



**SP Transmission, SP Distribution and SP Manweb (SPEN)**

**Regulating Energy Networks for the Future: RPI-X@20  
Third party right to challenge Ofgem's final price control decisions**

**9<sup>th</sup> April 2010**

## Introduction and Overview

SP Energy Networks (SPEN) welcomes the opportunity to respond to Ofgem's Emerging Thinking – Third party right to challenge its final price control decisions.

In our opinion a third party right of challenge would, on balance be undesirable, as it would:

- Downgrade the status of Ofgem's review to a preliminary stage;
- Inevitably delay decision making, investment and implementation of improvements;
- Hold back the progress of government energy and climate change policies;
- Fail to protect adequately the interests of future customers;
- Increase the uncertainty surrounding the outcome of price controls;
- Increase perceived regulatory risk, thereby raising the cost of capital.

Nevertheless, if Ofgem were to decide to introduce a third part right of challenge we believe that it should be reserved to Consumer Focus, as the major representative body of customers at large. We think the Competition Commission is the body best placed and resourced to undertake an investigative appeals process. Bodies which choose to appeal should face the prospect of bearing an appropriate proportion of the costs to deter appeals which lack sufficient merit. The gatekeeper should be the Competition Commission itself, as it is independent of Ofgem.

## Potential advantages and disadvantages of a third party right of challenge

*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?*

We believe that the effect of a third party appeal mechanism would be to reduce Ofgem's role and that the Price Control Review would become merely a pre-cursor to the main decision making stage.

Ofgem has developed substantial expertise in energy related matters over many years and it is very unlikely that another body would have the same degree of industry expertise.

An appeal process would inevitably delay the decision making, by at least several months. This would delay investment programmes and delivery of their benefits to customers and society. It would also hold back the progress of government energy and climate change policies. Implementation of other improvements in the price control, such as enhanced incentive mechanisms, would also be "put on hold" and the associated benefits would not be attained. The disbenefits of such interruptions and delays must be offset against any potential benefits of a third party right of challenge.

The possibility of a third party challenge increases the uncertainty surrounding the outcome of a price control and also the timing and scale of changes to use of system charges.

This would increase perceived regulatory risk, thereby raising the cost of capital. In particular, the introduction of the right of third party challenge would increase downside risk, as third parties would only be expected to intervene when they perceived the proposed price control to be less than sufficiently demanding of licensees.

There are clearly especial difficulties in adequately taking into account the interests of future customers which need to be represented in an objective manner during the process. The opinions of many representative bodies are based on their experience of issues which they have been involved with and, to varying degrees, the views expressed by their members or clients. Clearly, the views of future customers cannot be ascertained directly but, nevertheless, their interests must be protected. It is helpful that Ofgem's statutory duties have been clarified in this regard.

At present, we recognise that the involvement of stakeholders in price reviews could be seen as being relatively limited. We believe that wider participation could be encouraged through a programme of coordinated market research, which would allow a much greater diversity of customers to express their views. Moreover, the market research can be designed to investigate the inevitable trade-offs involved in providing and operating gas and electricity networks. This programme should be sponsored by a group including representative stakeholders, Ofgem and licensees.

The funding of such a programme, however, would need to be considered further. For example, whether stakeholders would be expected to contribute to the costs or whether it was centrally funded by Ofgem and recovered through licence fees. One possible approach would be for Ofgem to fund the core research with supplementary research being funded by stakeholders, potentially on a shared basis.

We support the aim of improving the effectiveness of the regulatory regime. However, we believe that the focus of RPI-X@20 should be on making the price control review process more effective and transparent so that appeals would not be necessary, in any case. It is conceivable that the availability of subsequent appeal would reduce the perceived pressure to “get the Final Proposals right”. Similarly, difficult political and social issues may be left to the appeals body to resolve. Also, there may be a perception that the price review process is only a preliminary stage and parties may be tempted to conserve resources and effort until the appeals stage.

There are significant differences between the energy sector and the regimes for communications and airports. This is reflected in the legislation which applies to each of these sectors. It is notable that the proposed reforms to airport regulation followed criticism of the CAA and a conclusion by the Competition Commission that “the current system of regulation of the designated airports (Heathrow, Gatwick, and Stansted) is a feature that distorts competition”.<sup>1</sup> Nevertheless, the DfT proposes<sup>2</sup> to limit third party appeals to Passenger Focus, as its perspective is judged to be more aligned with that of passengers themselves, and not to establish a right of appeal for airlines.

***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?*

In our view, the disadvantages of a third party right of challenge outweigh the potential advantages.

There are many potential stakeholders, many of whom have quite narrow and limited interests, so it would seem impractical to give all of them a specific right of challenge. Even if a list of eligible parties were to be drawn up, new entities could emerge over time, which may feel aggrieved if they also were not given a right of appeal.

However, it is likely that the more entities who have a right to appeal then it would become inevitable that there would be more appeals, some of which may be vexatious or without sufficient merit.

It is conceivable that one or more stakeholders would seek to delay the implementation of a measure with which they disagreed, such a price rise, through appealing the Final Proposals.

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<sup>1</sup> Competition Commission (2009) “BAA markets investigation: A report on the supply of airport services by BAA in the UK, 19 March, paragraph 10.269, page269

<sup>2</sup> Department for Transport (2009) “Reforming the Framework for the Economic Regulation of Airports – Decision Document”, December

For example, such a tactic would appear to be advantageous for a supplier with a substantial proportion of fixed price contracts. We doubt that even the prospect of potentially having to bear some or all of the costs would necessarily deter such delaying tactics, especially where there is a financial benefit from delayed implementation.

If only a very small number of parties have standing to appeal, those parties may perceive additional pressure to challenge Ofgem's decisions, so as to be seen to be actively representing stakeholders' interests. It is not clear that a "quango-like" body would be deterred from making appeals, which are likely to be unsuccessful, by the prospect of having to pay costs, as these would effectively come from public funds or possibly license fees.

***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?***

Notwithstanding our comments above, the introduction of a permission stage, undertaken by a competent and informed body, should allow vexatious challenges and those clearly without merit to be filtered out. However, borderline cases may be admitted which could still result in a significant number of appeals. Furthermore, a preliminary stage would add to the overall length of the appeals process.

Nevertheless, there may be benefit from a body with wider experience of other industries and regulatory decisions assessing the grounds of appeal. However, this may inhibit novel challenges and potentially slow development of the regulatory regime for the energy sector.

The fewer bodies that have standing to appeal would be expected to decrease the number of appeals and reduce the scope for conflicting appeals by different bodies.

## Options for introducing a third party right of challenge

*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?*

Implementing a third party right of challenge under existing legislation would markedly constrain its design and the process which would be followed. We doubt that the outcome would prove to be satisfactory and may serve only to increase dissatisfaction with the regulatory process. It is likely that dissatisfied parties, including some who may have been denied the right to appeal, would then press for further reform, which would probably require primary legislation.

If there is a clear basis for third party right to challenge an outcome within the current legislation, we would be surprised if potential challenges had not already been considered. If third parties have decided not to explore this route further, it suggests that it would not be adequate.

It is not clear how Ofgem would propose to introduce a third party right of appeal under existing legislation, especially where the licensee purported to accept the Final Proposals. Moreover, it is not clear on what basis Ofgem would designate which third parties, if any, would be allowed to appeal. It seems likely that if Ofgem were to admit one third party, others would seek to follow.

If it is decided that the introduction of a third party right of appeal is necessary, it would be better to implement this through an appropriate change in legislation. This would allow the process to be tailored to the energy sector. Also, it would be possible to clearly designate the parties which would have standing to appeal, set a maximum timetable for the process and establish the basis on which costs would be allocated.

## Issues to consider in designing a right of challenge

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

One of the most important aspects would be who has standing to appeal. The more parties which have the right to appeal then the more it becomes necessary to ensure adequate gate-keeping, tight timescales for the process and appropriate potential liability for costs. It seems likely that primary legislation would be required to provide a clear basis for these.

The other major is the nature of the appeal: namely, adjudicative or investigative. A closely associated matter would be to which body the appeal is made.

The timetable would be mainly driven by the nature of the appeal and the resources of the body making the decision.

In general, we think the Competition Commission is the body best placed and resourced to undertake an investigative appeals process. We hope this could be accomplished within six months from referral, with the option for a potential extension to nine months.

**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?*

As, on balance, we do not support a third party right of challenge we have not evaluated all the potential options, at this stage.

## A potential design for debate

**Question 1:** *Do you have any comments on the potential design of a third party merits-based right of challenge?*

We think that any third party right of appeal should be limited to only those parties which are clearly aligned with customers' interests. The most obvious candidate would be Consumer Focus. However, undertaking a Competition Commission referral may stretch their current resources. In our opinion, it would be impractical to allow individual customers a right of appeal.

The gatekeeper should be the Competition Commission itself, as it is independent of Ofgem. The Competition Commission is also sufficiently familiar with the regulatory regimes in the energy and other sectors to make an informed decision in a short period of time. The Competition Commission should publish its own guidance on the criteria for allowing appeals to proceed and produce a written justification of any decisions made on whether to allow an appeal to proceed.

Third party grounds of challenge should be focused on customers' interests.

The nature of the challenge should be on its merits. Judicial review already allows the process to be challenged.

The scope of the challenge should encompass the full price control package, although the party appealing may choose to highlight one or more aspects. If third parties were free to appeal individual elements of the package, it would be difficult to ensure that the overall balance of the price control package is maintained. Also, there is a risk that several narrowly focused challenges could potentially distort the price control package.

The outcome of a Competition Commission referral should be that the Competition Commission makes the final decision on the price control. Otherwise, Ofgem may face pressure to amend further the Competition Commission's recommendations.

The timescales for the appeals process should be clearly defined.

Parties which appeal should face potentially the costs of all parties. This would act as a potential deterrent to appeals without sufficient merit.

**Question 2:** *Do you have any alternative designs that you think Ofgem should consider were we to introduce such a right of challenge?*

No.