

Title: Proposals for implementation of licence modification appeals under the EU Third Package Lead department or agency: DECC Other departments or agencies: N/A	Impact Assessment (IA)
	IA No: DECC0030
	Date: 01/10/2010
	Stage: Consultation
	Source of intervention: EU
	Type of measure: Secondary legislation
Contact for enquiries: Hannah Lewis, hannah.lewis@decc.gsi.gov.uk	

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary? The EU Third Package introduces new requirements that: the regulator must have powers enabling it to perform regulatory tasks in an efficient and expeditious manner, a suitable right of appeal must be available to all parties affected by a decision of the regulator, and the regulator must be able to implement binding decisions. The consultation on the EU Third Package explains our view that Ofgem's current licence modification process could potentially fall short on these tests. We have proposed to replace the current system with a process whereby Ofgem can make a licence modification decision which is appealable by licence holders to an appropriate body. We believe that this will implement the Directive and should improve competition.	
What are the policy objectives and the intended effects? <ul style="list-style-type: none"> - To implement the requirements of the Third Package directives. - To do this in a way which results in a coherent, consistent, and practical domestic framework. - To ensure robust regulation for the benefit of consumers. - To provide appropriate safeguards for licensees to challenge a decision of the Regulator where it considers the Regulator has not acted within its powers and in a way which is consistent with the facts. 	
What policy options have been considered? Please justify preferred option (further details in Evidence Base) Various options surrounding the details of the appeal system have been examined in the accompanying Consultation, including a minimalist implementation of the Directive, which would limit a new appeals system to Third Package decisions. However, we concluded this option would lead to a complex and dysfunctional regulatory system, with two different decision making processes for linked decisions. This impact assessment focuses on two options. The first option is to introduce an appeal on the merits for all directly affected parties through a rehearing to the Competition Commission. This system would be similar to that used for energy code modifications. The second option is to introduce an appeal on the merits for directly affected parties through a review by the Competition Appeal Tribunal. This is similar to those used in the telecoms sector. We are minded to have a different appeal structure for price control decisions. Option one, an appeal to the CC, is our preferred option because the CC has significant economic and sectoral experience which would be relevant to the hearing of appeals.	
When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed Ongoing by EU
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Not applicable

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date:.....

Description:

Introduce an appeal based on the merits of the case for licence changes to the Competition Commission

Price Base Year 2010	PV Base Year 20	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.01	1	0.6m	8.1m
High	0.01		4.6m	68.0m
Best Estimate	0.01		0.6m	8.1m

Description and scale of key monetised costs by 'main affected groups'

The Competition Commission faces a one-off set up cost. There are then ongoing costs which are associated with each appeal. These are faced by business, Ofgem and the CC and depend on the number of appeals per year. While we assume that business will only pursue an appeal if it is in its' interest, only the cost element has been captured as part of this impact assessment.

Other key non-monetised costs by 'main affected groups'

There may be some third party costs associated with each appeal, however we are unable to anticipate these at this stage.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Business, Ofgem and consumers should benefit as a result of these measures. The measures are designed to enable more efficient regulation, which should improve competition and therefore benefit consumers. The proposals will also give all directly affected parties an equal right to appeal and challenge the regulator's decisions. This would be fair to all licensees and may increase competition. Building up case law and having appeals may increase regulatory stability and lower the cost of capital.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The cost analysis is extremely dependent on the assumptions made regarding the average number of appeals made per year. We have tried to illustrate this sensitivity by using a range of numbers however we are unable to anticipate the correct value and would welcome evidence as part of this consultation.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB: 0	AB savings: 0	Net: 0	Policy cost savings:	Yes/No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	Great Britain				
From what date will the policy be implemented?	03/03/2011				
Which organisation(s) will enforce the policy?					
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded:		Non-traded:		
Does the proposal have an impact on competition?	Yes				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs:		Benefits:		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties¹ Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	15
Small firms Small Firms Impact Test guidance	No	
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	<u>RIA for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005</u>
2	<u>Impact Assessment for the Market Power Licence Condition</u>
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

- **Problem under consideration**

The EU Third Package introduces new requirements that: the regulator must have powers enabling it to perform regulatory tasks in an efficient and expeditious manner, a suitable right of appeal must be available to all parties affected by a decision of the regulator, and the regulator must be able to implement binding decisions. The consultation on the EU Third Package explains our view that Ofgem's current licence modification process could potentially fall short on these tests. We have proposed to replace the current system with a process whereby Ofgem can make a licence modification decision which is appealable by licence holders to an appropriate body. We believe that this will implement the Directive and should improve competition, by enabling more effective regulation and giving market participants an equal right to appeal.

- **Rationale for intervention**

These proposals are designed to ensure the implementation of the Third European Package. The proposals should also lead to an increase in competition in the electricity and gas market. This is primarily achieved through four mechanisms. Firstly, the proposals would give market participants a right to appeal which would be fair to all licensees. This would remove the current disadvantage that applies to small companies. Secondly, the new process would be more transparent and would enable Ofgem to issue binding decisions outright, potentially resulting in more efficient decision making. Thirdly, the mechanism would increase the accountability of GEMA decisions, and fourthly, building up case law through appeals may increase regulatory stability.

- **Policy Objectives**

The policy objectives are;

- To implement the requirements of the Third Package directives.
- To do this in a way which results in a coherent, consistent, and practical domestic framework.
- To ensure robust regulation for the benefit of consumers.
- To provide appropriate safeguards for licensees to challenge a decision of the Regulator where it considers the Regulator has not acted within its powers and in a way which is consistent with the facts.

- **Background**

Under the current system, in order for changes to standard and standard special licence conditions to be made, Ofgem's proposals have to be supported by 80% of the relevant licensees. To determine whether this threshold is met, Ofgem has to apply two tests: that at least 80% of relevant licensees do not object and that 80% of relevant licensees measured by market share do not object. If one or other of these tests is not met, Ofgem is not able to proceed with the proposed modification and has a number of options: it may abandon the proposals; it may alter them in the hope of gaining sufficient support in a further consultation, or it may decide to make a licence modification reference to the Competition Commission (CC).

In order for changes to be made to special licences Ofgem must agree the change with each individual licence holder, otherwise it must abandon the proposals, alter the proposals, or make a licence modification reference to the CC. For further information regarding the different types of licence please see paragraph 1.1 and 1.2 of the accompanying consultation document.

Under our proposed new system, Ofgem would make a licence modification. Should a company be dissatisfied with Ofgem's modification, the company would then decide whether or not to appeal Ofgem's decision based on both their expectations of the costs of the appeal and their chance of success. The process would be the same for all types of licence modification (standard, special, and standard special), however there would be a different structure and outcome of appeal for price control decisions due to their complex economic nature.

- **Description of options**

We have considered several different design options associated with the type of appeal. We have compared the qualitative costs and benefits of each of these detailed options and have included both a quantified costs and benefits analysis of our preferred bundle of options and an illustrative example of how the alternative options may be combined to form an alternative package of options.

It is worth noting that there are some natural connections between the different design options, for example the time limit is related to the structure of the appeal which in turn is related to the possible outcomes.

Several detailed design options have been considered in the consultation document including:

- What should be the structure of the appeals mechanism? Ie should it be based on a rehearing or an investigative approach?
- What should the grounds for appeal be? Ie should the appeal be on judicial review grounds only? should the appeal also be able to be heard on the merits of the case?
- Who are the affected parties that should have the right to appeal? Ie those directly affected licensees only, directly affected licensees and other materially affected licensees or directly affected licensees and other materially affected parties?
- Which would be the most appropriate appeal body for our purposes? Should the appeal body be the Competition Commission or the Competition Appeals Tribunal?
- What should the time limits for the process be?
- What should be the possible outcomes of an appeal? Ie. should the appeal body be able to remit the decision to the regulator with recommendations or vary the regulator's decision?
- Should the regulator's decisions be suspended on appeal?
- Do price control decisions need a different structure and what that should be?

The two broad policy models for consideration are the process for code modification appeals to the Competition Commission, and the current process in the telecoms sector for appeals to the Competition Appeal Tribunal.

- Option One is the preferred package of 'options'. This option includes the introduction of a merit-based appeals system which would enable all directly affected parties to appeal licence changes to the Competition Commission.

This appeal would be to the Competition Commission, and would use similar grounds to those set out in the Energy Act 2004 for code appeals; where the appeal body is required to both look at matters of law and to take into account errors of fact, and the weight attributed to relevant matters. This appeal process would be structured as a rehearing where the CC considers the argument and evidence before it and to request further information for the clarification of evidence. Parties directly affected by the decision would have the right of appeal. As in the codes process, we would be minded to give the appeal a time limit.

We are also minded to introduce a different appeal structure for price control decisions as these decisions warrant more in-depth understanding of the circumstances surrounding pricing arrangements, it would therefore be more appropriate to allow a full investigation of these decisions, where the appeal body may substitute a new price control determination for that of Ofgem.

Option Two is an illustrative example to highlight some of the other options surrounding the type of appeal which have been considered in the consultation.

- Illustrative example: 2nd package of options is to introduce a merit-based review appeals system which would enable directly affected parties to appeal licence changes to the Competition Appeal Tribunal.

This appeal would be a merit-based review appeal to the Competition Appeal Tribunal. The CAT is a judicial body and would hear adversarial appeals in a rehearing format, but again with scope to request further information from appellants. Under the CAT's normal rules appellants would have 2 months to submit their evidence before an appeal could commence, but there is then no overall time limit for the duration of the appeal. The CAT specialises in matters of law and competition, therefore price control decisions, which involve in-depth economic issues, would need to be referred to the CC.

- **Strict Implementation**

We have considered the case for introducing changes to strictly implement Third Package decisions, this would involve introducing a parallel system for the implementation of European decisions. However we have concluded that this would be impractical and against better regulation principles as it would require the separation of the domestic and European elements of a particular decision, creating two substantively different, yet potentially linked regimes. We believe that this is impractical as a number of duties imposed on the national regulatory authorities under the Third Package are functions which Ofgem already carry out under the domestic regime and it is impossible to distinguish whether they have been imposed as a result of European obligations or Ofgem' domestic functions.

In addition, the implementation of a decision may have both a domestic and European angle to it, depending on the context and licences involved. We therefore consider that, assuming that this separation was possible, from a better regulation point of view, it would be complex and dysfunctional to create two parallel regimes for implementing and subsequently appealing the same decision. In practice this could mean that the same licensees would be given different rights in respect of the different elements of a single decision.

We have been unable to quantify the costs and benefits of a minimum implementation option at this stage. However we expect the costs to be greater than those outlined below. We expect many third package and non-third package decisions to be linked, in which case we envisage that either:

- 1) The number of appealable decisions under the Third Package process would be less under this minimum implementation option than under our preferred option, but the total number of Ofgem decisions would be greater, if linked domestic and Third Package decisions were disentangled. In this scenario, we would expect increased costs to energy companies from the increase in consultations. Although there would probably be fewer appealable decisions, we would envisage additional appeals where there is a dispute over the correct process; or
- 2) Ofgem would have to use a dual legal basis to take decisions with Third Package/ EU and purely domestic issues. This may mean that an appeal to the Third Package/ EU part of the decision also automatically triggers a modification reference to the Competition Commission, which would be an expensive additional process.

In either of these scenarios, there may also be more indirect costs related to additional regulatory uncertainty. The benefits associated with minimum implementation may also be reduced compared to the options outlined below. We would welcome any evidence on these costs and benefits of the minimum implementation option as part of this consultation.

- **Costs and benefits of each option**

In this section we have firstly examined the broad benefits of an appeal mechanism and then the qualitative costs and benefits of individual design options. We have then provided a quantitative cost analysis of our preferred 'package' of options (Option One) and an illustrative example of an alternative 'package' of options (Option Two).

1) Broad Benefits associated with an appeal mechanism

Currently, Ofgem regulates companies through the terms of their licences. Ofgem can make changes to standard licences through Collective Licence Modifications (CLMs), the current process allows companies to block a CLM if 20% of affected licence holders object to the proposed change. Ofgem can make changes to special licences through agreement with each individual licence holder. If a licence modification is blocked, Ofgem may then abandon the proposals, it may alter them in the hope of gaining sufficient support in a further consultation, or it may decide to make a licence modification reference to the Competition Commission (CC). Introducing either of the proposed options should benefit competition in the electricity and gas markets in five ways:

- 1) An equal right to appeal and challenge the regulator's decisions would be fairer to licensees and may increase competition.
- 2) The new process would be more transparent as major objections may be dealt with through the appeals process. The proposed process would enable Ofgem to issue binding decisions outright, potentially resulting in more efficient decision making. This would enable more efficient economic regulation of the market.
- 3) If there is an increase in appeals under the new mechanism, we may also see an increase in the accountability of the Gas and Electricity Markets Authority (GEMA) decisions, as the appeal body would provide an additional level of scrutiny.
- 4) Building up case law and having appeals may increase regulatory stability and in turn may lower the cost of capital faced by market participants.
- 5) Having a right of appeal means that decisions which could have costs for business could, in the right circumstances, be successfully challenged. This may mean that certain costs for business could be avoided.

These benefits arise as a result of replacing the current process with the proposed appeals process. We would expect them to be broadly similar regardless of the appeals option chosen. However, as we note later, we would only expect companies to pursue an appeal if they believed that the expected benefits of appeal outweighed the costs.

We have been unable to quantify the benefits at this stage. One method for evaluating the benefits of more efficient regulation would be to look at the benefits of decisions that have previously been blocked and may have passed if this regime had been in place, we have not been able to conduct this analysis at this stage and would welcome any evidence on this or the broader benefits as part of the consultation.

2) Qualitative costs and benefits of individual design options

Several detailed appeal design options have been considered in the consultation. The qualitative costs and benefits of these design options have been considered below. There are links between some of the options, which have also been briefly explored below.

- What should be the structure of the appeals mechanism?

There are two possible options regarding the structure of the appeals mechanism, these are a rehearing or an investigation. The first option is adjudicative, while the second option is investigative. For definitions of these processes please see paragraph 2.6 of the accompanying consultation document.

A rehearing process would allow the appeal body to consider evidence submitted by the appellant, Ofgem, and potentially other parties submitting evidence, and weigh up the arguments and evidence to reach a decision.

An investigative appeal would be more likely to be longer than a hearing that reviews the information that was before the original decision-maker. Investigative appeals have a wider remit, are therefore more resource intensive and the costs to the appeal body are greater. There may also be a greater cost on business and Ofgem as they may require more time, legal resources and documentation compellation for parties. There may also be further duplication of Ofgem's work due to additional analysis and consultation. However a investigative appeal would allow for even greater scrutiny of the economic considerations that underpin the regulator's decision which go to the heart of a business operation. As this option is likely to be more costly, we might assume that there would be few appeals, but of greater cost.

The government proposes that the appeal body be required to reach its decision on modifications (other than those relating to special licence modifications on price controls) through a rehearing process. We believe that a rehearing process balances the costs and benefits of the different structures of appeal best.

- What should the grounds for appeal be?

There are two options available for the grounds for appeal: an appeal on judicial review grounds only, or judicial review grounds plus on the merits of the case. For definitions of these options please see paragraph 2.10 of the accompanying consultation document.

A merits based approach will have different costs depending on how wide the grounds for appeal are and the analysis that follows refers to the difference in breadth of grounds for appeal, with a merits based approach having broader grounds than a judicial review approach. The main difference between a merits based approach and a judicial review approach is that economic and market questions would be considered. Allowing appeals on the merits of the case, not just on judicial review grounds, is likely to mean that more appeals are allowed, as there are broader grounds for appealing decisions. This would be expected to result in higher costs overall from an increase in the number of appeals.

However appeals based on the merits of a case should also mean higher associated benefits, particularly around competition and consistency of economic regulation. In addition a merits-based appeal would provide a greater challenge function to decisions with costs to business.

A very widely defined merits appeal may have a much larger risk associated with a much increased number of appeals and correspondingly higher costs. If this in turn slowed decision-making, the benefits around stable, consistent framework may be reduced.

An appeal on judicial review grounds only would be restrictive compared to a merits based approach. This may mean that the cost per appeal is lower and fewer appeals are heard.

The government is minded to introduce a carefully defined right of appeal on the merits. We believe that a merits-based appeal balances the costs and benefits of the different options best. This process would be broadly similar to that contained in the Energy Act 2004 which provides the procedure for reviewing amendments to industry codes, which we believe would support a consistent approach to energy regulation.

- Who are the affected parties that should have the right to appeal?

There are three options available for defining who should have the right to appeal, these are: (1) directly affected licensees only, (2) directly affected licensees and other materially affected

licensees or (3) directly affected licensees and other materially affected parties (including consumer groups).

In general extending the number of parties able to appeal decisions is likely to result in a greater number of appeals. This in turn will have a knock-on effect on the costs to the appeal body, Ofgem and business. Allowing materially affected parties including consumer groups to appeal may also result in costs to the voluntary sector.

However a greater number of appeals would also result in higher associated benefits as discussed above. These would be subject to diminishing returns as a larger number of appeals slowed down decision making.

The government is minded to allow those parties directly affected (1) by a decision a right of appeal, but we welcome evidence whether there is a case for giving other parties a right to appeal.

- **Which would be the most appropriate appeal body for our purposes?**

There are two options for appropriate appeal body: the Competition Commission (CC) and the Competition Appeals Tribunal (CAT).

The CAT specialises in tribunal style adjudication between the different views on competition issues. If the CAT was chosen there would be initial set-up costs associated with gaining expertise on energy markets. The CC is already the established appeal body for code modifications and already has expertise in competition, economics and energy markets. We have assumed that set-up cost of the CC would be limited to around £10k (assumption used in the previous impact assessment for introducing an appeals process for code modifications). We have not been able to get information about the set-up costs of the CAT, however assume that they would be similar to those of the CC.

We would assume that the cost per appeal would also vary depending on the appeal body chosen. Evidence from a recent appeal to the CC suggests that the CC's cost per appeal may be around £150k per appeal. While we would assume that a more limited appeal (as heard by the CAT) would have lower per-appeal cost, it would also depend on the length of time to hear the appeal. As discussed later, the CC allows for tailor-made time limits, while CAT uses its rules of procedure. CC referrals could therefore potentially be lower cost.

A further issue to consider is the treatment of price control decisions. The CAT would be unable to consider price control elements of an appeal and these would need to be referred to the CC. This could increase the time and cost of hearing these cases.

The Government considers there is a strong case for appointing the CC as the appropriate appeal body in relation to licence modifications.

- **What should be the possible outcomes of an appeal?**

There are a range of possible remedies the appeal body is able to enforce, including the ability to confirm, quash, remit and give recommendations and vary the decision. We will explore the last two in more detail.

The possible outcomes of an appeal are linked to the type of appeal, an adjudicative process would only give the option of referring the decision back to the regulator with recommendations. The regulator would then do the work of varying. An investigative approach would allow the appeal body to make the variation, or make much more detailed recommendations.

Remitting a decision is potentially less costly to the appeal body than varying the decision because the appeal body is not replacing the decision with its own but rather enabling the original decision-maker, who is in possession of all the relevant context, to re-take the decision in the light of decision of the appeal body.

Government is minded to give the appeal body the power to confirm, quash, remit the matter back to the regulator and give specific recommendations as this will minimise costs. We are minded to give the appeal body the power to vary the decision for price control decisions as this links to an investigative approach.

- **What should the time limits for the process be?**

The potential to set time limits for the process is intricately linked to the process and linked to the choice of appeal body (CC allows for tailor-made time limits, while CAT uses its rules of procedure).

A longer appeal is likely to be more costly to all involved (appeal body, Ofgem and business). It is also likely to create uncertainty. However longer time limits allow for greater scrutiny of decisions.

The Government proposes that there should be a time limit for both lodging an appeal and for the maximum time within which an appeal must be heard. We consider 4 weeks and appropriate time scale for lodging an appeal and a period of 4 months for the resolution of appeal. We believe this provides an adequate balance between cost and scrutiny of decisions.

- **Should the regulator's decisions be suspended on appeal?**

The options are to allow decisions to be automatically suspended, suspended at the discretion of the appeal body or to not allow suspension.

Allowing automatic suspension of the regulator's decisions on appeal, or giving the appeal tribunal discretion to suspend decisions would reduce costs associated with implementing decisions that may then potentially be over-turned. This would reduce costs for both business and Ofgem. We considered allowing automatic suspension of decisions on appeal however this has been dismissed as it would presents a risk of 'gaming' the system.

As a counterfactual, if no decisions were capable of being suspended pending the result of an appeal this would have a large cost on both Ofgem and business associated with complying with decisions that may be quashed or varied. These costs would be unrecoverable and there may be some additional costs of undoing some decisions.

In order to achieve balance between the need to prevent unrecoverable costs to business and limit the effect of gaming Government is minded to allow appellants to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal. The appeal body will be given discretion to suspend decisions on application where those decisions would result in significant expense for the appellant and/or the need to disclose confidential information that would be unnecessary is the appeal succeeded.

- **Do price control decisions need a different structure and what that should be?**

Price control arrangements are mainly contained in special licence conditions and apply to individual network companies. Network companies are heavily regulated and decisions on price controls can have a large effect on these companies including acting to, but not limited to, discourage investment.

Due to the complex nature of these decisions it may be prudent to subject them to closer levels of scrutiny than on appeal.

While taking an in-depth, investigative approach to price controls seems likely to make these appeals more expensive, it would ensure a thorough review of decisions very fundamental to the monopoly companies' financial position.

The Government considers there may be a case for allowing different treatment of special licence modification relating to price controls, in terms of the structure of the appeal process being introduced.

Please note that we have outlined below the detailed costs associated with two packages of options.

3) Detailed costs of preferred 'package' of options (Option One) compared to alternative illustrative package of options (Option Two)

The costs of the different packages of options are broadly similar and summarised below:

Appeal body costs – transition and ongoing

We would expect the appeal body to face an initial one-off set-up cost and then on-going costs for each appeal. The set-up costs are small when compared with the ongoing costs of appeal.

Regulator costs – ongoing

We would also expect there to be a direct cost on Ofgem for each appeal, these costs would vary depending on the type of appeal and are discussed later.

Business costs – ongoing

There would also be a cost to businesses who decided to appeal. Evidence provided in confidence suggests that companies may spend around £175k per appeal. This may however not include internal costs of time, etc. We would, however, assume that companies would only appeal when it was in their interest. We would therefore assume that businesses would only appeal when they believed that, given the probability of them winning an appeal, the benefits would outweigh the costs of the appeal. We would welcome evidence on the costs of an appeal as part of this consultation.

The Government is minded to provide the appeal body with the discretion to award costs on either side of an appeal or to the 'loser'. We are unable to anticipate the distribution of costs, and have assumed for the purposes of this impact assessment that each body meets its own costs, plus half of the CCs costs.

There could also be initial upfront legal costs associated with deciding whether or not to appeal. We are unsure how much these would be and how often they would apply (i.e. would these costs be associated with every licence change, or would companies only examine the possibility of appeal for a small number of changes). We would welcome any evidence on this, and the size of these costs to companies as part of the consultation.

Costs of Individual Options

In order to establish the costs, we need to establish how many appeals we can expect under the new regime. Since 2003, Ofgem has made 97 changes to standard licences (approximately 12 per year on average) and has had a licence change blocked 4 times (approximately 0.6 times per year). We would also expect the number of appeals to increase as the proposals give

all licensees an equal right to appeal. The increase could be limited by the fact that we would also expect Ofgem to make additional efforts to 'appeal-proof' their decisions. This may be through extended consultation or other methods. Ofgem's budget, and therefore costs, are funded by the licence fee, paid by licensees and ultimately consumers. It should also be noted that Ofgem carry out impact assessments for licence modifications where there is a major and important change.

A previous impact assessment for introducing an appeals process for code modifications assumed that there were between 5 and 10 additional code appeals per year. Following these changes there have only been two code appeals, fewer than the numbers assumed for the impact assessment. For this impact assessment we will assume that there are between 0.6 and 5 additional appeals per year, as experience from the code appeals suggests that we expect the true number to be towards the lower end of the spectrum due to the reasons discussed above.

Quantification of costs by option are below. These initial estimates are based on the assumptions described above and we would welcome evidence on these as part of the consultations. The costs to Government and Ofgem of putting in place these measures has already been accounted for in the Impact Assessments accompanying the consultation on Implementation of the Third Package.

- ***Option One is to introduce a merit-based appeals system which would enable all directly affected parties to appeal licence changes to the Competition Commission***

The direct costs of this option on the CC are (these cost assumptions are taken from the previous impact assessment for introducing an appeals process for code modifications and evidence of costs from recent appeals):

CC's initial set-up costs = up to £10k
CC costs per appeal = £150k

This would lead to a net present value of £1.3m-11.0m depending on the number of appeals (between 0.6 and 5 a year), over a 20 year period, and applying a 3.5% discount rate. The CC's costs would be met by the parties as part of the award.

We estimate that each appeal will cost Ofgem £600k. This is based on experience of Ofgem's costs in relation to a recent code modification appeal which used external legal instruction. As this is just one example we are unsure whether this is representative of the costs Ofgem would face should appeals become more common and should therefore be taken as a guide. We would also expect there to be an opportunity cost in terms of Ofgem staff diverted from other activities. The costs will be met by the licence payers, and indirectly consumers. This would lead to a net present value of £5.3m – £44.1m depending on the number of appeals (between 0.6 and 5 a year), over a 20 year period and applying a 3.5% discount rate.

As discussed above evidence suggests that companies may spend around £175k per appeal. While we have costed this as part of the impact assessment, it is important to note that we would assume that companies would only appeal when it was in their interest, and therefore businesses would only appeal when they believed that, given the probability of them winning an appeal, the benefits would outweigh the costs of the appeal. This would lead to a net present value of £1.5m – £12.9m depending on the number of appeals, over a 20 year period and applying a 3.5% discount rate. We would welcome any additional evidence on the costs faced by companies as part of this consultation.

There may also be some third party costs associated with each appeal, however we have been unable to quantify these at this stage.

The total net present value of costs associated with this option are £8.2m - £68m. We would expect the true value to be nearer the lower end of this range. A summary of these costs is in the below table.

	CC	Ofgem	Business
Transition Costs	£10k		
Cost per appeal	£150k	£600k	£175k
Average Yearly Cost	£90k- £750k	£360k-£3m	£101k-£875k
Total NPV	£1.3m-£11.0m	£5.3m-£44.1m	£1.5m- £12.9m
Total NPV Cost	£8.1m - £ 68m		

NB: Range reflect an assumed number of appeals per year of between 0.6 and 5 appeals per year.

- ***Illustrative example: 2nd package of options is to introduce a merit-based review appeals system which would enable directly affected parties to appeal licence changes to the Competition Appeal Tribunal (Option Two)***

Several options have been considered in the consultation document including which would be the most appropriate appeal body for our purposes, what should be the grounds for appeal, what should be the structure of the appeal, and how we should address different licence types – for example special licences, which include price control matters. Option Two is an illustrative example of an alternative package of options surrounding the type of appeal which have been considered in the consultation.

The option has a direct cost on the CAT in the form of set-up costs, and then ongoing cost per appeal. We have been unable to provide quantitative evidence on these costs at this stage and would welcome any evidence as part of the consultation.

We have been unable to quantify the costs of this option to Ofgem and business. They may, however, be higher than option one. Evidence from telecoms appeals suggests that £315,000 may be a representative of industry spending on an appeal, however costs may vary by case. We would welcome evidence on this as these assumptions as part of the consultation.

We would expect Ofgem's costs to also be higher for this reason. To give an example of this, in the recent Impact Assessment of the Market Power Licence Condition, a benchmark of Ofgem's costs of an appeal to the CAT would be £250k to £600k where no external law firm is instructed and £500k to £1.2m where an external law firm is engaged.

We have been unable to estimate the total net present value of costs associated with this option, however for the reasons discussed above we have assumed they will be higher than those of Option One.

- **Risks and assumptions**

The cost analysis is extremely dependent on the assumptions made regarding the average number of appeals made per year. We have tried to illustrate this sensitivity by using a range of number however we are unable to anticipate the correct value and would welcome evidence as part of this consultation.

The cost per appeal will also in practice depend on the nature appeal.

- **Administrative burden and policy savings calculations**

These proposals should not have an administrative burden on business. Costs on business are associated with making an appeal only.

- **Wider impacts – competition impacts**

The proposals are designed to improve competition, through ensuring more effective regulation and reducing a competitive disadvantage faced by smaller industry participants under the current arrangements.

We do not expect there to be any specific impacts that require a specific impact test, however we welcome evidence on this as part of the consultation.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added to provide further information about non-monetary costs and benefits from Specific Impact Tests, if relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p>Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];</p>
<p>Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p>
<p>Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p>
<p>Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]</p>
<p>Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p>
<p>Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]</p>
<p>Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here] These measure will be continuously reviewed by policy teams in DECC and will be examined by the Commission.</p>