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9 April 2010

Dear Hannah,

Regulating Energy Networks for the Future: RPI-X@20 Emerging Thinking – Third party right to challenge our final price control decisions

SSE welcomes the opportunity to respond to the above consultation. We have responded separately to the main RPI-X@20 Emerging Thinking document.

Service is one of our core values and as such we are committed to ensuring full stakeholder participation throughout the price control review process to allow consumers' views to be fully discussed and taken into account in the price control decision. To this end, we fully support the stakeholder engagement incentives introduced in DPCR5 and the proposed extension of those proposals to transmission and gas networks as set out in the RPI-X@20 Emerging Thinking document. However, we are firmly opposed to the proposal to introduce a third party right of appeal of a price control decision to the Competition Commission, as we believe this will cause an unacceptable level of uncertainty in the price control process without adding any real value to consumers.

Our answers to the questions set out in the consultation document are attached in Appendix I. However, we summarise our key concerns below.

Firstly, there are innumerable parties with an interest in the outcome of the price control review process and there is, therefore, a significant risk of a high number of "frivolous" appeals, particularly as launching an appeal is a relatively straightforward and inexpensive process. It is not clear to us how Ofgem could limit the number of parties eligible for appeal. For example, there are a number of parties such as business customers and small generators that are not represented by any wider group. In addition, there is no reason to assume that groups, such as consumer bodies, are any more informed on what is best for future customers than is Ofgem. In any case, we would argue that any such limitation would be discriminatory.

There is also a considerable risk that those with a commercial interest, such as large suppliers, would 'game' the process and purposefully delay the implementation of the price control for commercial gain.

Historically, few network companies have appealed a price control decision. This is because of the disruption to the business associated with the uncertainty that an appeal carries. Looking forward, network companies are facing rising costs and investment and the impact of the uncertainty of the outcome of a Competition Commission reference, combined with the effects of a delay in implementation of the price control could seriously impact on business risk. It would therefore be of serious concern to network companies if appeals were to become the norm.

With so many parties able to launch an appeal, it appears inevitable that one or a number of appeals would be deemed justified. There is therefore a serious danger of the initial price control review process becoming a 'starter for ten', with parties waiting for the main event of the Competition Commission decision. Ofgem's position in the price control process could be seriously undermined.

Secondly, the proposal to introduce a third party right of appeal seems to contradict Ofgem's case in RPI-X@20 for bespoke settlements more suited to each network company's particular circumstances, as, if bespoke settlements were to be introduced, this would clearly make any appeal process extremely complex and time consuming.

Thirdly, under the DPCR5 incentives and the RPI-X@20 proposals, third parties will be fully engaged with Ofgem and network operators throughout the price control review process. This will ensure that Ofgem fully understands third parties' issues and, bearing in mind its principal duties, these will presumably, therefore, be fully taken into account in the production of the final proposals.

Finally, the proposals under the Code Governance Review (expected to take effect by Autumn 2010) include the incorporation of network charging methodologies into relevant industry codes, giving materially affected parties the opportunity to propose changes. This gives affected third parties a strong power, and a more relevant route to influence, the implementation of the price control. As we have said above, it is likely that the charging element of the price control will most affect suppliers and consumers, rather than the price control package as a whole which is common to all. This future ability to raise modifications to charging methodologies therefore appears to be an appropriate and proportionate means by which third parties can influence the implementation of the price control.

In summary, it is not clear to us that consumers in general, including both current and future customers, would benefit from a third party right of appeal. We also saw little evidence at Ofgem's public workshops on RPI-X@20 that there was even any demand for such a mechanism, and we remain firmly opposed to this proposal.

I hope this information is helpful to you. If you require any further information please do not hesitate to contact me.

Yours sincerely,

Rob McDonald
Director of Regulation

Appendix I

CHAPTER 2

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 agree with Ofgem that there are more disadvantages than advantages to introducing a third party merits-based right of appeal.

The most significant disadvantage would be the uncertainty (and therefore risk) that a third party right of appeal would create around the price control review process and the potential impact this would have on investment. This is particularly concerning at the current time when significant investment is likely to be required in order to ensure secure energy supplies for the future. Further clear disadvantages include: potential delays to the introduction of the price control: confusion in the price control review process (particularly if third parties are to be allowed to challenge elements of the price control, as network operators accept or reject final proposals based on the package as a whole which is likely to involve some trade offs): and, a risk that the final proposals will become a “starter for ten” with parties not engaging to their full potential in the knowledge that an appeal is likely. The last of these points identifies a further issue: a fundamental change in Ofgem’s role in the price control review process with the overall decision making power lying with the Competition Commission in many more cases.

We believe that there are several disadvantages not addressed in Ofgem’s consultation.

Firstly, parties such as consumer bodies will inherently endeavour to protect the interests of existing consumers; consequently there is a risk of undue focus on such customers with no similar representatives on behalf of future consumers.

Secondly, there is a risk that large parties with a commercial interest, such as suppliers, would ‘game’ the system and use it as a means to delay the implementation of the price control for commercial gain.

Thirdly, there is a risk that, unintentionally, one of the drivers behind decision making in the price control review process becomes the threat of appeal from a third party.

Importantly we believe that the advantages associated with a third party merits-based right of appeal can be (and are already being) achieved via other mechanisms, thereby avoiding the significant disadvantages already discussed.

The criteria for the stakeholder engagement incentive to be introduced in DPCR5 include demonstrating effective engagement with a range of stakeholders and clear evidence of improvement as a result of feedback from this engagement. The RPI-X@20 Emerging Thinking document builds on this consumer focus by proposing increased stakeholder engagement (including both network operators and Ofgem) across a wide range of parties, from domestic consumers to generators and special interest groups, as well as a need to demonstrate that due regard has been shown to their views. This increased customer focus and engagement will allow network operators and Ofgem to ensure that consumer issues are discussed and understood throughout the price control review process and that due regard is given to these issues in the writing of the final proposals.

In addition to this it must be borne in mind that Ofgem’s primary duty is to protect the interests of existing and future customers in relation to electricity conveyed by distribution or transmission systems.

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?

As detailed in our answer to Question 1, we think that the disadvantages far outweigh the advantages.

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?

The design of the right of challenge could to some extent limit the disadvantages.

The most significant issue related to the design of the right of challenge is around whom would be given such a right, in order to limit the number of appeals launched. There are innumerable parties with interest in the price control review and it is unclear how Ofgem could limit the parties eligible for appeal without acting discriminatorily.

There is a further serious issue regarding the elements of the price control that third parties could challenge. It would not be appropriate for parties to cherry-pick elements of the price control to challenge. DNOs accept the entire package of a price control, and this usually involves a considered trade off. In addition to this, under RPI-X@20 proposals, Ofgem is proposing to introduce bespoke settlements more suited to the circumstances of each network company; a third party right of challenge could risk the achievement of these bespoke arrangements and result in more homogenised price controls.

With regards to decisions around which challenges would be eligible for appeal, a strict set of criteria would need to be developed which would include: the materiality of the challenge; whether the issue had been raised in previous engagement; and whether the party had actively engaged throughout the process.

Key to the design of a right of challenge would be strict time limits to ensure that any delay to the implementation of the price control was minimised.

CHAPTER 3

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?

The clear difference between this option and using existing legislation, as detailed in the consultation, is that with existing legislation Ofgem would have to be the “gatekeeper”. We firmly believe that it is not appropriate for Ofgem to be the gatekeeper for an appeal process. There is a risk that Ofgem would be unable to give an unbiased decision due to the threat of a Judicial Review. We believe that the only appropriate gatekeeper would be the Competition Commission.

CHAPTER 4

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

We have no further comments in addition to those given in our response to question 3 above.

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?

We have no further comments in addition to those given in our response to question 3 above.

CHAPTER 5

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

We have no further comments to add.

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

Although we do not have any alternative designs to propose, we note the ways in which third parties can already influence the price control review process and other associated charging issues in order to demonstrate that introducing a third party right of challenge would not add value to the price control review process.

Third parties currently have a route to challenge price control decisions through Judicial Review. This allows parties to challenge whether a decision was reasonable and whether account was taken of all relevant facts and representations made.

The proposals under the Code Governance Review (expected to take effect by autumn 2010) include the incorporation of network charging methodologies into relevant industry codes. The effect of this would be to give materially affected parties such as suppliers and consumer bodies a strong power and a more relevant route to influence charging methodologies and effectively the implementation of the price control. As we have said above, it is likely that the charging element of the price control will most affect suppliers and consumers, rather than the price control package as a whole. This ability to raise modifications therefore appears to be an appropriate and proportionate means by which third parties can influence the implementation of the price control.