



**AN EFFICIENT AND EFFECTIVE MECHANISM FOR THIRD
PARTY RIGHTS OF APPEAL ON PRICE CONTROL REVIEWS
REPORT TO CENTRICA**

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1. INTRODUCTION

1.1. Purpose of this report

This report has been produced by CEPA to support Centrica's response to Ofgem's consultation on "Third party rights of appeal to our price control decisions"¹, which is a parallel consultation alongside Ofgem's Emerging Thinking consultation for its RPI-X@20 review.² The paper also takes account of the range of earlier reports that have been produced by Stephen Littlechild, LECG, John France, ourselves and others, and aims to contribute to further discussion on the right for third parties to appeal Ofgem's decisions on price controls.³ The report builds on, and should be read alongside, these earlier reports, and particularly the previous CEPA report for Centrica. The appendix to the Littlechild paper provides a useful summary of the previous papers.

This paper firstly expands on the discussion of the advantages and disadvantages of allowing third party rights of appeal for regulators price control decisions.⁴ We do not repeat fully the discussion in our earlier paper, but focus particularly on the issues raised in Ofgem's consultation and the other reports published since our first paper was developed. As Ofgem's consultation document recognises, many of the advantages and disadvantages are specific to the context of the actual mechanism proposed. For example, the risk of frivolous or unmerited appeals depends substantially on the extent to which there is a strong gatekeeper to initially consider the merits of potential appeals and the deterrents in place, e.g. awarding of costs to unsuccessful appellants. We therefore build on the framework set out in the Ofgem consultation paper to outline a third party appeals mechanism. In designing the mechanism we have tried to develop a workable appeals mechanism based on the idea of balancing the desirable qualities of allowing broader third party appeal rights with strong safeguards in the form of a gatekeeper, clear grounds of appeal and allocation of costs to ensure that frivolous appeals are kept to a minimum.

Our proposed mechanism has been developed assuming that there would be an opportunity for legislation to be introduced to put in place the best possible mechanism for third party appeals. However, Ofgem has indicated in its consultation that it believes the current statutory provisions allow a third party right of appeal. Therefore, we have also considered what further information and guidance Ofgem could provide to help give practical effect to this power. While Ofgem's indication that third party appeals can occur under the current arrangements is very welcome, there are some limitations to the design of the mechanism given the current legislative provisions, which mean that new legislation may nevertheless be desirable.

¹Ofgem: "Third party right to challenge our final price control decisions"

<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/right%20to%20challenge.pdf>

²Ofgem: "Regulating energy networks for the future: RPI-X@20 Emerging Thinking"

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=36&refer=Networks/rpix20/publications/CD>

³ All these papers have been published on Ofgem's RPI-X@20 web forum at <http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Pages/rocag.aspx>

⁴ Given the focus of Ofgem's consultation and its RPI-X@20 review, we have focused on the merits of third party rights of appeal for price control decisions, rather than all licence modifications.

1.2. Background

In addition to Ofgem’s consultation, since our last paper the Department for Transport (DfT) has published its decision “Reforming the Framework for the Economic Regulation of Airports”. The document among other things outlines a decision that all parties with a material interest (including a designated passenger interest group, Passenger Focus) should be able to appeal “Tier 1” regulation decisions (i.e. the decision as to whether or not an airport should be subject to price controls) to the Competition Appeals Tribunal. It further decided that the right to challenge proposed licence modification for price controls would improve the regulatory process and determined that a designated passenger body, Passenger Focus, would have the right to challenge, along with the airport operator that holds the licence.

As in our previous report we generally use a broad definition to characterise the consumers of regulated network companies to align with the use of the expression “third parties” by Ofgem, but discuss the specific issue of designated consumer groups having a right of appeal, similar to the approach adopted by the DfT.

1.3. Structure of the report

The remainder of the report is structured as follows:

- Section 2 further considers some of the advantages and disadvantages of allowing third party appeals of price control decisions.
- Section 3 builds on the framework outlined by Ofgem in its consultation paper and outlines an alternative third party appeals mechanism based on the framework.
- Section 4 discusses how the identified existing rights in the existing legal framework could be implemented, including potential guidance from Ofgem, and implementation issue if new legislation was passed.
- Section 5 draws together the conclusions of the paper.

2. ADVANTAGES AND DISADVANTAGES OF THIRD PARTY APPEALS

2.1. Introduction

The debate on whether or not third parties should be allowed to veto or challenge the outcome of a network price control process by challenging the licence change implementing it has attracted a number of high quality think pieces from various parties. In this section we develop some of the key arguments on advantages and disadvantages of providing third parties with the ability to challenge. The section is structured around specific issues and builds on the arguments outlined in earlier work, with a particular focus on the issues raised in Ofgem's consultation.⁵

2.2. Balance of the price control process and decision

The ability for third parties to appeal price control decisions could shift the potential balance of the price control process. In its Emerging Thinking consultation Ofgem outlines arguments that introducing a right to challenge to third parties could enhance the regulatory process by providing an incentive on network companies to focus on the needs of their consumers on an ongoing basis, encourage third parties to engage more effectively in the process, and improve the effectiveness of the regulatory framework by improving the quality, accountability and legitimacy of Ofgem's decision making.

It also highlighted a number of issues, including that there is a risk that the regulator might get "captured" and focus undue attention on the needs of interest groups in order to limit the risk of appeal against its decision.

Ofgem recognises that historically, the emphasis of the regime has been:

"...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 .. in circumstances where there is uncertainty about what is the best way for network companies to deliver efficiently over the long term." (Para 2.8, *Right to Challenge*, Ofgem, 2010.)

We agree with Ofgem that in this context the interests of third parties will become more important to ensure that the price control process remains robust. In addition to this, as the background paper "Performance of Energy Network under RPI-X@20" suggests, there is some evidence of systemic historical outperformance by both the gas and electricity distribution networks of the price control targets. While out performance is to be welcomed where it delivers benefits for customers through reduced prices in the longer term, persistent and significant out performance of price control settlements could be interpreted as a signal that the price controls were not sufficiently challenging to the companies concerned.

In this context it can also be observed that there has not been an appeal of a price control by one of the network companies since 1997, when the appeal by BG Transco of Ofgas' proposed price

⁵ It has also been suggested that Judicial Review offers consumers sufficient recourse and as such substantive third party right of appeal is not necessary. The key issue here is that Judicial Review is focused on regulatory process, which is important, but cannot address substance, which is also important. The third party appeal discussed in this report is related to substance and would build on the existing Judicial Review right.

control was considered by the Monopolies and Mergers Commission. In that period Ofgem has set a lot of price controls⁶, and it may be notable that no company has felt the proposals from Ofgem were sufficiently tough to justify an appeal.⁷ It is also notable as a contrast that companies chose to challenge Ofwat's price determinations in 2000 and 2010, although in both cases it was only a very small subset of all the companies covered by the determinations that chose to challenge. The Competition Commission has raised related concerns about whether the current system discourages appeals⁸.

John France notes that the regime is deliberately not balanced in order to safeguard the property rights of the network owner. The network owner has the right to a revenue-stream arising from owning the property rights to his network asset, and hence, in order to protect his interests has the ability to challenge a price control determination. While France's argument has merit it is important to note that energy networks by nature are natural monopolies and it should be qualified to indicate that the owner has a right to a revenue stream resulting in a "normal" profit. The complicating factor is that the rational owner of a monopoly asset will inherently have the ability and the incentive to earn a higher return than this.

In the emerging regulatory world where outputs and the delivery of a sustainable energy sector will become more important the interests of consumers and network users become more important, and more complex than before. Previously the regulator could feasibly argue that he would protect the interests of consumers best by minimising the overall network costs. When the preferences of the consumers become more complex then this increases the advantage of allowing consumers the ability to raise objections to the final process.

2.3. Impact on cost of capital

Ofgem set out that a further potential disadvantage with introducing a wider right to appeal price control decisions would be to increase the overall regulatory uncertainty for the regulated company and should therefore be accompanied by a higher cost of capital allowance. It further suggested that a risk is that it would increase the risk if unwarranted challenges are lodged which disrupt or delay the price control.

In our earlier paper we outlined how a wider right to appeal would also have the effect of ensuring that the regulator takes onboard a wider range of views and thus increases the robustness of the decision, reducing the risk of interim determinations or re-openers and diminishing the possibility of large changes between different price controls. This would imply that the effect on cost of capital would either be likely to be neutral or indeed constitute a case for reducing it based on a reduction in regulatory risk (assuming there are robust gatekeeper safeguards in place).

An additional aspect to this is that the Competition Commission would assess an appeal on the same basis as the regulator. The Competition Commission is widely recognised as a competent

⁶ DPCR3, 4 and 5, TCPR 3 and 4 and GDPCR1, excluding roll-overs etc.

⁷ It is important to note that we would also argue that if there had been a lot of appeals by network companies this might suggest that Ofgem's price control proposals were persistently too tough.

⁸ Peter Freeman: "Key challenges at the Competition Commission"

http://www.competition-commission.org.uk/our_role/speeches/pdf/freeman_kings_college_280508.pdf

body to hear this type of appeal and would only uphold well founded appeals that improved the quality of a decision. An increase to the uncertainty faced by network companies arising from a wider right to appeal would only arise if they considered that Ofgem has, or is likely to, make decisions that the Competition Commission would substantially change – i.e. a form of regulatory arbitrage between Ofgem and the Competition Commission was possible. Although not wholly analogous it is notable that the current system of airport regulation in the UK involves an automatic referral to the Competition Commission for each price control review before a final decision is made by the Civil Aviation Authority. We have not seen any clear evidence that this regime has increased the cost of capital for the airports concerned over and above what it would have been.

One way in which a view on the empirical impact of this could be formed would be through a consideration of the telecoms sector. However, unpicking whether the change in the ability to appeal has affected risk or whether other external factors have changed would be difficult.

2.4. Impact on security of supply and investment

Ofgem's consultation paper outlines two potential effects related to investment and security of supply:

- the right to challenge could provide network companies with a greater incentive to consider the needs of consumers on an ongoing basis and to be expected to try to avoid the need for a challenge; and
- the mechanism could lead to increased uncertainty, feeding through to an impact on investment at a time when the industry is delivering large infrastructure projects.

Additional issues have also been raised in relation to the impact on investment in network resilience and through that security of supply. These issues can broadly be categorised as firstly an impact through a perceived lack of alignment of incentives between energy supplier and end users; and secondly, the risk of a delay to investment due to challenges having a negative impact on security of supply. We address these two issues in the sections below.

2.4.1. Alignment of incentives

One concern raised is that the incentives of intermediaries, for example energy supply companies, are not fully aligned to those of the consumer in the area of investment to maintain security of supply arising from network reliability.

In his paper John France outlines an argument that this arises from the fact that while suppliers are users of the energy networks, they are not able to influence the services these provide and hence differentiate themselves and compete based on investment in these networks – the service of the network remain the same for the consumer in an area irrespective of what energy supplier the consumer has. France argues that this causes a moral hazard issue for the suppliers since their incentive to ensure their consumers have reliable energy suppliers will align with that of the consumers. The reliability of energy supplies is clearly a matter which matters to consumers.

The argument that suppliers suffer from a moral hazard problem due to the fact that they cannot compete on reliability is problematic. In the third consumer panel report published in October

2009 Ofgem investigated, among other things, the degree of understanding consumers have of the energy industry⁹. The sessions with Ofgem’s expert consumer panel revealed a limited degree of understanding of industry structure. Box 2.1 outlines the understanding of expert consumers after the third session of the panel.

Box 2.1: Consumer panel feedback

“Expert consumer” understanding of energy industry structure¹⁰

- Participants had a reasonable recall of the industry structure overall but only a few had a very good understanding.
- Extraction, generation, transportation, the National Grid and supplier were most easily recalled, for both gas and electricity supply.
- Some mentioned local or regional networks/distribution, although the majority struggled with this area.
- A minority mentioned Transco for gas supply or gas shippers.
- There was little mention of network companies and no mention of individual network companies by name.

It is interesting to note that these findings are among a group of “expert consumers”, who had in previous sessions received presentations outlining the industry structure. The results are likely to indicate a level of understanding higher than the average domestic consumer. These findings follow a similar finding reported by the regulator in 2005 when it was considering the competition impact of branding between the energy suppliers and distribution companies¹¹.

This suggests that while suppliers of gas and electricity may not be able to effectively compete based on reliability of their service, the supplier hub structure means that their consumers still, to an extent, hold them to account for network reliability, and address their grievances at them. As the suppliers will be judged on the quality of the network, which they cannot influence through conscious actions such as investment, it is nevertheless in their best interest to take a balanced view on investment in networks. This view is likely to be closely aligned to that of their consumers.

2.4.2. Impact of delayed investments

Another impact on security of supply could arise if the challenge to the price control was to delay the control being implemented. Clearly it is in everyone’s best interest that the already

⁹ Ofgem Consumer First Panel: “Research Findings from the Third Events”
<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Ofgem%20panel%20third%20events%20report%20FINAL.pdf>

¹⁰ Ofgem: Consumer First Panel – Research findings from Third Events – page 11
<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Ofgem%20panel%20third%20events%20report%20FINAL.pdf>

¹¹ Ofgem: Open letter on Ofgem’s review of branding in the electricity distribution and supply markets:
http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/9471-branding_open_letter.pdf

lengthy and detailed price control processes are implemented and are not extended further through challenges.

In principle there could be an impact on security of supply arising from a delay in investment, however in practice this is likely to be limited in most cases. The length of life of network assets are typically very long, given this the impact on consumers of a delay in investment of six to 12 months will in practice be minor. This is particularly true regarding investment in distribution networks. On a transmission level the risk can be slightly higher; we note for example that the expansion in transmission capacity to accommodate the LNG import terminals at Milford Haven was subject to delays, as well as planning challenges. This has however not had a practical impact so far given the delays to the terminals themselves. It does however, importantly, illustrate that delays could have an effect, in particular if there is a high demand period.

In order to ensure that critical investments are not delayed by challenges it would be appropriate to ensure that strict timescales are implemented to control how long an appeals process would take. In addition to this the practical impact of an appeal on investment can be mitigated if the price controls are implemented while the challenge is ongoing. This could be done in a similar way to the water sector where in the case of a challenge the regulator's proposed price control is implemented for the first year of the control. If the Competition Commission decides to make changes based on the appeal then those changes are implemented from the second year of the control period.

The biggest challenge facing electricity networks is coping with the growth in nuclear power, micro-generation, wind farms and electric vehicles as we move towards a low carbon economy. The parties best placed to challenge Ofgem's assumptions on these issues are the generators and suppliers who operate directly in these areas. This creates a rationale for these to have a significant role, and a right to appeal the price control decision.

2.5. Conclusions

We have outlined three areas of the debate where the effect of introducing the right to challenge price control decisions has been particularly raised in Ofgem's consultation. We have summarised our findings on the potential positive and negative impacts of introducing the right to challenge on the balance of the price control process/mechanism, the cost of capital and investment and security of supply in table 2.1 below. The table also includes the pros and cons we identified in our previous paper.

Table 2.1 Costs and benefits summarised

| Issues | Potential impact |
|---|--|
| Impact on the balance of the mechanism | <p>(+) Provides clearer input of consumer preferences into the licence modification.</p> <p>(+) Increases the weight of consumer interest in the process and increases consumer involvement from the start of the process.</p> <p>(+) In order for an appeals system to best achieve accountability, the right of appeal must be available to those with material interest with regard to the regulators duties.</p> <p>(-) Potential weakening of the interest of the regulated company.</p> <p>(-) The appeals may be used to cause disruption, or to delay decisions that the appellant do not agree with.</p> |
| Impact on Ofgem | <p>(+) Increased incentive on the regulator to engage with a wider range of stakeholders.</p> <p>(+) Increases legitimacy of regulator's decisions by ensuring its decisions are aligned with its statutory duties.</p> <p>(+) Over time the decision making of the regulator will increase as it learns from past mistakes, its understanding of parties preferences increase and its processes get more and more inclusive.</p> <p>(-) The right to appeal may lead to Ofgem being sidelined to a role of a mediator of stakeholders views as it is not considered the final decision making power and hence two price controls effectively take place.</p> |
| Impact on cost of capital | <p>(-) Regulatory uncertainty increases due to frivolous appeals causing the cost of capital to increase.</p> <p>(+) Regulatory uncertainty is reduced as the decisions are based on a more solid foundation, with a much reduced risk for revisions through for example interim adjustments.</p> <p>(+) Regulatory uncertainty is reduced as the regulated companies will have an increased incentive to engage with its customers and to understand their preferences. This will reduce the likelihood of appeals.</p> <p>(+/-) Cost of capital is unlikely to change directly as a cause of the appeal as the Competition Commission is considered a competent body and would consider the appeal on the same basis as the regulator. Would only increase the cost of capital if it was perceived that regulatory arbitrage was possible.</p> <p>(+/-) Risk of appeals low as regulator has an incentive to engage to the fullest extent with stakeholders and to avoid the cost of appeal.</p> |
| Impact on security of supply and investment | <p>(+/-) Suppliers cannot compete on security of supply and investment in energy networks and may therefore under represent, or be uninterested in the end consumers preference for supply security.</p> <p>(+) In practice consumers cannot separate the role of the supplier from the network operators and as the most public facing of the bodies the suppliers are more likely to be held to account by their customers for disruptions.</p> |

We would like to stress that these arguments are made in a largely generic fashion and that the effects outlined may be dependent on the overall design of the challenge mechanism. We will discuss a specific mechanism in more detail in the next section.

3. DESIGNING AN APPEALS MECHANISM

3.1. Introduction

In its consultation paper Ofgem firstly separated out the building blocks of a system of appeals and then outlined a proposed model as a basis for discussion. We welcome this approach as in our view the advantages and disadvantages of introducing third party appeals are primarily a function of how the appeal mechanism is designed as a whole and it is therefore appropriate to consider packages of options. This view is similar to that taken by the DfT in their decision on a regulatory model for airports:

“...the issues of (i) who can appeal (ii) over which decisions and (iii) under which processes are inextricably linked. The wish to enable interested parties to have rights of appeal is to be balanced against the concerns that appeals become too numerous or take too much discretion from the regulator or that the system otherwise becomes unduly inefficient.”¹²

In light of this it is more useful to build on the analysis in the previous section to assess the benefits and disadvantages against specific models.

In this section we adopt Ofgem’s approach of using a spectrum of options as a useful starting point and employ this to illustrate an alternative model of consumer appeals.

One important aspect that impacts on the exact design of the appeals mechanism is whether or not it would be implemented within the current legal framework or through a change to primary legislation. Both these options have advantages; implementation through the existing legal framework could potentially be done more quickly and easily, but may be limited in the scope of important aspects such as the gatekeeper role and the award of costs – both of which are important elements of a framework designed to minimise the risk of frivolous appeals. Introduction through primary legislation would not share this weakness, however it is dependent on the willingness and ability of Government to introduce the legal provisions.

It would probably be preferable for third party rights of appeal to be introduced through new legislation as this would allow a more robust mechanism to be introduced. Furthermore, while Ofgem’s willingness to use the existing legislation is welcome, it is reasonable to acknowledge that the existing legislation was not introduced with a view to facilitating third party rights of appeal.

In outlining our model we have assumed that it will not be constrained by the limitations of the current framework. We do however briefly discuss the potential benefits of new legislation at the end of this section.


¹² Department for Transport: “Reforming the framework for the Economic Regulation of Airports – Decision Document”
<http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationairports/decisiondocument/pdf/decisiondocument.pdf>

3.2. The Ofgem “Spectrum of Options” model

In order to facilitate a consistent debate we have adopted the same “Spectrum of Options” approach to describing our model as Ofgem outlined in its consultation.

The approach is based on a matrix outlining three potential answers to each of the eight key issues relating to the design of a mechanism. Figure 3.1 outlines the range of options in this spectrum.

Figure 3.1: Design of a third party right of challenge (source: Ofgem)

| |  | | |
|---|--|---|-------------------------------------|
| 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 | Effect 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 controls |
| 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 |

In the context of discussing the spectrum of option it is also worth considering the five good regulation principles from the Hampton review. These are summarised in Table 3.1.

These principles provide an important context within which policy options can be considered. They are worth keeping in mind when considering changes to existing regulatory frameworks.

Table 3.1: Principles of good regulation¹³

| Principle | Explanation |
|-----------------|---|
| Proportionality | Alternatives to regulation must be fully considered before deciding on state intervention |
| | The impact on all those affected by the regulation should clearly establish the right balance between risk and cost; without unnecessary demands on those being regulated |
| | Enforcement action (i.e. inspection, sanction etc.) must be in proportion to the seriousness of the offence |
| Accountability | Regulators must be accountable to stakeholders |
| | There must be well publicised, accessible, fair and efficient appeals procedures |
| Consistency | New regulations must be consistent with existing regulations |
| | New regulations must be consistent with EU and international trade and competition policy |
| | There must be consistent enforcement by relevant authorities across the country |
| Transparency | Objectives (including the need for regulation) are clearly defined and communicated to all concerned |
| | Regulations must be simple and clear |
| | Those regulated must be made aware of their regulation and helped to comply |
| | Proposals must be published and ample time for consultation must be given before decisions are taken |
| | Regulatory failures must be handled openly by Government |
| Targeting | The approach is aimed at the problem and not scatter-gun or universal |
| | Flexible targets should be preferred to rigidity. Regulators and regulated must be given scope to decide how best to achieve those targets |
| | Regulations should be reviewed from time to time to test whether they are still necessary and effective |

3.3. An alternative model

In this section we develop a specific model aimed at delivering a workable balance between the right of appeal and avoiding frivolous appeals. The proposal is designed to ensure that the regime realises the key benefits of the appeals mechanism of:

- aligning the balance of the regime to the development of networks;
- ensuring better regulation principles are met; and
- increased consumer focus.

At the same time the model needs to ensure that the costs arising from the risk of poorly grounded, spurious or malevolent appeals are minimised. This is accomplished by placing

¹³BERR: “Better Regulation, Better Benefits: Getting the Balance Right; Main report”
<http://www.berr.gov.uk/files/file53252.pdf>

emphasis on the necessity for a strong gatekeeper along with ensuring the costs of appeal are, to a significant extent, carried by the losing party.

3.3.1. The Ofgem model

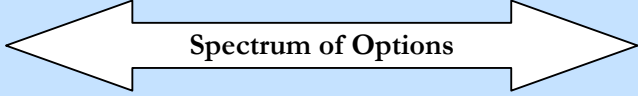
Ofgem outlines a proposed model in order to “spur the debate”. This model is outlined in the grey shade areas of Figure 3.2. Ofgem’s model was consciously developed to ensure that it could be implemented without requiring legislative change.

We have used the Ofgem model as a starting point, but relaxed the assumption about the requirement of legislative change to implement it. Instead we have considered the design from the perspective of what a good regulatory practice model, that balances the right of appeal against the need to discourage frivolous challenges would look like.¹⁴

3.3.2. Summary of features

Figure 3.3 summarises our alternative model within the context of the Ofgem “Spectrum of Option” framework, the model we suggest is highlighted in bold text while the grey boxes illustrate the strawman Ofgem proposed.

Figure 3.2: 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 | Effect 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 | Competition Commission makes recommendation on price control to Ofgem | Competition Commission makes final decision on controls |
| 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 |

¹⁴ We discuss the potential merits of implementation through legislative change separately in section 4.

In the following sections we discuss the specific features of the model. We consider that some of the aspects of the model to require more debate than others. In particular we have focused our discussion on the role of the gatekeeper, who can challenge, the scope of the challenge, the outcome of a Competition Commission reference and awarding of the costs of the appeal. Some of the areas, such as nature of the challenge and the implementation of licence change is not discussed as we consider their case to have been well presented in Ofgem's emerging thinking consultation document.

3.3.3. Gatekeeper

The gatekeeper role is to ensure that challenges investigated are based on robust grounds and ensure that the appellant has engaged fully with the process before the appeal.

The gatekeeper function should be interpreted in conjunction with how cost of appeals and the restrictions on who can challenge are designed. It is important that these three characteristics are well designed in order to ensure that frivolous, or vexatious appeals are discouraged while retaining the benefits of an expanded right of appeal. This is particularly important in the context of the experience of the appeals regime existing in the GB telecoms sector. In this sector the Communications Act 2003 gave a person affected by a decision the right to appeal Ofcom's decisions. In addition to this it placed a duty on the Competition Appeals Tribunal to refer price control matters to the Competition Commission for determination. This means that in practice there is no effective gatekeeper function for appeals in the telecommunication appeals framework regarding price controls.

A number of options have already been outlined on who should be gatekeeper for appeals:

- Ofgem;
- Independent Panel; or
- Competition Commission.

In his paper Stephen Littlechild notes that Ofgem should not be gatekeeper as it would already have considered the facts of the matter, and he further notes that the Competition Commission would not be suitable given that acting as both the gatekeeper and appeal body would in practice mean considering the facts twice. Ofgem itself notes that giving the gatekeeper role to an independent panel would require an additional body to obtain the knowledge necessary to consider the complexities of price controls and add an extra layer of bureaucracy.

The merger regime currently has a two stage process, both within the UK and at a European level. For mergers without a Community interest the Office of Fair Trading (OFT) serves as its own gatekeeper concerning which of the notified or non notified mergers it considers. It then undertakes a review, in prescribed timescales, of the merger to establish if it is problematic. If the merger is found to be likely to raise concerns then the OFT will refer the case to the Competition Commission for a fuller investigation and the potential imposition of remedies, or accept binding undertakings from the merging undertaking in lieu of referral to the Competition Commission.

In this case the OFT effectively serves as both a gatekeeper for which mergers it investigates¹⁵ and as the gatekeeper for the Competition Commission by deciding which decisions should be referred. While these regimes are not appeals as such, they do include an assessment by a body of whether or not to investigate a matter, as well as an assessment of whether another body should be asked to investigate it further.

A number of options could potentially be devised to ensure that the role of the gatekeeper has a degree of separation from either the original decision body (Ofgem) or the appeal body (Competition Commission):

- The Competition Appeals Tribunal could be asked to consider whether or not an appeal should be considered by the Competition Commission. This would have the benefit of using a body that is already familiar with the processes from its role in hearing Judicial Review challenges.
- Ofgem could ask its consumer panel to assess if the appeal should be allowed or not. This may be particularly relevant if the appellant also needs to demonstrate that his interests are aligned with those of customers and to demonstrate that they had already effectively engaged in the price control process.
- The Gas and Electricity Markets Authority could be divided on price controls and a small number of the non-executive members could absent themselves from the original decision on the price control for the purpose of potentially considering if a potential appeal should be allowed. This may raise an issue of balance in GEMA.

These three options each use existing bodies to create a degree of separation between the deciding body, the appeal body and the gatekeeper. If a separate body was to be considered as gatekeeper there may be merit in making the Competition Commission the body deciding on the modification (rather than relying on the regulator to implement its recommendation) in order to streamline the appeals process and reduce the number of steps involved.

The Competition Commission currently fulfils the role of gatekeeper (as well as appeal body) for the appeals mechanisms in energy codes, which is generally considered to function well. For example, the Competition Commission holds that the appeal route is “a tightly constrained right of appeal”¹⁶. In addition to this the Competition Commission is subject to tight timescales, in its role as gatekeeper, within which it must either allow an application to appeal or not. It would not generally be expecting to hear arguments that are significantly different from those considered by Ofgem and importantly it may refuse requests for appeals on the grounds that they are trivial, vexatious or if they have no reasonable prospects of being successful¹⁷.

¹⁵ The UK merger regime relies a system of voluntary notifications of mergers to the OFT. The OFT publishes guidance on what constitutes a “relevant merger situation” and when it considers that mergers may be problematic. In addition to notifications it also relies on its own intelligence unit, as well as tips from market participants. There is no requirement for a merger to have been notified for the OFT to start an investigation.

¹⁶ Competition Commission: “Guide to Appeals in Energy Code Modification Cases”
http://www.competition-commission.org.uk/rep_pub/rules_and_guide/pdf/cc11.pdf

¹⁷ In addition to this parties are only allowed to raise appeals against decisions where the industry code panel’s recommendation is not in line with Ofgem’s decision.

The energy codes process is generally considered successful in that it allows a relatively wide right of appeal, while at the same time, the fact that only one appeal has been raised since the right was introduced in 2004 (and the appeal was successful), suggests that it has not created an incentive to raise vexatious or frivolous appeals.

The fact that a body has already considered an issue or that they would be the one effectively considering it does however not necessarily prevent the body from fulfilling an effective gatekeeper role. LECG argues that the Competition Commission would, for example, have an incentive not to consider arguments in an appeal that have not previously been presented to the regulator. We would tend to agree with Littlechild who argues that the regulator would not be the appropriate gatekeeper in this case, unless a measure is taken to ensure that the authority does not consider the same issue twice. Even though there exists independent parties who may undertake the function of gatekeeper the Competition Commission is still likely to be the most suitable option.

3.3.4. Who can challenge?

When considering placing limitations on which third parties are allowed to challenge a price control decision, it is first important to recognise that the Competition Commission will assess challenges on the same basis as Ofgem (i.e. based on its statutory duties). It would be expected to disallow challenges from bodies that have not effectively engaged with the regulator during the price control process, as well as those of parties that cannot effectively demonstrate that their arguments are only out of self interest, and misaligned with the objectives of the regulator. The combination of the fact that the Competition Commission's assessment basis will be the same as the regulator, and that this body is widely considered competent to hear appeals would mean that frivolous appeals should to a significant extent be discouraged through design.

It may nevertheless be possible to formalise a test of who can challenge price control decisions by requiring the party to demonstrate to the gatekeeper that, a) their interests align with those of the end users (for the purpose of the licence modification); and b) they have effectively engaged with Ofgem in the process. An alternative option to ensure that the number of appeals are limited would be to focus the right of appeal to the licence holder and nominated consumer groups. It is argued that this would strike a balance between providing a counterweight to the right of the licence holder to appeal and the desire to control the frequency of frivolous and spurious appeals. This argument was adopted in the DfT consultation on the right to appeal the Civil Aviation Authority's decisions in relation to airport price controls. In its decision the DfT stated that:

“This symmetrical right to challenge proposed licence modifications (including decisions on price regulation and service quality) appears to the DfT to be likely to enhance regulatory decision taking and the balance of interests provided the system overall remains proportionate and efficient.”¹⁸

¹⁸ Department for Transport: “Reforming the framework for the Economic Regulation of Airports – Decision Document”
<http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationairports/decisiondocument/pdf/decisiondocument.pdf>

The DfT decision is in many ways a special case when considered from an energy regulation point of view. In the airport sector the suggested regime significantly expanded on the ability to challenge the regulatory decisions, starting from a lower starting point than the current energy regime. The DfT is adopting an approach based on the ability of a nominated consumer group (Passenger Focus) and the licence holder to challenge price control decisions to the Competition Commission based on the merit of the decision. In its decision it considers this approach to build upon the existing “standard” model as used in energy licence modifications – which is that the licence holder is granted the ability to appeal decisions.¹⁹

A similar approach in energy would be to allow one or several of the consumer and industrial bodies and representative groups for energy, such as Consumer Focus and the Major Energy Users Council to appeal price control decisions. This might, however, be less appealing in the energy sector for several reasons. There is a wider variety of user categories of energy networks represented in energy than there is for airports. A non-exhaustive list of potential interest groups, all with a viable interest can be found in Box 3.1.

Box 3.1: Potential interest groups in energy

| Interest groups |
|---|
| <ul style="list-style-type: none"> • 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, suppliers); • network companies (including independent networks); • investors and their representatives; • special interest groups; and • other regulators (including the Health and Safety Executive). |

(Source: Ofgem)

The interests of these groups are unlikely to be aligned, and, as we have outlined earlier their preferences will perhaps not remain aligned over time. This presents a problem in identifying specific interest groups to allow to appeal. In addition to this there are in some cases several industry associations, trade bodies and consumer organisations within the same category.

A potential problem with limiting the right of appeal to industry associations, rather than individual parties arises from the ownership structure of the industry. For example the parent companies of several of the member of the Association of Electricity Producers are also active in the operation of distribution and transmission networks. This is however not true for all its members. In the context of challenging price controls this may effectively make it difficult for

¹⁹ Although Ofgem’s consultation clarifies that it considers that third parties can challenge price control proposals under the existing legislation. This is discussed further in this report.

the association to decide on whether to challenge or not, with legitimate concerns of some of its members effectively “blocked by committee”.

As we outlined in the previous section, consumers are generally not well informed about the energy industry structure, and in particular about the service separation between their supplier and network operator. In light of this it is perhaps not surprising that domestic consumer organisations such as Consumer Focus have not engaged with the specialised area of price controls.

Some energy network users can have fairly obvious interests that do not align with consumers, or the statutory duty of the regulator. For example, energy suppliers also (at least in the case of the big six suppliers) own related assets. This may in some circumstances, relating to network investment, create incentives for the suppliers interest to diverge substantially from consumers. The main way this may happen is if the investment in a particular transmission project would enhance the capacity of the network by removing a constraint and hence reduce the need for the system operator to call upon a particular plan in the balancing mechanism. Such incentives are however relatively transparent and easy for the regulator, Competition Commission or gatekeeper to detect – and if nothing else it can be brought to its attention by other users.

In spite of this it still remains the case that in many cases, with regard to network price controls, the interest of energy suppliers may be aligned with the consumers and the interests of a particular supplier could be easily detected by the gatekeeper based on its earlier interactions in the process.

In its report into BAA airports the Competition Commission discussed the right to appeal. In the report it discusses the relationship between airlines and airports, where a similar relationship exists to that between an energy supplier and the network company. The Competition Commission outlines the key objective of a right to appeal is to enhance the accountability of the regulator which is “...normally best provided by allowing those persons with a material interest at stake to defend that interest.”²⁰ It further reasons in relation to a duty to promote the interests of airlines that it “...does not mean that the interests of airlines should be pursued where they are contrary to the promotion of competition or the interest of users.”²¹

Ofgem suggests that a route that follows a similar line of reasoning to that of the Competition Commission, and allows a broader range of parties to challenge licence condition amendment provided that the party could demonstrate that certain conditions are met:

- demonstrate that their interests are aligned with those of end consumers; and
- demonstrate that they effectively engaged with Ofgem and the network companies in the price control review.

This would amount to an effective, albeit informal gatekeeper mechanism. An organisation’s interests may not always fully align with those of consumers. It is nevertheless possible that they

²⁰ CC Final Report on BAA p.279:

http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/545.pdf

²¹ CC Final Report on BAA p.275:

http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/545.pdf

are sufficiently aligned for an appeal to carry merit from a consumer viewpoint. In practical terms we recognise that demonstrating this raises some issues including:

- How do you demonstrate that your interest is aligned with those of consumers?
- Which consumers categories does it refer to? And
- What would the threshold be for demonstrating that one had “effectively engaged”?

For some of these questions a more concrete answer is possible than for others. For example, engagement could be demonstrated by providing information to the regulator, responses to consultations and participation in industry meetings and seminars. Centrica regularly participates and responds to the price control processes for both distribution and transmission and effectively engages in the processes.

The tests still present a practical challenge as they will inevitably be qualitative in nature and the assessment subjective. This is, however, still an improvement as not focusing the right of appeal to single nominated interest or consumer groups will also ensure that price control reviews are scrutinised from more than one perspective. It is also an improvement on the broader right found in telecommunications as it requires the consumer interest to be clearly demonstrated to the gatekeeper.

3.3.5. Scope of challenge

The scope of an appeal raises important issues relating to the complexity of the issues being challenged. In principle it may be possible to devise a regime that allows challenges to a limited part of a price control. In practice this is likely to be difficult, for example, allowances on capital and operating expenditures tend to be related. The nature of price controls mean that a full challenge is likely to remain appropriate in many, or most, cases.

Introducing the ability to consider a more limited type of challenge raises the possibility of reducing the cost of the appeal. It does however place a responsibility on both the appeal body and the gatekeeper and raises a number of issue to consider, including:

- Who decides what the scope of the investigation should be?
- Should it be limited to considering the scope raised in the appeal?
- Should the question if the appeal scope can be considered in isolation be considered by the gatekeeper? In such a system the person making the appeal would need to provide a motivation for the issue being considered separately and the gatekeeper to determine if this is appropriate after consulting with the licensee. And
- Should the appeal body have the freedom to establish the scope of an appeal on a case-by-case basis?

It is possible that a combination of the above is appropriate – i.e. the gatekeeper could have the discretion to disallow challenges if it felt their scope was not reasonable and the Competition Commission (if different) could have the discretion to expand the scope of the appeal if it considered that it could not be considered in isolation.

Despite this there is a compelling argument that one should be careful not to “throw the baby out with the bathwater”, in particular given the costs associated with developing a regime. Allowing the challenge on more limited grounds however means that the regime needs to be devised with sufficient safeguards to ensure that “cherry-picking” of issues does not lead to an inappropriate overall determination. For example, in cases where more capital expenditure is allowed in order to facilitate a lower operating expenditure, the capital expenditure cannot be challenged without also considering the intrinsically linked operating expenditure.

In our framework we recognise the difficulty presented by allowing the scope of appeals to be limited to a part of a licence change in the context of a price control. We consider that there could be merit from an efficiency point of view in considering the option that an issue could be considered in isolation, however, there should not be a presumption that this can be done.

While a licensee will only appeal the price control proposals as they relate to itself, it is possible that a third party may appeal all price controls in a sector where multiple companies are regulated, and many of the parameters of the price control are the same for each company. If a third party considered that the cost of capital was inappropriate it would logically appeal all the price control determinations. It is however important to note that in practice this may not lead to a significant increase in uncertainty, through an increased volume of appeals, compared to the current regime. In the 1990s Scottish Power successfully challenged through Judicial Review a decision by the regulator. The challenge was based on an earlier decision by the Monopolies and Mergers Commission in favour of Scottish Hydro regarding provisions that were also relevant to Scottish Power’s network. Currently if a network company was to successfully appeal a control to the Competition Commission on a general provision, such as the cost of capital, or menu regulation, then Ofgem would very likely need to apply the outcome of the appeal across the whole regulated sector. This creates a similar impact and risk to that of several individual challenges from a third party.

It is however important to recognise that a third party may choose to only appeal one or a small number of the price control determinations. For the recent electricity distribution price control review, Ofgem’s analysis provided substantial information to allow third parties to understand Ofgem’s view about the relative efficiency and performance of each DNO, which could be the basis for a third party to consider challenging only one or a limited number of the price controls. Keeping open the opportunity for challenges on only limited aspects of a price control review will minimise the potential burden of appeals where a third party wants to challenge a common parameter such as the cost of capital.

3.3.6. Outcome of Competition Commission reference

On the subject of what the outcome of a third party challenge to a price control would be we consider that an approach consistent with the current approach would be appropriate.

When a challenge is made to other licence conditions the Competition Commission provides advice to Ofgem on changes. Ofgem then implements these changes by amending the licence conditions. If the Competition Commission is not satisfied that Ofgem has taken its changes into account then it can require Ofgem to make specific changes. This approach is consistent with the current legislation.

3.3.7. Awarding of costs

The awarding of costs is an important factor to consider in designing an appeals process, particularly for the purpose of avoiding vexatious, or frivolous appeals. The risk of an unsuccessful challenge should be coupled with the risk of not only having to pay ones own costs of the appeal, but also for a proportion of the opposing parties' costs. This is particularly important when the deciding body acts in an adjudicative, rather than an investigatory role, however it still applies in the investigatory role as the unsuccessful challenging party should be asked to pay for the investigation undertaken by the Competition Commission.

The process to award costs is complicated by the fact that the Competition Commission may decide to allow some parts of an appeal, while dismissing others. This raises the issue of who should pay for each part of the cost of the appeal when appeals are partially upheld. The Competition Commission could be empowered to decide what was a reasonable proportion of costs to allocate at a partly successful appeal.

A further issue to consider is what arrangements need to be made to ensure that parties who raise appeals have the ability to cover the costs that they could be required to pay following the appeal. This is particularly important as, contrary to the arrangements for appeals to modification decisions in the energy codes the parties subject to the codes will not always be tied to the industry arrangements (by, for example, being a party to a code).

3.3.8. Implementation of the licence change

One important issue raised by Ofgem as a disadvantage of allowing a wider right to appeal is that it might delay investment and hence have a detrimental effect on for example security of supply or network operating costs.

In practice the effect of this can be reduced by firstly ensuring that there are strict timescales for the appeal process, and secondly by ensuring that by default the price control is implemented. While in theory this might raise the risk of stranded investments, in practice the risk of this will be minimised through the tightly controlled timescales of the appeal process.

One common sense way of ensuring that challenges do not adversely impact on investment, or the implementation of a price control is to ensure that sufficient time is allowed in the process to accommodate a time-controlled challenge. This would ensure that irrespective of whether or not a price control is challenged or not the new control would be implemented on schedule. The potential drawback to this is that it would necessitate the use of a marginally greater amount of forecast data to accommodate the earlier timing of the determination.

A further alternative can be found in the water sector. In price controls for water Ofwat's determination is implemented for the first year of a control and any changes following the appeal to the Competition Commission is only introduced for the second year of the control. In making its decision the Competition Commission of course has regard to this fact. This would avoid the risk of strategic appeals to delay the implementation of price control decisions.

3.4. Summary

In this section we have set out a model of an appeals mechanism for consumers to appeal final price control decisions. Our proposed mechanism focuses on ensuring that the mechanism provides the desirable incentives on all market participants, as well as ensuring that the role of Ofgem as the regulator is not reduced, but rather the process enhanced to take better account of the better regulation principles and the greater move towards accountability as seen, both in the energy network codes and in the airport sector.

We consider that this can be accomplished through a well designed, robust, gatekeeper process, with a recognised party serving as gatekeeper. In our view this role is best filled by the Competition Commission as it is a recognised body with a good track record in this role from the energy codes. In addition to this we do not consider it appropriate to limit the right to appeal to designated bodies; it is important to consider the realities of the industry structure and the interactions between the market participants in determining who should have the right to appeal. In particular we have outlined that consumer groups to date have been largely uninterested in the price control process, but that, in many cases the interests of the energy companies and the consumer groups will be aligned with respect to network price controls as the end consumers have difficulties isolating the service they are provided by network operators from their energy supply.

In light of these realities we have included the idea outlined by the Ofgem's "spur the debate" model that an appellant would have to firstly demonstrate that their interests are aligned with those of end consumers; and secondly demonstrate that they effectively engaged with Ofgem and the network companies in the price control review.

Our proposed model balances the increase in the better regulation characteristics of improving the balance of the regime, while at the same time ensuring that frivolous appeals are minimised and discouraged.

4. IMPLEMENTATION THROUGH LEGAL CHANGE OR EXISTING FRAMEWORK

In the previous section we outlined a model designed without the specific boundaries of being designed to be implemented without legislative change. However, we welcome Ofgem's indication in its consultation that the current legislative framework can be used to permit third party right of appeal. In this section we briefly discuss two of the benefits of implementing a right to challenge through the legislative route, and then set out some of the areas in which it would be helpful if Ofgem could provide more detail about how it can help implement the right to appeal it has identified in the existing framework.

While we recognise that the exact limitations on our proposed mechanism implied by the current legislation would need to be considered further it is nevertheless worth highlighting some points.

- *Gatekeeper role:* The Ofgem emerging thinking consultation highlights this as one of the areas where current legislation may present a barrier. In our proposed regime the gatekeeper would be asked to consider if the appellant's interest was aligned with that of consumers and that they had fully engaged with the price control process. Assuming both of these were assessed favourably it would place Ofgem in a position where it would already have been subjected to the argument; and be asked, presumably after rejecting it once, whether or not it should be considered again by another body. It is not clear that this places the best incentive on the regulator to be the gatekeeper.
- *Awarding of costs:* Another area where Ofgem identifies uncertainty is the area of cost allocation of an unsuccessful appeal. We consider this, along with the gatekeeper role, to be an important component of ensuring the regime strikes the right balance between the benefits of appeals and the potential cost of frivolous challenges. It is important in order to create an incentive on the appealing parties to restrict appeals to material matters that there is a risk that they carry the cost of an unsuccessful appeal. Conversely their cost if the appeal is successful should be carried by the regulator.

Both of these issues can more clearly be addressed by implementing the right to appeal through new legislation rather than relying on the existing one. In addition to this new legislation would in all likelihood be clearer and improve regulatory certainty of the regime.

It is however still important to recognise that there could be limitations on when such a change could practicably be introduced due to constraints such as parliamentary time. To ensure that the existing right of challenge under the current legislative framework is clear it would be helpful if Ofgem could as a minimum explain:

- *Who would have the right to challenge?* Can Ofgem confirm that providing a party can show that the basis of its appeal is aligned with consumers' interests there would be no formal restriction on who could challenge?
- *What timescale and process would a request to challenge have to follow?* For example, would a challenge need to be notified to Ofgem by the same date as the companies' subject to price control have to confirm whether they accept or reject the price control? Alternatively, would parties have until the end of the consultation on licence condition changes to notify a challenge? It would also be helpful if Ofgem could indicate what

information it would expect to be provided by a party notifying an intention to challenge. We assume as a minimum the issues being challenged would need to be set out, along with the principle reasons for challenge and why the party believed that its challenge was in consumers' interests, but it would be helpful if Ofgem could clarify this.

- *How it would propose to fulfil the gatekeeper role?* As we have noted earlier in this paper we are concerned that Ofgem might struggle to accept that there could be a basis for challenging its decision as not being in consumers' interests. Therefore, it would be helpful if Ofgem could explain how it will fulfil the gatekeeper role, including how it will ensure the staff and/ or Authority members involved are able to take an objective view of the request to challenge, what opportunity the third party would have to make its case, particularly if Ofgem was considering rejecting the right to challenge, and to what extent Ofgem would provide reasons for rejecting any request to challenge. Of course, if this was done in a transparent manner, as we would expect, the appellant would have the right to Judicial Review if it felt that the process followed by Ofgem was inappropriate or wrongly implemented.
- *Recovery of costs for an unsuccessful challenge?* Where a licence holder is the party requesting a challenge there is no issue in principle with Ofgem recovering the costs of an unsuccessful appeal, and Ofgem could seek a written *ex ante* commitment to pay such costs. It is likely to be more difficult in the case of non-licence holders, but we would encourage Ofgem to consider requiring such parties to provide an *ex ante* commitment to pay costs if their appeal is unsuccessful, and perhaps also to provide evidence of availability of funds to do so. Ofgem could also ask the Competition Commission to provide a view on what proportion of costs should be recovered in the case of a partially successful appeal.

We consider it is very important for Ofgem to provide a document setting out the process that it envisages being followed by third parties seeking to challenge future price control decisions. Without clarification from Ofgem about how the process for third party appeals under the current legislation will work there is a genuine risk of increased regulatory uncertainty for price regulated companies and third parties who might consider exercising their right of appeal.

5. CONCLUSIONS

In our previous paper “Consumers’ Right to Appeal Regulatory Decisions” we concluded that there was a move towards a general consensus in the regulated industries in the UK that closer engagement with consumers is a necessary element of better regulation. We also established that *ex-post* engagement would be the appropriate approach and outlined some of the cost and benefits of an *ex-post* appeals process.

In this paper we have discussed the costs and benefits of appeals further and built upon the model in Ofgem’s “Emerging Thinking – Third party right to challenge our final price control decisions” document to develop a robust *ex-post* appeals mechanism that balances the benefits of appeals against the potential cost of frivolous appeals. More specifically we have:

- touched on the impact on the balance of the mechanism and argued that while in the past the efficiency driven framework has been appropriate this no longer holds true in the emerging framework when customers preferences are becoming more complex;
- expanded on the implications for the cost of capital, outlining that the impact of introducing a right to appeal could be ambiguous, however as the Competition Commission is considered a competent body in this field it is not likely to increase the regulatory risk;
- considered the impact on security of supply and investment and outlined how the poor understanding of the industry structure by end consumers means that they will hold their energy suppliers directly accountable for disruptions. This means that it is in the suppliers best interests to ensure networks are well maintained and well functioning;
- outlined a model of how a right to appeal could be structured to safeguard against the cost of frivolous appeals, while retaining the benefits of increasing the accountability and balance of the regime. This focuses on a strong gatekeeper function separated from the regulator, appeals open to parties that can demonstrate that their interests are aligned to those of consumers and that they have engaged effectively with the process and robust awarding of costs against the losing party; and
- briefly contemplated the potential implementation of a right to appeal and held that implementation through legislative change would be preferable from a better regulation and clarity point of view. It is however welcome that Ofgem has identified the right to third party appeal within the existing legislative framework and we believe it is very important for Ofgem to provide more information about how this could be given practical effect to avoid unnecessary regulatory uncertainty.

We encourage the RPI-X@20 project to continue to develop its thinking in this field and to assess a realistic mechanism that includes features such as a strong gatekeeper and awarding of costs.