and subsequent delays in the network companies taking forward investment or other activities covered by the price control. If certain aspects of the challenge process had predefined timescales, this could go some way toward addressing some of this uncertainty but it is likely that it would remain to some degree.

4.55. Strict timings for each stage of the challenge process could help to reduce uncertainty over the outcome of the regulatory settlement. They could also help to minimise delays to network activities that could result if a third party challenge were initiated. However, they may also limit the quality of any assessment undertaken if there was insufficient time to take account of evidence, for example by the gatekeeper or the Competition Commission, and thereby increase the risk of other challenges (e.g. a JR of the Competition Commission decision). As with the current arrangements an option would be to allow for extensions to the timescales as necessary, although this would not help with uncertainty.

Who would pay costs of a challenge?

4.56. As noted earlier, concerns have been raised that third parties would make a large number of, potentially unwarranted, challenges because there would be no real downside to lodging a challenge. As discussed earlier, third parties would face their own costs associated with a challenge and there would be reputational concerns and concerns that network companies would delay providing services at a level of quality that the third party requires.

4.57. The costs of a challenge relate to the financial costs associated with legal representation, other advisers, management time and general staff costs as well as the potential reputational costs in the event of an unsuccessful challenge. It may be possible to increase the potential costs liability of third parties further by designing the right, if it is introduced, so that third parties would have to contribute to the costs of other parties involved in the Competition Commission investigation (notably Ofgem's costs) if the challenge was not upheld. The case for apportioning costs needs to be considered in the context of wanting to ensure that parties are not deterred from making genuine warranted challenges with the need to limit the risk of unwarranted challenges.

4.58. Under existing legislation there is provision for the Competition Commission's costs to be recovered from licensees in accord with a direction from the Competition Commission (s177 of Energy Act 2004) or in the absence of such a direction from the licensees generally in accordance with principles set out by Ofgem. There is no provision for Ofgem's costs, or costs of parties involved, to be recovered from a party that raised a challenge.

4.59. If a third party right of challenge were introduced using primary legislation, this would allow the freedom to determine the mechanism for apportioning costs and the proportion of costs that challenging parties should face. We will need to consider further whether and how third parties wishing to make a challenge could be required to contribute to the costs of Ofgem, or even other parties, in the event that the Competition Commission did not agree that the matters raised by the reference operate or may be expected to operate against the public interest.

When would the price control licence condition be modified?

4.60. As set out in Figure 1, if the licensed network company accepted final price control proposals but a third party seeks to challenge the price control decision there are a number of different options that could be considered for when the price control licence modification would be made. The change could be made at the start of the price control period, as would be the case now when a company accepts final proposals, or it could be made after a Competition Commission reference. Alternative options, involving some but not all aspects of the price control being implemented along the original timescale could also be considered.


4.61. If implementation of the proposed price control was delayed this could lead to uncertainty and delay in the progression of network activities. Implementing some or all of the price control before a reference could limit these concerns. However, applying any changes from a Competition Commission Report on a reference retrospectively could be complicated and create its own uncertainties.

5. A potential design for debate

Chapter Summary
 → To aid analysis and to stimulate debate we have developed a potential design for a third party merits-based right of challenge that we think could be introduced under existing legislation. This builds on the options discussed in Chapter 4 and is put forward to spur the debate. As noted earlier, this discussion does not reflect a presumption that a right should be introduced but informs the decision on whether to introduce such a right.

→ **Question 1:** Do you have any comments on the potential design of a third party merits-based right of challenge?
 → **Question 2:** Do you have any alternative designs that you think Ofgem should consider were we to introduce such a right of challenge?

Figure 2: Potential design of a third party right of challenge



Gatekeeper	Competition Commission	Ofgem	Independent panel
Who can challenge?	Parties aligned with consumer interests	Parties apply through designation process	Specified parties
Grounds of challenge	Public interest focus on final consumers	Public interest focus on wider set of parties	Affect on party making challenge
Nature of challenge	Process based	Merits based	Challenge on process or merits
Scope of challenge	Single issue only	Single issue or full control	Full control only
Outcome of CC reference	Public interest decision only	CC makes recommendation on price control to Ofgem	CC makes final decision on control
Challenge timings	Timetable for all aspects of process	Timetable applicable to certain aspects	No predefined timescales
Awarding of costs	Face own costs	Face own costs and proportion of others	Face costs of all parties
Implementation of licence change	Delayed implementation	Non-challenge elements implemented	Price control implemented

5.1. In Chapter 4 we discussed the spectrum of options that would need to be considered if we were deciding how best to design a potential third party right of challenge on our final price control decisions. Building on this discussion, we set out in Figure 2 a potential design for consultation. The options in this potential design are circled in the Figure for each aspects of the design.

5.2. We have compiled this design on the basis that a third party right of challenge would be introduced under existing legislation, although we will consider further whether all aspects are feasible under existing legislation. We think this potential design of a challenge mechanism could deliver the potential advantages identified in Chapter 2 whilst managing and limiting the potential disadvantages.

5.3. We welcome views on this potential design, including ideas on potential alternative designs for a third party right to challenge price control licence modifications. As emphasised earlier, the presentation of this design does not reflect a presumption that a merits-based third party right of challenge should be introduced. The potential design is presented to inform the decision on whether to introduce such a right and to allow us to understand better views on how to design such a right, were we to take the idea forward.

Features of the potential design

Gatekeeper

5.4. If a third party right of challenge was introduced under existing legislation, as presumed in the design presented here, Ofgem would be the gatekeeper of the process. This would mean that an expert body was making gatekeeper decisions, but we recognise that there would be concerns about the independence of Ofgem as the gatekeeper. This would need to be managed through clear, transparent, robust and objective guidance on circumstances in which a challenge would be likely to result in the Authority making a modification reference to the Competition Commission.

Who could appeal and grounds for appeal

5.5. In the potential design presented here, parties seeking to launch a challenge would need to demonstrate that they were seeking to address an aspect of the proposed price control that could be detrimental to consumers. They would need to demonstrate a level of materiality of this effect. These constraints on the grounds for appeal would be the main mechanism used to limit parties willing and able to make a challenge. In addition, we will consider whether third parties would only be able to challenge the final proposed regulatory settlement if they could demonstrate ongoing engagement throughout the process.

Scope and nature of appeal

5.6. In terms of the scope of the third party right of challenge, a merits based mechanism would be the approach used in this potential design. This would complement the existing JR process by allowing parties to challenge the grounds on which our decision had been taken.

5.7. In this potential design we would make a reference to the Competition Commission and would have the discretion to determine whether a reference relates to a single issue or to the package as a whole, depending on the nature of the public

interest concern. Single issue cases would only be considered where the element of the price control being challenged was sufficiently separable from the rest of the package.

5.8. The Competition Commission would 'investigate and report' on the matter, collecting its own information and evidence to inform its decision. This may include new information not previously available to Ofgem when making its final price control decision (e.g. an extra year of data).

Outcome of the Competition Commission reference

5.9. In this potential design, the Competition Commission would investigate the matter referred to it and report to Ofgem on whether there was a public interest concern and if there was the Competition Commission would make a recommendation on what the price control modification should be. This is consistent with the approach under existing legislation.

Timescales

5.10. To further minimise uncertainty and delay, the challenge process in this potential design would be conducted in as tight a timescale as possible, subject to existing legislative requirements and constraints.

Awarding of costs

5.11. In the potential design, all parties would pay their own costs of a challenge and current arrangements for paying Competition Commission cost would apply. As noted earlier, if we were to introduce a third party merits-based right of challenge we think it is important that there is real downside to lodging such a challenge whilst recognising the need to enable warranted challenge to be made. In this potential design there may be benefit, in some cases, in requiring that the challenging party faced not only its own direct costs but also a proportion of our costs. This could help to deter unwarranted challenges but we need to further explore whether we would be able to do this under existing legislation.

Implementation of price control licence modification

5.12. As far as possible, the challenge should minimise disruption to the price control and therefore if the network companies are willing to agree to the proposed regulatory settlement, the price control would be implemented within the original timescales. There may be circumstances in which it is appropriate only to implement elements of the package that are not subject to a challenge and we would consider what approach to take on a case by case basis.

Appendices

Index

Appendix	Name of appendix	Page number
1	Consultation responses and questions	33
2	Associated documents	35
3	The Authority's powers and duties	38
4	Glossary	40
5	Feedback questionnaire	41

Appendix 1 - Consultation response and questions

1.1. Ofgem welcomes the views of interested parties in relation to any of the issues set out in this document. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.2. Responses should be received by 9th April 2010 and should be sent to:

RPI-X@20 consultation - Local Grids and RPI-X@20
Ofgem
2nd floor
9 Millbank
London
SW1P 3GE
Email: RPI-X20@ofgem.gov.uk

1.3. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on our website www.ofgem.gov.uk. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.4. Respondents may request that their response is kept confidential. Respondents who wish for their responses to remain confidential should clearly mark them to this effect and include the reasons for confidentiality. Confidentiality disclaimers within emails will not be taken to represent a request for confidentiality with respect to the response itself. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. We will publish a summary of responses on the website and we will consider comments received during the course of RPI-X@20. Any questions on this document should, in the first instance, be directed to:

Cloda Jenkins, Head of Regulatory Review
Ofgem
2nd floor
9 Millbank
London
SW1P 3GE
Email: cloda.jenkins@ofgem.gov.uk

Chapter 2

- **Question 1:** Do you have any views on the potential advantages and disadvantages of a third party merits-based right of challenge? Are there any factors that we have not identified or considered?
- **Question 2:** Taking account of our ideas on the wider regulatory framework, set out in our recently published Emerging Thinking consultation paper, particularly the role of enhanced engagement by network companies and Ofgem, do you think the advantages outweigh the disadvantages, or vice versa?
- **Question 3:** To what extent could the design of the right of challenge, and how it is implemented (whether through existing or primary legislation), mitigate the potential disadvantages?

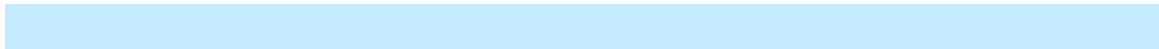
Chapter 3

- **Question 1:** Do you have any views on whether it is preferable for us to implement a third party merits-based right of challenge through existing legislation or for Government to introduce a right through a change in legislation?

Chapter 4

- **Question 1:** Do you have any views on the issues that need to be considered when designing a third party merits-based right of challenge?
- **Question 2:** Do you have any comments on the options that could be considered in relation to each aspect of the design of the right?

Chapter 5

- **Question 1:** Do you have any comments on the potential design of a third party merits-based right of challenge?
 - **Question 2:** Do you have any alternative designs that you think Ofgem should consider?
-
- 

Appendix 2 - Associated documents

Parallel consultation papers:

- **Regulating energy networks for the future: RPI-X@20 Emerging Thinking**
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/emerging%20thinking.pdf>
- Embedding financeability in a new regulatory framework
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20financeability.pdf>

Supporting papers:

- Longer-term price controls, Reckon LLP (2010)
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/reckon%20lt%20controls.pdf>
- Enhanced engagement
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20engagement.pdf>
- Incentivising efficient longer-term delivery of desired outcomes
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20long%20term.pdf>
- A specific innovation stimulus
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20innovation.pdf>
- Greater role for competition in delivery
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20competition.pdf>
- Simplicity of the framework: issues to consider
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20simplicity.pdf>
- Alternative ex ante and ex post regulatory frameworks
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20alternatives.pdf>
- Update on domestic and EU policy context
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20policy.pdf>
- Glossary
<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/glossary.pdf>

RPI-X@20 February consultation, supporting papers and consultant reports

- Regulating energy networks for the future: RPI-X@20 Principles, Process and Issues
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/rpix20/publications/CD>

RPI-X@20 working papers

- Regulating energy networks for the future: RPI-X@20, Delivering outcomes: Consumer engagement in the regulatory process
http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Role%20of%20consumers%20working%20paper_FINAL.pdf

-
- Regulating energy networks for the future: RPI-X@20, Delivering desired outcomes: Who decides what energy networks of the future look like?
<http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/rpix20%20who%20decides%20what%20energy%20networks%20of%20the%20future%20look%20like%20FINAL.pdf>
 - Regulating energy networks for the future: RPI-X@20, Innovation in energy networks: Is more needed and how can this be stimulated?
http://www.ofgem.gov.uk/Networks/rpix20/forum/innovation/Documents1/RPI-X20%20Innovation%20Working%20Paper_FINAL%20DRAFT.pdf
 - Regulating energy networks for the future: RPI-X@20, Delivering a sustainable energy sector and value for money - A modified ex ante incentive framework
<http://www.ofgem.gov.uk/Networks/rpix20/forum/for/Documents1/Modified%20ex%20ante%20regulatory%20framework.pdf>
 - Regulating energy networks for the future: RPI-X@20, Delivering outcomes: Ensuring the future regulatory framework is adaptable
<http://www.ofgem.gov.uk/Networks/rpix20/forum/do/Documents1/FINAL%20Adaptability%20paper.pdf>
 - Regulating energy networks for the future: RPI-X@20, Delivering a sustainable energy sector and value for money - What do we mean by 'efficiency'?
http://www.ofgem.gov.uk/Networks/rpix20/forum/do/Documents1/what%20do%20we%20mean%20by%20efficiency_publish.pdf
 - Regulating energy networks for the future: RPI-X@20, Delivering a sustainable energy sector and value for money: enhancing competitive pressures on regulated networks
<http://www.ofgem.gov.uk/Networks/rpix20/forum/cp/Documents1/RPI-X@20%20Working%20Paper%20-%20Enhancing%20competitive%20pressures%20-%20Final.pdf>
 - Regulating energy networks for the future: RPI-X@20 - Working paper 1: What should a future regulatory framework for energy networks deliver?
<http://www.ofgem.gov.uk/Networks/rpix20/forum/do/Documents1/RPI-X20%20Working%20Paper%20-%20What%20should%20a%20future%20energy%20regulatory%20framework%20deliver%20-%20Final.pdf>

Consultant reports for RPI-X@20 (since February 2009)

- Should energy consumers and energy network users have the right to appeal Ofgem price control decisions? LECG (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Right%20of%20Appeal%20Final.pdf>
- Consumer involvement, ex post regulation and customer appeal mechanisms, response to consultant and contribution documents, Stephen Littlechild (2009)
[http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Consumer%20involvement%20ex%20post%20%20consumer%20appeal%2029%20Nov%202009%20\(2\)%20\(2\).pdf](http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Consumer%20involvement%20ex%20post%20%20consumer%20appeal%2029%20Nov%202009%20(2)%20(2).pdf)
- RPI-X@20, Technological change in electricity and gas networks, KEMA (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/innovation/Documents1/KEMA%20Technology%20changes%20Final%20Report.pdf>
- The case for ex post regulation of energy networks, LECG (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/for/Documents1/Final%20report%20ex%20post%20regulation.pdf>

-
- The role of future energy networks, Frontier Economics (2009)
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Networks/rpix20/forum/for>
 - Energy Services Companies – their benefits and implications for regulation and the consumer, Peter Boait (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/cp/Documents1/Ofgem%20RPI-X20%20ESCo%20paper%20final.pdf>
 - Does Electricity (and Heat) Network Regulation have anything to learn from Fixed Line Telecoms Regulation? Michael Pollitt (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/cp/Documents1/Telecoms%20Pollitt.pdf>
 - A review of the rail and water regulatory models – lessons for energy, CEPA (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/lfor/Documents1/Review%20of%20regulation%20in%20rail%20and%20water.pdf>
 - New Zealand Gas Industry Regulation – lessons for energy, CEPA (2009)
<http://www.ofgem.gov.uk/Networks/rpix20/forum/lfor/Documents1/NZ%20gas%20regulation.pdf>

RPI-X@20 industry working groups

- RPI-x@20 Consumer Working Group Paper
http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Consumer%20Working%20Group%20Paper_FINAL.pdf
- RPI-X@20 Working Group Report on Innovation in Energy Networks
<http://www.ofgem.gov.uk/Networks/rpix20/forum/innovation/Documents1/FINAL%20working%20group%20paper%20on%20innovation.pdf>
- RPI-X@20 Finance Working Group Paper
<http://www.ofgem.gov.uk/Networks/rpix20/forum/financing/Documents1/Finance%20WG%20-%20Final%20Final.pdf>
- RPI-X@20 Investment Working Group Paper
<http://www.ofgem.gov.uk/Networks/rpix20/forum/investment/Documents1/Working%20group%20on%20investment%20final%20paper%20public%20version.pdf>

Other sources for RPI-X@20 supporting material

- RPI-X@20 web forum – contains Ofgem, consultant, academic and stakeholder publications and responses to RPI-X@20 related issues.
<http://www.ofgem.gov.uk/Networks/rpix20/forum/Pages/forum.aspx>
- RPI-X@20 workshops
<http://www.ofgem.gov.uk/Networks/rpix20/publications/Presentations/Pages/Presentations.aspx>

Speeches by Alistair Buchanan on RPI-X@20

- Is RPI-X still fit for purpose after 20 years? October 2008
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=8&refer=Media/keyspeeches>
- Ofgem's 'RPI at 20' project, March 2008
<http://www.ofgem.gov.uk/Media/keyspeeches/Documents1/SBGI%20-%2006%20MARCH.pdf>

Appendix 3 – The Authority’s powers and duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority’s powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.¹⁴

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly¹⁵.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them¹⁶;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.¹⁷

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

¹⁴ entitled “Gas Supply” and “Electricity Supply” respectively.

¹⁵ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

¹⁶ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

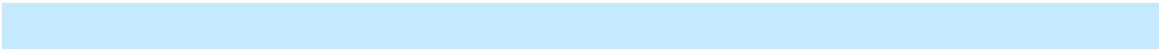
¹⁷ The Authority may have regard to other descriptions of consumers.

- promote efficiency and economy on the part of those licensed¹⁸ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation¹⁹ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.



¹⁸ or persons authorised by exemptions to carry on any activity.

¹⁹ Council Regulation (EC) 1/2003

Appendix 4 - Glossary

1.1. A full glossary of all technical terms in our suite of Emerging Thinking papers can be found on our website (<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/glossary.pdf>).

Appendix 5 - Feedback questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk