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|--|-----------------------------------|
| Title: Final Impact Assessment for Proposals for Implementation of the EU Third Energy Market Package (Over-arching IA) | Impact Assessment (IA) |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Other |

Introduction

Since the mid-1990s, the European Union (EU) has put in place legislation that aims to support the creation of a single energy market within the EU by introducing competition and removing barriers to cross-border trade. This gradual transition has been progressed to date through two previous packages of legislation. A third internal energy market package (the ‘Third Package’) was adopted in July 2009 and must be transposed into national law by all Member States by March 2011¹.

The Third Package consists of two Directives – one concerning the internal market in natural gas and one concerning the internal market in electricity – and three Regulations – one on conditions for access to the network for cross-border exchanges in electricity, one on conditions for access to the natural gas transmission networks and access to gas infrastructure and one establishing a new Agency for the Cooperation of Energy Regulators (ACER).

Intended Effects

The Third Package has been designed to increase competition in many areas of the energy market, through creating a more liberalised market with enhanced consumer protection and improved functioning of energy markets. This should lead to greater security of supply, and more competitive prices and services.

- The main objective of the Third Package is to create a fully liberalised market by ensuring strong consumer protection measures are in place;
- a fully independent regulator; and
- well developed network ownership arrangements

In those areas where GB is required to take more action to ensure compliance, the costs and benefits from implementation of the Third Package will be more substantial. In other areas, we believe costs and benefits from GB’s implementation will be limited as GB is compliant in many areas but significant benefits could derive to GB from ensuring the compliance of other Member States. These benefits will come through the promotion of cross-border trade

¹ Undertakings affected by the transmission network unbundling requirements of the Third Package will have an extra year after the requirements have been transposed into law, to comply, and therefore will have until 3 March 2012.

and the lowering of barriers to market entry to additional players across the EU, which could result in lower prices for GB energy imports.

We believe that the Package will have an overall positive effect on the economy, by creating a level playing field across Europe on which UK-based companies can operate. Taken together, the measures will contribute to enhancing consumer protection, promoting competitive energy markets, increasing security of supply, reducing regulatory uncertainty, and increasing the autonomy of the National Regulatory Authority.

For most provisions of the Third Package, our final proposal for implementation represents minimum compliance, which we believe will impose a minimal burden on business while maximising the benefits of the Third Package for the UK. This option is preferred as we wish to ensure that UK business is not placed at a disadvantage in the internal market as a result of these measures. Our final proposal for implementing a licence modification appeals system to meet Third Package requirements does exceed the minimum requirements of the Directive, but we believe that our preferred option will deliver a coherent regulatory framework leading to improved decision making and greater regulatory certainty.

Measures

This Impact Assessment (IA) attempts to capture, at a high level, the benefits and costs to GB of the final proposals for implementation of the Third Package.

All of the key measures within which GB is currently non-compliant have been examined in individual Impact Assessments included in this document. Each Impact Assessment (IA) discusses the final proposals for implementation, rationale and costs and benefits in more detail, taking into account evidence received during the consultation process. These have also been summarised at the end of this Impact Assessment.

In many cases, individual measures contribute to more than one policy objective. For the purposes of this Impact Assessment, however, we have brigaded individual measures under the primary policy objective that they target.

Consumer Switching

The relevant measure requires suppliers of electricity and gas to ensure that where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected within three weeks.

This measure is designed to improve the switching process for consumers by reducing the time it takes to switch. High levels of switching are associated with greater competition in the market, which should result in lower prices, increased product ranges for consumers, and increased innovation from suppliers.

Currently in the UK, it takes an average of between 4-6 weeks to switch electricity, and slightly longer to switch gas. This new measure will give consumers a legal right to switch within three weeks unless there are extenuating circumstances; for example, where the customer has not given the supplier adequate or accurate data to enable the transfer. The 3

weeks will start from the end of any cooling off period, which should not exceed 14 calendar days consumers will be given to cancel the contract. Energy suppliers will be required to make improvements to their systems and processes to ensure that as many people as possible are switched within 3 weeks. Ofgem will provide relevant guidance to suppliers about proportionate changes they need to make to their IT systems.

In practice the UK has already effective switching arrangements. This measure will reduce the time taken to switch slightly and therefore we expect the benefits to consumers to be limited.

A brief summary of the costs and benefits of the preferred option is set out in Table 1.

| Table 1: Consumer Switching | |
|--|--|
| Costs | Benefits |
| <p>There will be costs to suppliers from making changes to their systems and processes. This is difficult to quantify at this stage as work would need to be done to review the scale of upgrades needed.</p> <p>In addition, there will be a one-off administrative cost to energy suppliers in order to amend their standard terms and conditions.</p> | <p>There will be a direct benefit to switching customers who take advantage of their new gas/electricity tariff in a reduced time. However, we recognise that this, at least in some part, represents a transfer from suppliers to consumers.</p> <p>There may be an indirect effect as quicker switching could lead to greater competition in the market.</p> |

Consumer Information

The measures include a requirement on suppliers to ensure consumers are informed about their actual consumption and costs and can request that data is provided to other suppliers; a requirement for suppliers to inform customers about the means of dispute settlement available to them; an energy consumer checklist to provide consumers with information about their rights and other issues that may affect them. Finally, there is a requirement on suppliers to keep certain data at the disposal of the national regulatory authority.

These measures are designed to improve the quality and quantity of information available to consumers on both their individual consumption, their rights, and industry processes. Greater transparency and consumer awareness is a driver of competitive energy supply markets. In the long term these measures may enable consumers to better act as a competitive constraint on suppliers' pricing and provide strong incentives on suppliers to reduce costs, improve service and develop innovative products. However the proposed changes are only expected to have a minimal direct impact on GB consumers as these measures are already in place to a large extent. The costs on suppliers may be higher as they are required to collect and provide extra data.

A brief summary of the costs and benefits of the preferred option is set out in Table 2.

| Table 2: Consumer Information | |
|---|---|
| Costs | Benefits |
| <p>This measure imposes a small one-off cost to energy suppliers associated with changing promotional material and sending out the concise version of the Consumer Checklist. There may be larger costs associated with data collection and an increased administrative burden associated with the provision of information to regulatory bodies.</p> <p>There is also a one-off cost to Consumer Focus² for compiling and keeping the checklist under review.</p> | <p>There is a direct benefit to consumers who will be able to use their consumption information to take advantage of more suitable tariffs and improve their services as a result of access to information about dispute settlement mechanisms.</p> |

Transmission and Distribution Networks

The measures introduce new requirements for full ownership unbundling of transmission, and introduce greater monitoring powers around the continued legal unbundling for distribution.

The network-related objectives of the Third Package are designed to improve competition through better regulation, unbundling and reducing asymmetric information, and improving security of supply by strengthening the incentives for sufficient investment in transmission and distribution capacities.

However, in the area of transmission and distribution networks, the GB gas and electricity arrangements are to a large degree already compliant with the Third Package. One of the key areas we need to address, however, is to provide the legislative framework within which Ofgem can certify transmission systems as meeting the requirements of ownership unbundling. We do not expect the cost of this measure to be significant.

A brief summary of the costs and benefits of the preferred option is set out in Table 3.

² The Government intends to consult on the future of consumer bodies. Should this consultation result in changes to the role of status of Consumer Focus, we would expect this work to be carried out by any successor body.

| Table 3: Transmission and Distribution Networks | |
|---|---|
| Costs | Benefits |
| <p>This measure imposes legal and administration costs associated with legislation changes and licence modifications to ensure compliance with TSO and DSO unbundling requirements for both Ofgem and the TSOs. There will be administration and legal costs to Ofgem and TSOs associated with the TSO certification process, particularly where derogations are requested. There may be additional costs associated with strengthened information gathering powers for Ofgem enforcement of DSO unbundling articles. There may also be costs to DSOs of ensuring independence of compliance officer.</p> | <p>GB is already compliant to a large degree and we would therefore expect the benefits to be minimal. Full compliance could lead to small gains in terms of more efficient networks (less congestion, more investment), decreased market concentration leading to lower energy prices for consumers, and higher innovation in the energy sector. The likely extent of these benefits is small, as under 10% of GB transmission assets are not already fully ownership unbundled and the European Commission acknowledges that even then the GB system exemptions function reasonably well.</p> |

Citiworks Ruling: Third Party Access to Licence Exempt Networks

Following the European Court of Justice (ECJ) ruling on the Citiworks case in May 2008, there is now a requirement to provide for third party access in respect of all transmission and distribution systems. This also applies to licence exempt electricity and gas distribution networks which are required to offer third party access under the Electricity Directive and the Gas Directive. Closed Distribution Systems (licence exempt networks) will continue to be required to provide third party access under the EU's Third Package.

The policy objective is to ensure third party access to licence exempt energy distribution networks. This will ensure energy customers benefit from competition in the energy supply market and ensures the compliance of the GB electricity market with EU law.

A brief summary of the costs and benefits of this preferred option is set out in Table 4.

| Table 4: Citiworks Ruling: Third Party Access to Licence Exempt Networks | |
|--|--|
| Costs | Benefits |
| The main costs associated with providing third party access to these networks are those associated with metering – either meter provision or ‘deemed’ metering. Costs will vary substantially according to the implementation models chosen. | There will be benefits associated with reductions in energy use, where meters are provided. Switching consumers will benefit from lower energy prices. The evidence is ambiguous on the extent to which these benefits are likely to be achieved. |

Gas Storage and LNG Facility Impacts

These measures include a requirement for Storage System Operators (SSOs) to be legally unbundled, for third party access to storage facilities that are technically and / or economically necessary to be strengthened, for all gas storage and LNG operators to be designated, and for more information to be made publically available by gas storage and LNG facility operators.

The measures are intended to have the effect of reducing market power, increasing competition, increasing efficient investment and use of assets, helping to allow gas to flow to where it is needed most, and enhancing security of supply. However, the actual measures are unlikely to have a large impact.

In DECC's consultation on the implementation of the EU Third Package, we considered two options for implementing the key provisions: through the Gas Act 1986 (legislation) or through the introduction of licences for SSOs. The consultation document contained both options. Following the majority view in response to the consultations, DECC has selected to implement the obligations through legislative change.

DECC received little firm evidence in the consultation responses to inform its estimates of the costs and benefits of implementing the Third Package. A qualitative summary of the costs and benefits of the preferred option is set out in Table 5.

| Table 5: Gas Storage and LNG Impacts | |
|--|--|
| Costs | Benefits |
| There may be small costs associated with unbundling, some costs associated with reduced economies of scope on vertically integrated firms, and costs associated with additional information provision by LNG and storage facilities. | The benefits specifically arising from GB implementing the gas market measures will be: benefits to consumers from more competitive pricing and increased security of supply; benefits to storage users from information transparency and non-discriminatory allocations; and benefits |

| Table 5: Gas Storage and LNG Impacts | |
|---|---|
| Ofgem may experience small additional costs due to enforcement. | to investors arising from greater regulatory certainty. |

National Regulatory Authority

The Third Package includes a number of measures to enhance the independence, impartiality and transparency of the national regulatory authorities. These measures include requirements on Member States to ensure that staff employed by national regulators are able to act independently of market interest. Compared to the Second Package, the Directives require an expansion to the regulator's duties, for example in relation to cross border issues, and a requirement to ensure that they have the necessary powers to carry out their duties.

GB has in place many of the requirements in the Directives in relation to independence and transparency, although some of these requirements do not go far enough (please see section on Licence Modification Appeals below) .

Although it is difficult to put a monetary value on the benefits associated with these measures, we would expect the intangible benefits arising from these measures to be an increase in the integrity of the regulator and a better functioning of the EU internal market. This could lead to better market outcomes and overall reduced costs for consumers.

For the reasons set out above, we expect the actual impact of these measures to be small. A brief summary of the costs and benefits of the preferred option is set out in Table 6.

| Table 6: National Regulatory Authority | |
|---|--|
| Costs | Benefits |
| These measures will increase Ofgem's duties, a number of which are monitoring. There may also be an increase in the administrative costs Ofgem faces, for example through an obligation to report to the Commission and ACER (the Agency for the Co-operation of European Regulators) on its activities. Overall we expect the costs associated with individual measures to be small. | We would expect the intangible benefits arising from these measures to increase the integrity and workings of the regulator, as well as the consistency of regulation in Europe. This should lead to better market outcomes for both industry and consumers. |

Licence Modification Appeals

As referred to above, the Third Package gives the National Regulatory Authority numerous regulatory tasks and stipulates that it must have powers to, amongst other matters: take autonomous decisions; implement binding decisions by the European Commission and ACER; and carry out its regulatory tasks in an efficient and expeditious manner. It also requires that Member States ensure that suitable mechanisms are in place under which a party affected by the decision has a right of appeal. Taken together, the Government considers that these requirements mean that the current process for licence modifications must be amended to enable the regulator to carry out its duties.

Under the current system, Ofgem's proposed change or introduction of a standard licence condition can be blocked by 20% of the relevant licensees (measured by number of licence holders or market share). If the proposal is blocked then Ofgem can either re-consult on a modified proposal or refer the proposal to the Competition Commission (CC) for a decision. For conditions specific to one licensee, the licensee must agree to the proposal. Failure to reach agreement with that licensee means that if Ofgem wants to impose the change, it must refer its proposal to the CC for a decision. In considering a reference made to it, the CC investigates whether the licence modification operates or may operate against the public interest.

Our preferred option is the introduction of an appeals system which will enable all directly affected licensees (i.e. those holding the class of licence to which the modification decision relates), all materially affected licensees and Consumer Focus (where consumers are materially affected), to appeal all licence decisions to the CC. The CC will have an adjudicatory function (rather than a full investigatory function), but will have the right to review all relevant aspects of the decision under appeal. Under this option, Ofgem will make a licence modification decision (after the current statutory consultation period). If that decision is to modify a licence condition, a directly affected licence holder, another materially affected licence holder or Consumer Focus (where consumers are materially affected) can, with sufficient grounds, appeal that decision to the CC.

Our final proposal for implementing a licence modification appeals system to meet the Third Package requirements does exceed the minimum requirements of the Directive, in that:

- it applies to all Ofgem licence modifications decisions rather than introducing an appeals system for the implementation of decisions in relation to the regulatory tasks arising from the Third Package only; and
- it extends the right of appeal from directly affected licensees only to other materially affected licensees and Consumer Focus (where consumers are materially affected).

However, we concluded that, were minimum implementation feasible, the resulting costs would be uncertain, and it would likely lead to increased regulatory uncertainty and risk of satellite litigation. In addition, though extending the right of appeals may lead to an increase in the number of appeals (and thereby an increase in costs), we believe that this will deliver a coherent regulatory framework leading to improved decision making and greater regulatory certainty.

A brief summary of the costs and benefits of the preferred option is set out in Table 7.

| Table 7: Implementation of Licence Modification Appeals | |
|--|--|
| Costs | Benefits |
| <p>Monetised costs include the one-off set-up cost to the CC, and ongoing costs associated with appeals borne by the CC, Ofgem and business. These latter costs depend on the number of appeals per year.</p> <p>Non-monetised costs include costs associated with interested parties giving evidence at each appeal</p> | <p>Monetised benefits include ongoing cost-savings from avoided licence modification references, to the CC, Ofgem and business.</p> <p>Non-monetised benefits include improved quality of decision making; improved efficiency of decision making; increased fairness and competition; increased transparency and accountability; and reduced cost of capital for licensees.</p> |

Implementation Costs

There are some additional costs on Government and Ofgem associated with implementation of the Third Package that are not captured elsewhere. These costs are associated with drafting and implementing licence changes. We estimate the costs on Government to be a one-off transitional cost of approximately half a million pounds. Ofgem advise that the one-off cost to them of drafting licence changes is in the region of £150k.

Post Implementation Review

Table 8 below sets out DECC's Post Implementation Review plan for GB implementation of the EU Third Package.

| Table 8: Post Implementation Review Plan |
|--|
| <p>Basis of the review: DECC will review its approach to implementation of the Third Package within 5 years, to ensure it still meets the stated policy objectives, and to inform the European Commission's own considerations of the success of the legislative package.</p> |
| <p>Review approach and rationale: DECC and Ofgem will continue working closely with stakeholders during the implementation phase. Wherever appropriate, DECC may request data from the energy suppliers as further evidence of how the implementation phase is working.</p> |
| <p>Baseline: The implementation of the Third package formalises or introduces new requirements; the baseline is the position before these policies were introduced or formalised.</p> |

Success criteria:

Implementation will be reviewed against the original success criteria, including whether the policy is working on the ground, the costs to business and the benefits to consumers.

Monitoring information arrangements:

The Third Package sets out certain monitoring and enforcement responsibilities for Ofgem. For certain aspects of implementation, Ofgem will provide guidance and update its enforcement guidelines. DECC will continue to work with the regulator to assess the impact of the Third Package measures and to ensure that the framework works efficiently.

| | |
|--|-----------------------------------|
| Title: Third Package: Articles concerning provision of consumer information Lead department or agency: Department for Energy and Climate Change Other departments or agencies: | Impact Assessment (IA) |
| | IA No: DECC0004 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Other |
| Contact for enquiries: Marina.Pappa@decc.gsi.gov.uk Luke.Davison@decc.gsi.gov.uk | |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

There are several articles in the EU 3rd Package which are intended to increase the information available to consumers and therefore enable consumers to make more informed decisions when they choose tariffs and suppliers. These include providing transparent consumption data to consumers based on actual readings, making information available about dispute settlement mechanisms and complaints and providing a consumer energy checklist. There is an additional requirement on suppliers to keep certain data at the disposal of the regulatory authorities. In some areas, there is currently no obligation on suppliers and Ofgem to ensure that these requirements are met. It is therefore necessary for Government to put in place measures in the form of formal obligations to comply with the Directives.

What are the policy objectives and the intended effects?

These measures are designed to improve the quality and quantity of the information available to consumers on both their individual consumption, consumer rights and industry processes. Greater transparency and consumer awareness is a driver of competitive energy supply markets. In the long term these measures may enable consumers to better act as a competitive constraint on suppliers' pricing and provide strong incentives on suppliers to reduce costs, improve service and develop innovative products.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

The Government has taken a light-touch approach to ensure that it does the minimum required to comply with the requirements of the Directives. The preferred option includes, but is not limited to, the following measures:

- Introduce an obligation on energy suppliers so that where a customer provides a meter reading, and provided that the supplier is satisfied that this data is reasonable, the supplier should either send an updated bill to that customer or reflect this reading in the customer's next bill.
 - Amend Supply Licence to require energy suppliers to inform consumers that they can complain using the suppliers' complaints procedure and they can obtain a copy, and include this information in promotional materials.
 - Place a new obligation on energy suppliers to hold and make available to Ofgem data on all transactions in gas and electricity supply contracts and gas derivatives.
- Our preferred option captures all the benefits discussed, while imposing minimum costs on business.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

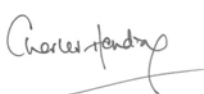
Please refer to over-arching IA

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

No

Ministerial Sign-off For Final 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: 12/01/2011

Summary: Analysis and Evidence Policy Option 1

Description:

Implement Option 1 (the minimum-compliance option) for all measures.

| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 1 | Net Benefit (Present Value (PV)) (£m) | | |
|--|--|------------------------|--|--|----------------------|
| | | | Low: -2.5 | High: 0 | Best Estimate: -1.25 |
| COSTS (£m) | Total Transition (Constant Price) | Year | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) | |
| Low | 0 | 1 | | | |
| High | 2.5 | | | | 2.5 |
| Best Estimate | 1.25 | | | | 1.25 |
| Description and scale of key monetised costs by ‘main affected groups’ | | | | | |
| The monetised costs are not expected to be large. The cost estimate covers the necessary system changes in the eventuality that all the suppliers are not compliant with the obligation to hold 5 years worth of transaction data. The costs will be closer to zero depending on the current level of compliance amongst suppliers. The one-off set-up costs for Consumer Focus ³ of the Energy consumer checklist is expected to be in the range of £20-25,000. | | | | | |
| Other key non-monetised costs by ‘main affected groups’ | | | | | |
| There will be some additional costs for suppliers from including updated meter readings in an annual statement; customers contacting them requesting them to pass their consumption data to another supplier; and potentially more customers utilising the dispute mechanism. | | | | | |
| BENEFITS (£m) | Total Transition (Constant Price) | Year | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) | |
| Low | | N/A | | | |
| High | | | | | |
| Best Estimate | | | | | |
| Description and scale of key monetised benefits by ‘main affected groups’ | | | | | |
| Other key non-monetised benefits by ‘main affected groups’ | | | | | |
| We expect there to be a direct benefit to consumers who change their consumption patterns as a result of consumption information and improve the services received from suppliers as a result of access to information on complaints procedures. There may be additional, intangible benefits to consumers as these measures are designed to improve the access and quality of information, which could result in an increase in consumers' market power and lead to greater competition in the supply industry. | | | | | |
| Key assumptions/sensitivities/risks | | | | Discount rate (%) | 3.5 |

³ The Government intends to consult on the future of consumer bodies, Should this consultation result in changes to the role of status of Consumer Focus, we would expect this work to be carried out by any successor body.

There is a risk that customers will suffer from information overload and therefore not realise the benefits of these measures.

The costs presented are illustrative based on previous published information in a 2008 impact assessment on the costs of providing historical consumption data in energy bills. There is significant uncertainty as to the complexity of any system changes needed to record 5 years worth of data and the proportion of suppliers who are already compliant.

| | | | |
|--|--|--|-----------------|
| Impact on admin burden (AB) (£m): | | Impact on policy cost savings (£m): | In scope |
| | | | Yes |

Enforcement, Implementation and Wider Impacts

| | | | | | |
|---|--------------|----------------|--------------------|---------------|--------------|
| What is the geographic coverage of the policy/option? | | | | | |
| From what date will the policy be implemented? | | | | | |
| 01/03/2011 | | | | | |
| Which organisation(s) will enforce the policy? | | | | | |
| Ofgem | | | | | |
| What is the annual change in enforcement cost (£m)? | | | | | |
| Does enforcement comply with Hampton principles? | | | | | |
| Yes | | | | | |
| Does implementation go beyond minimum EU requirements? | | | | | |
| No | | | | | |
| 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 duties⁴ <u>Statutory Equality Duties Impact Test guidance</u> | Yes | 8 |
| Economic impacts Competition <u>Competition Assessment Impact Test guidance</u> Small firms <u>Small Firms Impact Test guidance</u> | Yes No | N/A |
| Environmental impacts Greenhouse gas assessment <u>Greenhouse Gas Assessment Impact Test guidance</u> Wider environmental issues <u>Wider Environmental Issues Impact Test guidance</u> | No No | |
| Social impacts Health and well-being <u>Health and Well-being Impact Test guidance</u> Human rights <u>Human Rights Impact Test guidance</u> Justice system <u>Justice Impact Test guidance</u> Rural proofing <u>Rural Proofing Impact Test guidance</u> | No Yes Yes No | 8 8 |
| Sustainable development <u>Sustainable Development Impact Test guidance</u> | No | N/A |

⁴ 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 |
|----|--|
| . | |
| | European Commission Impact Assessment on Third Legislative Package |
| | Consultation on the Implementation of the EU Third Internal Energy Package |
| | EU Third Package Consultation Stage Impact Assessment |
| | DECC's Call for Evidence |

+ 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 | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring cost | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual costs | N/A | N/A | N/A | N/A | N/A | N/A | | N/A | N/A | N/A |
| Transition benefits | N/A | N/A | N/A | N/A | N/A | N/A | | N/A | N/A | N/A |
| Annual recurring benefits | N/A | N/A | N/A | N/A | N/A | N/A | | N/A | N/A | N/A |
| Total annual benefits | N/A | N/A | N/A | N/A | N/A | N/A | | N/A | N/A | N/A |

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

Evidence Base (for summary sheets)

Issue

There are several requirements in the EU 3rd Package which are intended to increase the information available to consumers and therefore enable consumers to make more informed decisions when they choose tariffs and suppliers. The UK is currently not compliant with some of these requirements in that there are no formal arrangements in place and it is therefore necessary to amend Licence Conditions in order to ensure compliance.

This impact assessment will first examine the requirements relating to consumer information with which the UK is currently non-compliant, and will then discuss the options available to ensure compliance and the associated costs and benefits.

All of these measures are designed to improve the quality and quantity of the information available to consumers on both their individual consumption, consumer rights and industry processes. Greater transparency and consumer awareness is a driver of competitive energy supply markets. In the long term these measures may enable consumers to better act as a competitive constraint on suppliers' pricing and provide incentives on suppliers to reduce costs, improve service and develop innovative products.

Articles and Associated Options

Availability of consumption data

Article 3 (5b) of the Electricity Directive (ED) and 3(6) of the Gas Directive (GD) requires Member States to ensure that customers are entitled to receive all relevant consumption data. In addition, Article 1 (i) of Annex 1 of both the Electricity and Gas Directives require Member States to ensure that customers are properly informed of actual consumption and costs frequently enough to enable them to regulate their own consumption. This information must be given using a sufficient time frame which takes account of the capability of customer's metering equipment (and the electricity production in question). Due account must be taken of the cost-efficiency of such a measure. No additional costs shall be charged to consumers for that service.

In order to comply with the requirement to provide consumers with consumption data the following options have been considered, with Option 1 being our preferred Option.

- Option 1: Introduce an obligation on energy suppliers so that where a customer provides a meter reading, and provided that the supplier is satisfied that this data is reasonable, the supplier should either send an updated bill to that customer or reflect this reading in the customer's next bill (unless the next bill is due in a matter of days). This updated consumption data should also be reflected in the customer's annual statement.
- Option 2: Introduce an obligation on energy suppliers so that where a customer provides a meter reading the supplier should send an updated bill to that customer.

In addition, to implement the requirement of paragraph (h) in Annex 1, which gives a right to customers to contact their supplier to request them to pass on their consumption data to another supplier, we propose introducing a new Licence Condition to give customers a right to contact their supplier to request them to pass on their consumption and metering data to another supplier, free of charge.

Consumer rights regarding dispute settlement

Article 3(9) (c) of the Electricity Directive lays down a new requirement on Member States to ensure that information concerning consumer rights regarding the means of dispute settlement available to them are specified in or with bills and in promotional materials.

In order to comply with this requirement the following option has been considered. This is the only option considered as it is the minimum compliance option.

- Option 1: Amend Supply Licence to require energy suppliers to inform consumers that they can complain using the suppliers' complaints procedure and how they can obtain a copy. Suppliers would be required to include this information in promotional material and in or with bills.

Energy consumer checklist

Article 3(16) of the Electricity Directive and 3(12) of the Gas Directive requires energy suppliers in co-operation with the regulatory authority to take the necessary steps to provide the consumers with a copy of the energy consumer checklist and ensure that it is made publicly available.

In order to comply with this requirement the following option has been considered. This is the only option we have considered as it is the minimum compliance option.

- Option 1: Give Consumer Focus⁵ the lead role of compiling and maintaining the checklist in co-operation with the industry and Ofgem. Suppliers to annually send their customers a concise list of the checklist, prepared by Consumer Focus.

Record Keeping

Article 41 of the Electricity Directive and Article 45 of the Gas Directive set out a number of requirements on Member States to require energy suppliers to keep at the disposal of the national authority, the national competition authorities and the Commission, for the fulfilment of their tasks, for at least 5 years, the relevant data relating to all transactions in gas and electricity supply contracts and gas derivatives with wholesale customers and transmission systems operators as well as storage and LNG operators or any party who sells electricity/gas to the licensee.

In order to comply with this requirement the following option has been considered. This is the only option considered as it is the minimum compliance option.

- Option 1: Place a new obligation on energy suppliers to hold this information.

Preferred Option

In order to minimise the costs to energy suppliers and Ofgem we intend to implement Option 1 of all these measures which we believe is the minimum-cost option, while still achieving the benefit discussed below.

Benefits

All the measures discussed above are aimed at improving the quality and accessibility of information to consumers. While it is difficult to quantify the benefits directly, we can make a qualitative assessment of the benefits of each of the different measures.

The first measure (availability of consumption data) is intended to make consumers better aware of their consumption patterns. This should allow them to regulate their consumption more effectively. This in turn will enable consumers who take advantage of the updated bill to pick more appropriate tariffs and adjust their consumption to maximise their satisfaction. This may also enable consumers to make more informed decisions when choosing suppliers, while promoting competition in the supply market.

The second measure (consumer rights regarding dispute settlement) is intended to improve awareness of dispute settlement mechanisms and improve access to them. This should have a direct impact on consumers who wish to complain through a reduction in search costs. In addition this could potentially lead to a reduction in market power of suppliers as consumers become better aware of their rights. As industry already complies with this measure, we expect the benefit to be small.

The third measure (the consumer checklist) is intended to provide consumers with an easily accessible source of information regarding their rights as consumers. As mentioned above this could potentially lead to a reduction in market power of suppliers as consumers become better aware of their rights. There is, however, a risk that this may lead to information overload and confusion which would limit the benefits of this measure.

⁵ See Footnote 1

The fourth measure (record keeping) is intended to improve transparency in the retail market in order to facilitate access. As with the previous measures this is intended to improve information and, in turn, competition in the market place. By making information available to the regulator this measure is primarily designed to aid with the prevention of abuse of market power.

The questions for a competition impact test provided by the OFT are, would the proposed policy:

1. Directly limit the number or range of suppliers?
2. Indirectly limit the number or range of suppliers?
3. Limit the ability of suppliers to compete?
4. Reduce suppliers' incentives to compete vigorously?

We do not consider that our proposals would restrict competition, therefore a full competition impact test has not been completed. However, this policy could have positive competition impacts following from more informed consumers being better able to act as a constraint on suppliers.

It is important to note that some of this information will be more accessible to consumers following the roll-out of smart meters regardless of implementation of these measures.

Costs

These measures will impose mainly administrative costs on the energy supply companies and Ofgem. Where possible we have attempted to make a quantitative assessment of the costs involved with each measure and where this has not been possible we have made a qualitative assessment of the costs involved.

Availability of consumption data

We have considered two options regarding consumption data.

- Option 1: Introduce an obligation on energy suppliers so that where a customer provides a meter reading, and provided that the supplier is satisfied that this data is reasonable, the supplier should reflect this reading in the customer's next bill (unless the next bill is due in a matter of days). This updated consumption data should also be reflected in the customer's annual statement.

Suppliers are currently required to visit customers at least once every two years, and as part of this visit a meter reading must be taken. However in practice most suppliers will visit customers much more frequently. Customers are also able to call in suppliers with their own meter readings.

Responses to the Call for Evidence and subsequent consultation have suggested that it is already standard practice within the industry to take account of consumer provided meter readings in the next bill, thus we would not expect this option to have any additional costs associated with it. However, there will be some additional costs for including updated meter readings in the annual statement.

- Option 2: Introduce an obligation on energy suppliers so that where a customer provides a meter reading the supplier should send an updated bill to that customer.

The direct cost associated with this measure would be on suppliers due to the re-issuing of bills. Information from suppliers has indicated that this option may cost suppliers in the order of several million pounds per year.

As Option 1 leads to similar benefits as Option 2, but at a lower cost to suppliers, this is our preferred option.

In addition, in order to implement the requirement of paragraph (h) in Annex 1, which gives a right to customers to contact their supplier to request them to pass on their consumption data to another supplier, we propose introducing a new Licence Condition to give customers a right to contact their supplier to request them to pass on their consumption and metering data to another supplier, free of charge. While we are unsure at this stage how this would work in practice and the specific costs and scale of the costs involved, overall we expect that there will be some benefits to consumers by being offered tariffs by perspective suppliers; we expect that this measure will also increase competition between the suppliers.

Consumer rights regarding dispute settlement

We have considered only one option regarding dispute settlement procedures.

- Option 1: Amend Supply Licence to require energy suppliers to inform consumers that they can complain using the suppliers' complaints procedure and how they can obtain a copy. Suppliers would be required to include this information in promotional material and in or with bills.

This option should have limited impact on suppliers as some of the information is already provided on promotional material.

There may also be an indirect effect due to a greater number of consumers utilising the dispute mechanism process as a result. However it is difficult to quantify the costs of this, as we are unable to estimate how many additional customers may use the process.

Energy consumer checklist

We have considered only one option regarding the energy consumer checklist.

- Option 1: Give Consumer Focus⁶ the lead role of compiling and maintaining the checklist in co-operation with the industry and Ofgem. Industry will be required to provide consumers with a copy of the checklist.

In addition, there will be a one-time small cost to Consumer Focus for compiling the checklist, and an ongoing cost of maintaining it. There may be some small costs to industry and Ofgem associated with co-operating with Consumer Focus on the compilation of the list. Ofgem estimates that its costs of cooperating with Consumer Focus on this will be minimal.

There may also be costs associated with providing the consumer checklist to customers. We assume that this will be done as part of billing; however there will be additional costs associated with designing, printing and mailing the checklist.

Record Keeping

We have considered only one option regarding record keeping.

- Option: Place a new obligation on energy suppliers to hold this information.

The main cost of this measure will fall on suppliers. There will be a one-time cost for setting up the databases, along with ongoing costs for maintaining them. The Commission will provide more information on how companies will be required to keep the data. It is possible, therefore, that as a result suppliers may have to create new systems which would potentially be quite costly.

Given this uncertainty, regarding the need to adapt systems, it is difficult to estimate a cost. However using evidence from an earlier published Impact Assessment (2008) regarding the provision of historic consumption data on bills we can set out what we believe to be an upper limit on those costs. In 2010 prices the one-off cost presented for bill and system re-design are £9.8 million. The proposed system changes in this case are expected to be significantly less complex, and it is possible that a number of suppliers already hold the data. Therefore the additional costs would be only borne by a proportion of suppliers. As a working assumption for this Impact Assessment we are assuming an upper bound of no more than £2.5 million.

This measure could potentially impose a significant administrative burden on suppliers, depending on the number of data requests made by Ofgem, the competition authorities and the Commission.

Information to be included in contracts with customers

We have considered only one option on the measure regarding information to be included in contracts with customers.

Option 1: Amend the Supply Licence to ensure the matters specified in paragraph 1 (a) of Annex 1 are always explicitly addressed on the face of the contract.

We expect there will be some cost to suppliers for having to include this information in contracts with customers.

Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998

⁶ See Footnote 1

Statutory Equalities Duties

The policy does not make a specific reference to how blind people or other groups that are not able to access standard billing information will be treated. We consider that the Supply Licence Conditions 26.2 and 26.3 requiring the licensee (the supplier) to provide information free of charge, which enables blind, partially sighted, deaf or hearing impaired people to ask or complain about any bill or statement of account or any other service provided to that consumer, addresses these concerns.

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

| | |
|---|---|
| Title: Proposals for implementation of licence modification appeals under the EU Third Package Lead department or agency: DECC Other departments or agencies: | Impact Assessment (IA) |
| | IA No: DECC0030 |
| | Date: 22/06/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Secondary legislation |
| | Contact for enquiries: Dawn.Armstrong@decc.gsi.gov.uk Vikram.Balachandar@decc.gsi.gov.uk |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The EU Third Package of measures concerning the internal market in gas and electricity (the Third Package) gives the National Regulatory Authority numerous regulatory tasks and stipulates that it must have powers to, amongst other matters: take autonomous decisions; implement binding decisions by the European Commission and the Agency for the Cooperation of European Regulators (ACER); and carry out its regulatory tasks in an efficient and expeditious manner. It also requires that Member States ensure that suitable mechanisms are in place under which a party affected by the decision has a right of appeal. Taken together, the Government considers that these requirements mean that the current process for licence modifications must be amended to enable the regulator to carry out its duties. The Government intends to introduce a revised appeals process to ensure compliance with EU law consistent with the domestic regulatory process.

What are the policy objectives and the intended effects?

The policy objective is to introduce an appeals process for licence modification decisions in order to implement requirements of the Third Package, and deliver a coherent and effective regulatory framework that enables the Regulator to take independent decisions and comply with EU obligations, whilst including appropriate safeguards for affected parties to challenge the Regulator's decisions. The proposed framework should result in robust regulation that benefits consumers and industry.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1 - To introduce a right of appeal in relation to licence modification decisions to the Competition Commission (CC) for all directly affected licensees (those holding the licence to which the modification decision relates).
 Option 2 – To introduce a right of appeal in relation to licence modification decisions for directly affected licensees, materially affected licensees and Consumer Focus, where consumers are materially affected.
 Option 3 (strict implementation) – To introduce a right of appeal as Option 1, but limited to licence modification decisions related to Ofgem's regulatory tasks under the Third Package.
 Option 1 is the minimum cost option, and should deliver benefits including improved quality and efficiency of decision making, increased fairness and competition and potentially reduced costs of capital. Option 2 may result in additional appeal costs. However, it is our preferred option, since we believe extending the right of appeal would improve the regulator's decision making process by giving a voice to all those materially affected by a decision, thereby contributing further to cost-effective regulation in GB and potential resulting benefits to business. We believe Option 3 would be extremely difficult (if not impossible) to operate in practice. If implemented, it may still entail some risk of non-compliance with Third Package requirements. Resulting costs could be uncertain, but we believe that risks are to the downside, i.e. that costs under Option 3 could be higher than estimated. Some of the anticipated benefits of the new process could be lost, as it would not cover all Ofgem licence modifications.

Will the policy be reviewed? Please see overarching IA. **If applicable, set review date:** Month / Year

What is the basis for this review? Not applicable **If applicable, set sunset clause date:** Month / Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

No

Ministerial Sign-off For SELECT STAGE 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: 13/07/2011

Summary: Analysis and Evidence Policy Option 2

Preferred Option: Introduce a right of appeal for directly affected licensees, materially affected licensees, and Consumer Focus, where consumers are materially affected, to the Competition Commission for licence modification decisions.

| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 21 | Net Benefit (Present Value (PV)) (£m) | | |
|-------------------------|----------------------|-------------------------|---------------------------------------|-----------|----------------------|
| | | | Low: -106.6 | High: 2.8 | Best Estimate: -13.7 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|--|---|-------------------------------|
| Low | 0.01 | | 10.8 |
| High | 0.01 | | 106.6 |
| Best Estimate | 0.01 | 1.5 | 21.3 |

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

Monetised costs include the one-off set up cost to the CC, and ongoing costs associated with appeals borne by the CC, Ofgem and business. Ongoing costs depend on the number of appeals per year. Costs associated with third parties giving evidence at each appeal.

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

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|--|---|----------------------------------|
| Low | 0 | | 0.0 |
| High | 0 | | 13.6 |
| Best Estimate | 0 | 0.5 | 7.7 |

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

Monetised benefits include ongoing cost-savings from avoided licence modification references, to the CC, Ofgem business and third parties.

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

Improved quality of decision making; improved efficiency of decision-making; increased fairness and competition; increased transparency and accountability; and potentially reduced costs 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 contested decisions made per year. We have sought to illustrate this sensitivity by using a range of values. Costs and benefits are estimated relative to a baseline of maintenance of the current process.

| | | | | |
|---|---------------|-----------|------------------|----------------------|
| Direct impact on business (Equivalent Annual) (£m): | | | In scope of OIOO | Measure Qualifies as |
| Costs: N/A | Benefits: N/A | Net: 0.02 | Yes | IN |

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? | N/A | | | | |
| What is the annual change in enforcement cost (£m)? | N/A | | | | |
| 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: N/A | | Non-traded: N/A | | |
| 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: N/A | | Benefits: N/A | | |
| Distribution of annual cost (%) by organisation size (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 duties ⁷ Statutory Equality Duties Impact Test guidance | Yes | 24 |
| Economic impacts | | |
| Competition Competition Assessment Impact Test guidance | Yes | 14 |
| Small firms Small Firms Impact Test guidance | Yes | 24 |
| Environmental impacts | | |
| Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance | No | N/A |
| Wider environmental issues Wider Environmental Issues Impact Test guidance | No | N/A |
| Social impacts | | |
| Health and well-being Health and Well-being Impact Test guidance | No | N/A |
| Human rights Human Rights Impact Test guidance | Yes | 24 |
| Justice system Justice Impact Test guidance | Yes | 24 |
| Rural proofing Rural Proofing Impact Test guidance | No | N/A |
| Sustainable development Sustainable Development Impact Test guidance | No | N/A |

⁷ 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 |
|-----|---|
| | RIA for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005 |
| | <u>Impact Assessment for the Market Power Licence Condition</u> |
| | <u>Implementation of the EU Third Package: Consultation on licence modification appeals</u> |
| | <u>Consultation on the Implementation of the EU Third Internal Energy Package</u> |
| | <u>Final Impact Assessments: Implementation of the EU Third Package</u> |

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 2010 prices

| | Y ₀ | Y ₁ | Y ₂ | Y ₃ | Y ₄ | Y ₅ | Y ₆ | Y ₇ | Y ₈ | Y ₉ |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Transition costs | - | 0.01 | - | - | - | - | - | - | - | - |
| Annual recurring cost | - | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Total annual costs | - | 1.51 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Transition benefits | - | - | - | - | - | - | - | - | - | - |
| Annual recurring benefits | - | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Total annual benefits | - | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |

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

Evidence Base (for summary sheets)

Background and Problem under Consideration

The EU Third Package of measures concerning the internal market in gas and electricity (the “Third Package”) provides that the National Regulatory Authority (NRA) must be capable of, among other matters:

- taking autonomous decisions;
- implementing binding decisions by the European Commission and the Agency for the Cooperation of European Regulators (ACER); and
- carrying out its regulatory tasks in an efficient and expeditious manner.

In addition, it requires Member States to ensure that sufficient mechanisms exist at national level to afford a right of appeal to persons affected by the Regulator’s decision.

Taken together, the Government considers that these requirements mean that the current process for licence modifications needs amending to enable the regulator to carry out its duties and effectively implement the requirements of the Third Package. The Government intends to introduce a revised appeals process to ensure compliance with EU law consistent with the domestic regulatory process.

Gas and electricity markets are competitive, but regulated markets. Market participants are required to hold a licence from Ofgem to carry out specific activities in relation to gas and electricity (or an exemption from the Secretary of State, for example, in relation to small operators such as microgeneration). One of Ofgem’s main tools for regulating the gas and electricity market is through licences. The licence sets out the conditions under which the licensee must operate. For some, the licence conditions also set the prices which the licence holder can charge other market participants, e.g. the price that National Grid as a transmission owner can charge supply companies for transmitting electricity and gas to their customers. A brief explanation of licensed activities can be found at Annex A.

Under the current system, Ofgem’s proposed change or introduction of a standard licence condition can be blocked by 20% of the relevant licensees (measured by number of licence holders **or** market share). If Ofgem does not secure this agreement it can either re-consult on a modified proposal or refer the proposal to the Competition Commission (CC) for a decision. For conditions specific to one licensee, the licensee must agree to the proposal. Failure to reach agreement with that licensee means that if Ofgem wants to impose the change, it must refer its proposal to the CC for a decision. In considering a reference made to it, the CC, investigates whether the licence modification operates or may operate against the public interest.

The current process risks falling short of Third Package requirements because it is capable of preventing the Regulator from taking autonomous decisions in relation to regulatory tasks and effectively implementing binding decisions of the European Commission and ACER, given that proposed changes to licences must either be supported by licence holders before they are introduced or be referred to CC for a decision.

In addition, the Government is concerned that all licence holders do not have an equal ability to challenge amendments to standard licence conditions. In some circumstances a single company may be large enough to meet the required 20% of market share to raise a blocking objection alone. This means there are circumstance where a single licensee can require Ofgem to either reconsider or to refer the proposal to the CC for a decision before any amendment can be made. Smaller companies are therefore particularly disadvantaged under this process.

Rationale for intervention

Our proposal is designed to ensure compliance with the EU Third Package and provide an opportunity for all licence holders to challenge the Regulator’s licence modification decisions. The proposal should also lead to an increase in competition in the electricity and gas markets by giving market participants a right to appeal which would be fair to all licensees, removing the current disadvantage that applies to small companies. It will create a more transparent and efficient decision making process, enabling the Regulator to issue binding decisions autonomously and expeditiously. It will increase the accountability of the Regulator’s decisions, as it could be subject to appeal from all licensees and materially affected consumers. In addition over time an appeals system is likely to lead to a build up of case law, which may increase regulatory stability. These benefits would be in addition to those already afforded by the

existence of judicial review, as judicial review is less likely to consider the technical merits of the Regulator's decisions.

Policy Objectives

The policy objectives are to introduce an appeals process for licence modification decisions in order to implement the requirements of the Third Package so that they deliver a coherent and effective regulatory framework that includes appropriate safeguards for licensees to challenge the Regulator's decisions. The intention is that the proposed framework will result in robust regulation that benefits consumers and industry.

Options under consideration

We considered three main options:

Option 1 is to introduce a right of appeal on all licence modification decisions to the CC for all directly affected licensees (i.e. those holding the licence to which the modification decision relates).

Option 2 is to introduce a right of appeal as Option 1 above, for all directly affected licensees, other materially affected licensees and also Consumer Focus⁸, where consumers are materially affected.

Option 3 is to introduce the same right of appeal as Option 1 above, but limited to licence modification decisions in relation to the regulatory tasks arising from the Third Package. Option 3 represents strict implementation of the EU Third Package requirements.

In addition, we have considered several different design options associated with each option. Option 2 is our preferred option.

Option 1 (appeals process for all licence modification decisions, right of appeal for directly affected licensees)

Option 1 is the introduction of a process that will enable all directly affected licensees to appeal all licence decisions to the CC provided they have sufficient grounds. The CC will have an adjudicatory function (rather than a full investigatory function), but will have the right to review all relevant aspects of the decision under appeal. Under Option 1, Ofgem will make a licence modification (after the current statutory consultation period). Having considered the consultation responses, Ofgem will make a decision. If that decision is to modify a licence condition, a directly affected licence holder (i.e. those holding the class of licence to which the modification decision relates) with sufficient grounds can appeal that decision to the CC within 4 weeks.

The grounds for appeal will be similar to those for code appeals as set out in the Energy Act 2004. In determining the appeal the CC considers matters of law and fact, whether Ofgem has acted in accordance with its statutory duties and the weight attributed to individual statutory duties in reaching the decision, and whether the decision achieves its intended effect. The CC would have the right to review all relevant aspects of the decision being appealed and would have powers to require parties to supply documents and attend hearings. For modification appeals that do not relate to a price control, the timescale for the CC to reach its decision will be 4 months (with the possibility of a one month extension). The CC will have the power to quash the decision, uphold the decision and issue binding directions. For price control decision appeals the process will be more in depth. This process may last up to 6 months (with the possibility of a one month extension). The CC will have the power to substitute a new price control determination in addition to the remedies available for determining other licence modification decisions.

Option 2 (appeals system for all licence modification decisions, right of appeal for directly affected licensees, materially affected licensees and Consumer Focus)

Option 2 would introduce an appeals system (as described for "Option 1" above), but extend the right of appeal to Consumer Focus (where consumers are materially affected) and other materially affected licensees.

⁸ The Government intends to consult next year on the future of consumer bodies. Should the role or status of Consumer Focus change as a result of the consultation, the right to appeal will apply to a successor body.

Option 3 (strict implementation)

Option 3 would introduce an appeals system (as described for “Option 1” above) limited to decisions relating to the regulatory tasks arising from the Third Package and maintaining the current collective licence modification process for other licence modification decisions. This option represents strict implementation of the EU Third Package requirements. However, as discussed in more detail below, this would be very difficult (if not impossible) to implement in practice, and may carry some risk of non-compliance with Third Package requirements.

Design options for an appeal process

As part of the assessment of options we have considered several different design features for the appeals process including:

- the structure of the appeals mechanism and whether price control decisions should be subject to a more in depth appeals process;
- the grounds for appeal;
- the appropriate appeal body;
- the time limits for the process;
- the possible outcomes of an appeal, including whether the appeal body should be able to remit the decision to the regulator with recommendations or substitute the regulator’s decision; and
- whether the regulator’s decisions should be suspended on appeal.

Cost-benefit analysis

Table 1 below summarises the best estimates of monetised costs and benefits to society of the three main options, relative to maintenance of the current licence modification process.

Table 1 Monetised costs and benefits to society of the main options (best estimates)

| £ million (PV) | Option 1 | Option 2 | Option 3 |
|--------------------|-------------|--------------|-------------|
| (Costs) | (17.1) | 21.3 | N/A* |
| Benefits | 7.7 | 7.7 | N/A* |
| Net benefit | -9.4 | -13.6 | -9.5 |

Source: Table 2, Table 13, Table 16. *Costs and benefits for Option 3 are not estimated separately.

Monetised cost and benefit estimates are uncertain, and are sensitive in particular to differences in assumptions around projected number of appeals given the different options. Hence, qualitative considerations are key in interpreting the quantitative analysis and judging which option is preferred. Option 2 is our preferred option.

Option 1 is the minimum cost option, and improves on the status quo by delivering some potentially significant non-monetised benefits, including: improved quality and efficiency of decision making; increased fairness and competition; increased transparency and accountability; and potentially reduced costs of capital.

While Option 2 may result in increased appeals (and therefore increased costs), it is our preferred option. We believe it would better contribute to furthering Ofgem’s statutory objectives and to decisions that better reflect the perspectives of different market participants, by giving Consumer Focus (where consumers are materially affected) and other materially affected licensees a right of appeal, thereby contributing further to cost-effective regulation in GB and potential resulting benefits to business. Given the scale of the electricity and gas industry⁹, even fractional benefits in this regard could offset the additional costs of Option 2.

As explained below, we believe that Option 3 (strict implementation) would be extremely difficult (if not impossible) to operate in practice. Even if possible to implement, developing different elements of a single package of measures using two different processes would give rise to a confused, inconsistent

⁹ For example, Ofgem estimates that companies will need to invest £32 billion by 2020 to deliver the networks required for the low carbon economy and to maintain secure, reliable supplies. See <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>.

and incoherent regulatory process. It is difficult to quantify the potential costs, although monetised costs are higher than Option 1. Cost estimates are based on the assumption that it is possible to implement. In addition, Option 3 entails the following risks:

the analysis may underestimate costs relative to other options (due to non-monetisation of some costs not incurred under other options);

non-compliance with the requirements of the Third Package (e.g. due to delays and inefficiencies in implementing decisions arising from EU obligations); and

by not applying the new appeals process to all Ofgem licence modifications, some of the benefits of the new process (summarised above, and discussed in more detail below) would be lost.

Below, we consider in more detail the monetised and non-monetised costs and benefits to society of Options 1, 2 and 3 relative to a baseline of maintenance of the current collective licence modification process (“business-as-usual”, or “status quo”). We choose this baseline, as it allows for a better comparison of the relative costs and benefits of Options 1, 2 and 3. We also consider the costs and benefits associated with the different design options associated with the type of appeal.

Monetised costs and benefits relate primarily to the costs associated with appeals incurred by the appeal body, Ofgem and business. Estimates are based on a 21 year appraisal period, from 2010 to 2030, with costs and benefits starting in 2011, and are stated in 2010 prices. We consider other impacts qualitatively. We consider distributional and specific impacts, including net costs to business, in a subsequent section.

We first consider the costs and benefits of Option 1. We then use Option 1 as a reference case for considering the costs and benefits of Options 2 and 3.

Option 1 (appeals system for all licence modification decisions, right of appeal for directly affected licence holders)

Option 1 includes the introduction of an appeals process which would enable directly affected licensees to appeal any licence condition change to the CC provided they have sufficient grounds. The costs and benefits, relative to business-as-usual associated with Option 1 are summarised in Table 2 below.

Table 2 Monetised costs and benefits associated with Option 1

| £ million (PV) | Low | Best estimate | High |
|--------------------|---------------|---------------|------------|
| (Costs) | (106.6) | (17.1) | (10.8) |
| Benefits | 0.0 | 7.7 | 13.6 |
| Net benefit | -106.6 | -9.4 | 2.8 |

Sources: Table 3, Table 8. Note: Figures may not sum exactly due to rounding.

In addition, there are some potentially significant non-monetised benefits, including:

improved quality of decision making;

improved efficiency of decision-making

increased fairness and competition;

increased transparency and accountability; and

reduced cost of capital for licensees.

We explore these in more detail below.

Costs

Table 3 below summarises the monetised costs associated with Option 1. Costs primarily relate to ongoing costs associated with appeals, which will depend on both the number of appeals and costs per appeal. Below we outline our reasoning behind the costs presented, including the assumptions we make on the number and costs of appeals.

Table 3 Monetised costs associated with Option 1

| £ million (PV) | Low | Best estimate | High |
|--|-------------|---------------|--------------|
| CC set-up costs | 0.011 | 0.011 | 0.011 |
| CC ongoing costs | 3.1 | 5.7 | 35.5 |
| Ofgem ongoing costs | 5.1 | 6.8 | 42.6 |
| Business ongoing costs (appellants) | 2.0 | 3.4 | 21.3 |
| Third Party costs | 0.6 | 1.1 | 7.1 |
| Total | 10.8 | 17.1 | 106.6 |

Sources: Table 4, Table 5, Table 6, Table 7. “Low” and “High” estimates for each header of cost are the lowest and highest costs respectively from the source tables.

Appeal body set-up costs

Based on a previous impact assessment¹⁰ for introducing an appeals process for code modifications, we estimate the CC could face one-off set-up costs of up to £11k¹¹.

Number of appeals

In order to estimate the ongoing costs, we need to establish how many appeals we can expect under the new regime. For this impact assessment, we assume that there are between 0.6 and 5 appeals per year on average, with a central estimate of 0.8 appeals per year. In the central case, we thus assume that a greater number of modification decisions are appealed under Option 1 as have been blocked on average under the current system (0.6 per year, see below).

Our central assumption on the average number of appeals (0.8 per year) also differs from that made in the consultation-stage version of the IA, in which we made a central assumption of 0.6 appeals per year. Though we cannot be certain of the impact, we now consider it is possible that giving directly affected licensees an equal right to contest a licence modification could lead to an increase in the average number of contested licence modifications. There is uncertainty over the range of the number of appeals, but experience from the code modification appeals procedure and other considerations, outlined below, suggest that we should expect the number of appeals to be towards the lower end of the spectrum.

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). However, the number of appeals under the proposed process may differ from this number, depending on:

- the Competition Commission’s ability to filter and join appeals;
- effort spent by Ofgem on “appeal-proofing” their decisions;
- the expected costs to the appellant of appealing; and
- the grounds for appeal.

Relative to business-as-usual, our proposals could increase the number of appeals by giving all directly affected licensees an equal right to appeal. It is worth noting that parties wishing to appeal a licence modification decision for different reasons would have to do so separately. In addition, the Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This will help to prevent smaller companies being denied access to the appeals process because of the potential cost. However, the following factors will tend to reduce the number of appeals:

We are proposing to give the CC discretion to dismiss trivial and vexatious appeals where there is no real prospect of success.

¹⁰ Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

¹¹ The previous impact assessment estimates set-up costs to the CC of up to £10k. We have assumed that this figure is stated in 2005 prices, and have converted to 2010 prices.

In order to keep costs down, the CC would consider whether it could amalgamate appeals, so that those appealing the same point are heard together.

The increase could be limited by the fact that we could also expect Ofgem to make additional efforts to 'appeal-proof' their decisions (though we discuss this in more detail below). This may be through extended consultation or other methods. It should also be noted that Ofgem carry out impact assessments for licence modifications where there is a major and important change. The extent to which Ofgem make additional efforts will, in turn, depend on the credibility of the threat of appeal.

Appellants may have to bear some costs, whereas previously it was possible for licence holders to block a modification without incurring any cost (though if Ofgem referred the decision to the CC, costs would be then incurred by licence holders). This will tend to deter appeals with little chance of success.

The impact of the grounds for appeal on the number of appeals is more complex. For those licence holders with greater power to block a decision under the current system, the setting of any required grounds for appeal might be expected to reduce the number of appeals, relative to business-as-usual. However, for those licence holders that do not currently have the power to block a decision, introducing wide grounds for appeal would tend to increase the number of appeals.

A previous impact assessment¹² for introducing an appeals process for code modifications assumed that there were between 5 and 10 code modification appeals per year. However, since the appeals process was introduced six years ago there have in fact been only two code appeals.

Table 4 below illustrates the impact on ongoing costs (under central cost of appeal assumptions, discussed in the following sub-sections) of varying the number of appeals.

Table 4 Sensitivity of ongoing costs to number of appeals under Option 1 (Present value, £ million)

| Number of appeals per year | 0.6 | 0.8 | 5 |
|--|-----|-----|------|
| CC ongoing costs | 4.3 | 5.7 | 35.5 |
| Ofgem ongoing costs | 5.1 | 6.8 | 42.6 |
| Business ongoing costs (appellants) | 2.6 | 3.4 | 21.3 |
| Third Party costs | 0.9 | 1.1 | 7.1 |

Competition Commission – ongoing costs

As well as initial set-up costs, the CC will incur costs of dealing with each appeal. Costs to the CC will depend on a number of factors, including the scope of the appeal, the amount of technical expertise required and the time allotted for investigation, hearings and considerations of the issues.

Based on advice from the CC, we assume that the CC could incur costs in dealing with a 6-month price control decision appeal in the range of £400k to £800k, and costs for a 4-month adjudicative hearing for other licence modification appeals in the range of £270k to about £600k. This gives an overall range of costs to the CC of dealing with appeals of £270k to £800k. As a central estimate, we assume costs to the CC of £500k, as we believe there are likely to be fewer appeals on price control decisions than on other licence modifications, as price control decisions will be taken only every 8 years.

Table 5 below shows the present value of ongoing costs to the CC, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 5 Sensitivity analysis of CC cost of appeal

| Cost per appeal (£k) | 270 | 500 | 800 |
|---|-----|-----|-----|
| CC ongoing costs (£ million, PV) | 3.1 | 5.7 | 9.1 |

Note that these assumptions differ from the assumptions made in the consultation-stage Impact Assessment, where we assumed CC costs (presumed to be in 2005 prices) per appeal of £150k, or

¹² Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

approximately £170k per appeal in 2010 prices¹³. These costs were based on a 2005 impact assessment for introducing an appeals process for code modifications. The CC advised that code modification appeals, though resource-intensive, are shorter and likely to cost less than the proposed licence modification decision appeals.

Ofgem – ongoing costs

We would expect there to be a direct cost on Ofgem for each appeal. These costs would vary depending on the length and intensity of the appeal. For example we expect a price control decision appeal to take up to 6 months and to be more in depth than appeals on other licence modification decisions. These costs would include initial, and any further, submission of evidence to the CC.

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 resource. As this is just one example we are unsure whether this is representative of the costs Ofgem would face should appeals become more common. However, this estimate would appear to be consistent with appeal costs estimated in the recent Impact Assessment of the Market Power Licence Condition¹⁴, for appeals to the Competition Appeals Tribunal (CAT):

Ofgem states that whilst the appeal costs to the competition appeals tribunal (CAT) will also vary on a case-by- basis, they consider that a reasonable benchmark would be £250k to £600k where no external law firm is instructed and £500k to £1.2m where an external law firm is engaged.

Under central estimates of the number of appeals, the present value of Ofgem's costs of appeals is £6.8 million.

Ofgem could also incur costs associated with “appeal proofing” licence modification decisions, but these costs may not be additional to any costs that might be incurred under the current system. Ofgem might incur costs currently (under business-as-usual) in designing licence modifications to avoid being blocked. It is also likely that Ofgem currently incurs costs in designing licence modifications to reduce the risk of judicial review. To the extent that Ofgem incurs additional costs associated with “appeal proofing”, we might expect a lower number of appeals, and hence offsetting lower costs associated with appeals.

The Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This could act as an incentive for parties to keep appeal costs to a minimum.

Business costs – appellants – ongoing

There would also be a cost to businesses that decided to appeal. These costs would include initial, and any further, submission of evidence to the CC. Costs may vary by case, depending on the number and nature of issues raised.

E.ON UK have advised us that their external legal costs for their appeal to the CC under Section 173 of the Energy Act 2004 in 2007 were £257k. As this relates to a code modification appeal, these costs may be lower than costs to business of our proposed licence modification appeals, as code modification appeals are shorter in duration. Other evidence provided in confidence suggests that companies may spend around £175k per appeal. These cost estimates may, however, not include internal costs of time. SSE, responding to the main consultation on GB implementation of the EU Third Package, suggested that costs could be in the range of £0.5m to £1m, although it is not clear from the response what this figure includes. Evidence from telecoms appeals suggests that £315k may be representative of industry spending on an appeal to the CAT. We believe that CAT adjudicative hearings for telecoms cases are similar to the type of hearings we are proposing, and cover similar types of regulatory decisions.

Taking the evidence above, we thus assume a central cost to business of £300k per appeal. We assume a lower and upper bound of costs of £175k and £750k respectively. Note that this differs from the assumption made in the consultation-stage impact assessment, due to the evidence we have received during the consultation period (see above).

¹³ Regulatory Impact Assessment for the Electricity and Gas Appeals (Designation and Exclusion) Order 2005

¹⁴ Published as part of the Energy Bill 2009 Impact Assessment, available at http://www.decc.gov.uk/en/content/cms/legislation/energy_act_10/energy_act_10.aspx

The Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This could act as an incentive for parties to keep costs to a minimum.

Table 6 below shows the present value of ongoing costs to business who appeal, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 6 Sensitivity analysis of business cost of appeal

| Cost per appeal (£k) | 175 | 300 | 750 |
|---|-----|-----|-----|
| Business ongoing costs (£ million, PV) | 2.0 | 3.4 | 8.5 |

There could also be initial upfront legal costs associated with deciding whether or not to appeal. We have not monetised these costs. We are unsure how much these would be and how often they would apply, although it is likely that these would not be significant, compared to the appeal costs themselves. We did not receive any additional information on this.

Third party costs – ongoing

There may also be some third party costs associated with each appeal. These may include the provision of evidence to the CC by parties other than the appellant(s), should the CC require them to do so. The process envisaged is that the CC will invite submissions. It will have powers to require other parties to provide evidence, but has found that in other appeals processes that it rarely needs to exercise this power. Interested parties will be able to voluntarily submit evidence to support either the case of Ofgem or the appellant. Evidence received in confidence shows that the costs to an “intervener” in a code modification appeal were approximately £160k. While code modification appeals are shorter than our proposed licence modification decision appeals, the proposals for the licence modification appeals process do not allow for “intervention” in the same formal sense as the code modification appeal process.

Under the Code Modification Appeals process those that are materially affected by a licence modification decision may apply to the CC to intervene. In the application they will need to demonstrate that they are materially affected by the decision. They must also include in a statement whether it supports or opposes the appeal and identify the grounds of appeal in relation to which the intervention is made, together with the facts and reasons relied on, or if the intervention opposes the appeal, identifying the facts and reasons why it believes the appeal should not succeed. If the CC gives leave to intervene the intervener effectively becomes a party to the appeal, with all the attendant expense that entails, including the possibility that it may have to pay a proportion of the CC’s costs.

We believe that the costs of submitting evidence to the CC should be substantially less for the licence modification appeals process, as there is no requirement to apply to intervene (and those that submit evidence will not be liable for the CC’s costs).

Taking the evidence above, we thus assume a central cost to third parties of £100k per appeal. We assume a lower and upper bound of costs of £50k and £200k respectively. Table 7 below shows the present value of ongoing costs to business who appeal, under different appeal cost assumptions, given central estimates of the number of appeals per year.

Table 7 Sensitivity analysis of third party cost of appeal

| Cost per appeal (£k) | 50 | 100 | 200 |
|--|-----|-----|-----|
| Third party ongoing costs (£ million, PV) | 0.6 | 1.1 | 2.3 |

Benefits

Table 8 below summarises the monetised benefits associated with Option 1. Benefits primarily relate to avoidance of costs associated with blocked licence changes under the current collective licence modification process. These cost savings will depend on both the number of blocked licence changes and the costs associated with them. Below we outline our reasoning behind the benefits presented, including the assumptions we make on the number and costs of blocked licence changes.

Note that the consultation-stage Impact Assessment did not include any monetised benefits. We now consider it is reasonable to assume that, in moving from the current licence modification process, costs

associated with blocking a proposed licence change may be avoided. These would include the cost of a referral to the CC and subsequent investigation and/or the cost of Ofgem modifying its decision and re-consulting.

Table 8 Monetised benefits associated with Option 1

| £ million (PV) | Low | Best estimate | High |
|--|------------|---------------|-------------|
| CC ongoing savings | 0.0 | 3.4 | 5.5 |
| Ofgem ongoing savings | 0.0 | 2.6 | 4.2 |
| Business ongoing savings (objecting licensee) | 0.0 | 1.3 | 3.2 |
| Third Party cost savings | 0.0 | 0.4 | 0.9 |
| Total | 0.0 | 7.7 | 13.6 |

Sources: Table 9, Table 10, Table 11. “Low” and “High” estimates for each header of benefit are the lowest and highest benefits respectively from the source tables.

In addition, there are some potentially significant non-monetised benefits, including:

- improved quality of decision making;
- improved efficiency of decision-making
- increased fairness and competition;
- increased transparency and accountability; and
- reduced costs of capital for licensees.

We explore these in more detail below.

Possible outcomes of a blocked licence change under business-as-usual

Under the current system, Ofgem’s proposed change or introduction of a standard licence condition can be blocked by 20% of the relevant licensees (measured by number of licence holders or market share). If a standard licence modification is blocked, it can either modify the proposal and re-consult or refer it to the CC for a decision. For conditions specific to one licensee, the licensee must agree to the proposal. Failure to reach agreement with the licensee means that if Ofgem wants to implement the decision it must refer its proposal to the CC for a decision. In considering a reference, the CC investigates whether the licence modification operates or may operate against the public interest.

Number of blocked licence changes and references to the Competition Commission

We assume that, on average, 0.6 licence modifications are blocked per year. 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).

One might expect that Ofgem would be likely to make a reference to the CC in most cases, if it has strong reason to believe that a proposed modification would contribute to achieving its statutory duties. Exceptions to this might be that when a decision is blocked, industry is able to suggest the possibility of a further option not considered at consultation stage. In practice, however, Ofgem has not made any licence modification references to the CC since 2003.

For the purposes of this impact assessment, we have taken as a central assumption that, in those cases where licence modification decisions are blocked, Ofgem decides to make a licence modification reference to the CC in 50 percent of those cases (i.e. 0.3 references per year). As lower and upper bounds, we assume that Ofgem makes references in zero and 80 percent of cases (zero and 0.5 references per year) respectively.

Table 9 below illustrates the impact on ongoing cost savings (under central licence modification reference cost assumptions) of varying the number of licence modification references.

Table 9 Sensitivity of ongoing cost savings to number of licence modification references under Option 1 (Present value, £ million)

| Number of references per year | Zero | 0.3 | 0.48 |
|--------------------------------|------|-----|------|
| CC ongoing cost savings | 0.0 | 3.4 | 5.5 |

| | | | |
|---|-----|-----|-----|
| Ofgem ongoing cost savings | 0.0 | 2.6 | 4.1 |
| Business ongoing cost savings (objecting licensee) | 0.0 | 1.3 | 2.0 |
| Third party cost savings | 0.0 | 0.4 | 0.7 |

Competition Commission –ongoing cost savings

Implementation of Option 1 will lead to the avoidance of costs to the CC associated with licence modification references under business-as-usual. Modification references are longer than most of our proposed appeals – generally 6-12 months, rather than 4-6 months. Modification references also require an investigative approach that under the new appeals process we are proposing only for price controls. Generally, one would expect the cost of an inquiry will increase if it takes longer. We have assumed that costs associated with licence modification references are in the range of £600k to £1m, with a central estimate of £800k.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 10 below.

Table 10 Sensitivity analysis of CC cost savings from reduced CC references under Option 1

| Cost per reference (£k) | 600 | 800 | 1000 |
|--|------------|------------|-------------|
| CC ongoing cost savings (£ million, PV) | 2.6 | 3.4 | 4.3 |

Ofgem – ongoing cost savings

Implementation of Option 1 could lead to the avoidance of Ofgem costs associated with licence modification references. We have assumed that these costs are £600k per licence modification reference, the same as the costs we assume Ofgem incurs in relation to our proposed licence modification appeals (see above), although Ofgem’s costs could be higher under the current licence modification process, as references take longer than they would under our proposed appeals process.

Under central estimates (see section above) of the number of references under business-as-usual, the present value of Ofgem’s cost savings from avoided licence modification references is £2.6 million.

In those situations where contested licence modification decisions do not result in a reference to the CC, Ofgem could incur costs associated with altering proposals for licence modifications. We have not monetised these cost savings. However, it is possible that Ofgem could still incur costs of altering proposals under Option 1, if the CC, in its judgement following an appeal, asks Ofgem to do so.

Business – objecting licensee – ongoing cost savings

Option 1 will result in cost savings to licensees where Ofgem would have referred a decision to the CC under business-as-usual. These costs would include initial, and any further, submission of evidence to the CC by the objecting licensee. We assume a central cost to business of £300k, and a lower and upper bound of costs of £175k and £750k respectively.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 11 below.

Table 11 Sensitivity analysis of business cost savings from reduced CC references under Option 1

| Cost per reference (£k) | 175 | 300 | 750 |
|--|------------|------------|------------|
| Business ongoing cost savings (£ million, PV) | 0.7 | 1.3 | 3.2 |

An equal right of appeal means that some businesses will receive additional powers to contest licence modification. These parties may gain from the introduction of Option 1, as it decreases the likelihood that they will incur unreasonable costs arising from the licence modification (either because they appeal, or because their threat of appealing is credible).

Third party cost savings – ongoing

There may also be some third party cost savings associated with avoided licence modification references. These may include the provision of evidence to the CC by parties other than the objecting licensee. We assume a central cost saving of £100k, and a lower and upper bound of costs of £50k and £200k respectively.

Given central assumptions (see above) on the number of blocked licence changes that result in licence modification references, this leads to the range of cost savings shown in Table 11 below.

Table 12 Sensitivity analysis of third party cost savings from reduced CC references under Option 1

| Cost per reference (£k) | 50 | 100 | 200 |
|---|-----|-----|-----|
| Third party ongoing cost savings (£ million, PV) | 0.2 | 0.4 | 0.9 |

Quality of decision-making

An equal right of appeal, on the technical merits of Ofgem's decision in relation to the specified grounds, should help improve decision making and ensure that Ofgem is able to autonomously make licence modifications that further its statutory duties. Under business-as-usual, licence holders meeting the blocking threshold can block decisions, possibly even when Ofgem is acting in accordance with its statutory duties and which are in the overall economic and financial interests of the market. Ofgem may not automatically make a licence modification reference to the CC. Even if Ofgem makes a reference, the CC's current public interest test may not necessarily be aligned with Ofgem's statutory duties. In addition, though judicial review exists currently, judicial review would not always allow consideration of the technical merits of the Regulator's decision. No actual appeals need take place for this benefit to arise - this benefit could also arise from the credible threat of an appeal.

Efficiency of decision-making

The proposed process would enable Ofgem to issue binding decisions autonomously and independently, potentially resulting in more efficient decision making. This would enable more efficient economic regulation of the market.

To the extent that Ofgem takes more time to design licence modifications, the time taken to issue decisions may increase somewhat. However, it is also worth noting that the appeal mechanism will be governed by a set of time limits.

Fairness and competition

An equal right to appeal and challenge the regulator's decisions would be fairer to licensees. On balance, we believe it could improve competition. Taking in turn the four questions of the Office of Fair Trading (OFT) competition impact assessment guidance¹⁵:

Will the proposal directly limit the number or range of suppliers?

Our proposals would not limit directly the range of suppliers in either the wholesale or retail energy markets, and would not directly affect the number of licensees.

Will the proposal indirectly limit the number or range of suppliers?

There is no reason to believe that the proposals would increase costs of some market participants relative to others.

Increased average costs on all participants could be argued to represent a barrier to entry. However, the central estimate (present value) of costs to business under Option 1 is £1.6 million (see Table 16 below). When spread across market participants, we consider this is unlikely to represent a significant barrier to entry.

Will the proposal limit the ability of suppliers to compete?

By removing asymmetries in licence holders' ability to contest licence modification proposals, the proposals could potentially lead to licence modifications less likely to favour certain market participants over others. This would tend to increase the ability of participants to compete.

¹⁵ http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft876.pdf

Will the proposal reduce suppliers' incentives to compete vigorously?

The proposals are unlikely to affect firms' incentives to compete vigorously, as they are unlikely to facilitate collusion between firms, or affect the ability of consumers to switch between suppliers.

Transparency and accountability

The new process would be more transparent as major objections to licence modifications would be dealt with through a transparent appeals process.

If there is an increase in appeals under the new mechanism, we would expect to see an increase in the accountability of Ofgem's decisions, as the appeal body would provide an additional level of expert scrutiny.

Cost of capital

Building up case law under appeals, on the technical merits of Ofgem's decisions in relation to the specified grounds, going beyond what judicial review would usually consider, may increase regulatory stability and in turn may lower the cost of capital faced by market participants. However, the build up of case law will take time and will depend on the frequency of appeals.

Some respondents to the consultation felt that the proposals could increase regulatory uncertainty. It is possible that this risk may in part arise as the equal right of appeal may give increased power to contest Ofgem's licence modifications to some licensees. We believe that this is likely only to represent the position of certain market participants, rather than licensees as a whole – smaller licensees are likely to gain from their increased power to contest Ofgem licence modifications.

The risk may also arise from uncertainty over the decisions that Ofgem may introduce. In order to minimise this risk, we have designed the appeals mechanism so that Ofgem's decisions will come into force only once the timescale for submitting an appeal has expired. Appellants will be able to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal, in circumstances where implementation of the licence change would result in significant unrecoverable costs (see section on Option design below). This could help to mitigate any negative effect of the proposals on regulatory uncertainty.

Option 2 (appeals system for all licence modification decisions, right of appeal for all directly affected parties, and also Consumer Focus and other materially affected licensees)

Option 2 would introduce an appeals system (as described for "Option 1" above), but extending the right of appeal to materially affected licensees and Consumer Focus, where consumers are materially affected. The majority of respondents to the consultation were in favour of extending the right of appeal to materially affected licensees. Generators and supply companies argued that changes to network company licences in particular could have a significant impact on them.

The costs and benefits, relative to business-as-usual, associated with Option 2 are summarised in Table 13 below.

Table 13 Monetised costs and benefits associated with Option 2

| £ million (PV) | Low | Best estimate | High |
|--------------------|---------------|---------------|------------|
| (Costs) | (106.6) | (21.3) | (10.8) |
| Benefits | 0.0 | 7.7 | 13.6 |
| Net benefit | -106.6 | -13.7 | 2.8 |

Source: Table 14, Table 15

Costs

As Option 2 extends the right of appeal to additional parties, it is possible that there will be, on average, a greater number of appeals under Option 2, when compared to Option 1. We have attempted to capture this by assuming that there will be 1 appeal per year on average, in the central case (compared to 0.8 per year under Option 1). As lower and upper bounds, we assume that there are 0.6 and 5 appeals respectively per year (the same bounds as for Option 1). It is possible that extending the right of appeal to additional parties will not lead to an increase in the number of appeals, if these additional parties are less likely to contest licence modifications relative to "directly affected" parties. It is worth noting that in order to appeal, other licence holders and Consumer focus will have to demonstrate that they/consumers are materially affected by the decision.

Given that Ofgem’s principal objective is to protect the interests of customers, one might expect that the likelihood of a Consumer Focus appeal is low. However, other materially affected licensees may have an interest in appealing, where they are likely to face a commercial impact from a proposed Ofgem licence modification of a different class of licence.

The monetised costs associated with Option 2 are summarised in Table 14 below.

Table 14 Monetised costs associated with Option 2

| £ million (PV) | Low | Best estimate | High |
|--|-------------|---------------|--------------|
| CC set-up costs | 0.011 | 0.011 | 0.011 |
| CC ongoing costs | 3.1 | 7.1 | 35.5 |
| Ofgem ongoing costs | 5.1 | 8.5 | 42.6 |
| Business ongoing costs (appellants) | 2.0 | 4.3 | 21.3 |
| Third Party costs | 0.6 | 1.4 | 7.1 |
| Total | 10.8 | 21.3 | 106.6 |

Option 2 may bring additional non-monetised costs, relative to Option 1:

There may be potential additional costs to Ofgem, relative to Option 1, associated with “appeal proofing” licence modification decisions against appeal from Consumer Focus and other materially affected licensees. These may be additional to costs that Ofgem would incur in designing licence modifications to reduce the risk of judicial review from these parties. To the extent that additional costs are incurred, the number of appeals may be reduced.

Additional uncertainty over the potential origin of appeals may increase regulatory uncertainty for all parties. However, it should be noted that, under Option 1, Consumer Focus and other materially affected licence holders would still be able to seek a judicial review of Ofgem’s licence modification decisions. In addition, the requirement for a party to demonstrate a material impact (before an appeal could proceed) might mitigate this risk.

Benefits

The monetised benefits of Option 2, relative to business-as-usual, are the same as Option 1, and are summarised in Table 15 below.

Table 15 Monetised benefits associated with Option 2

| £ million (PV) | Low | Best estimate | High |
|--|------------|---------------|-------------|
| CC ongoing savings | 0.0 | 3.4 | 5.5 |
| Ofgem ongoing savings | 0.0 | 2.6 | 4.2 |
| Business ongoing savings (objecting licensee) | 0.0 | 1.3 | 3.2 |
| Third Party cost savings | 0.0 | 0.4 | 0.9 |
| Total | 0.0 | 7.7 | 13.6 |

Source: Table 8

Option 2 may bring additional non-monetised benefits, relative to Option 1:

Additional scrutiny from additional parties (either through actual appeals, or because of the credible threat of appeal) of Ofgem’s decisions will ensure that Ofgem considers the impact of its proposals on these parties. Ofgem should face additional pressure to carry out its statutory duties at least cost from the view of all market participants, taken together, as it would be difficult for Ofgem to justify anything else to the CC. Given the grounds for appeal, we might also expect this to put additional pressure on Ofgem to ensure its decisions are made on the basis of correct factual information and have the intended effect. Ofgem’s decisions will be more accountable to Consumer Focus and other materially affected licensees.

Any increase in the number of appeals, relative to Option 1, may contribute to an increased build-up of case law, on the technical merits of Ofgem’s decisions. This could help to further reduce costs of capital.

Option 3 (strict implementation)

Option 3 would involve strictly implementing the EU Third Package requirements by introducing an appeals system (as described for “Option 1” above) for the implementation of decisions in relation to the regulatory tasks arising from the Third Package only, and maintaining the current licence modification process for domestic obligations. It should be noted that this would be extremely difficult (if not impossible) to operate in practice. This is because it would be impossible in many instances to determine with any certainty which process should be used, as the same licence modification could be deemed to be in relation to a regulatory task under the Third Package, or deemed to arise from Ofgem’s domestic duties depending on the context in which it is proposed.

For instance the Third Package provides that Ofgem has to help to ensure, together with other relevant authorities, that consumer protection measures are effective and enforced (Article 37 (1) (n) of the Directive). Ofgem is currently considering whether companies through licences should be obliged to give customers 30 calendar days' warning before putting prices up. This proposal could in some contexts be said to be arising from an EU obligation or in others arising out of domestic responsibilities.

Further difficulties would arise in relation to packages of measures which make up a licence modification, where some elements could be considered to arise from EU obligations and others may not. Developing different elements of a single package of measures using two different processes would give rise to a confused, inconsistent and incoherent regulatory process.

Given the difficulties in determining whether a proposed licence modification arises from EU or domestic obligations, operating a dual process would also give rise to disputes, legal challenge and increased regulatory uncertainty. Even if Ofgem’s choice of process were not challenged, delays in implementing decisions arising from EU obligations could occur if they were interlinked with decisions arising from domestic duties risking non compliance with the requirements of the Third Package.

Costs and benefits

Below we examine the range of costs and benefits associated with strict implementation in more detail, with the use of some illustrative scenarios.

Table 16 Net monetised benefits associated with Option 3

| Net benefits (£ million, PV) | |
|-------------------------------------|-------------|
| Scenario A | -9.0 |
| Scenario B | -9.4 |
| Scenario C | -10.0 |
| Average | -9.5 |

As set out above, we believe that Option 3 would be impractical and breach the principles of good regulation. It would require the separation of the domestic and European elements of a particular decision. Assuming that it is possible to determine whether a decision arises from EU or domestic obligations, it would require the creation of two substantively different, regimes - one ex ante and one ex post - and would increase regulatory uncertainty. Experience of the appeals process in telecoms has shown that dual processes lead to delay and inefficiency as there can be differences of opinion about which process and timetable to follow. Given the considerable uncertainties around how or whether this option could be made to work in practice, it is difficult to quantify the potential costs. We have attempted to do so by considering three possible scenarios set out below. We assume that each of these scenarios is equally likely, in the absence of further evidence. Monetised net benefits under these scenarios average £-9.1 million, using the same central assumptions on the cost and number of appeals as Option 1, where appropriate.

In addition, under Option 3, there are the following undesirable impacts:

the possibility of delays in decision making, raising concerns over the ability of Ofgem to perform regulatory tasks in an efficient and expeditious manner, and to implement binding decisions of ACER and the Commission;

delays and/or uncertainty (described in detail above) over additional litigation/appeals could lead to additional regulatory uncertainty; relative to Option 1, Option 2 and business-as-usual;

reduced transparency and accountability of decision-making relative to Options 1 and 2, due to the maintenance of the current collective modification process for decisions arising from domestic obligations; and

reduced fairness and competition, relative to Options 1 and 2.

The impacts of the Option 3 scenarios on Ofgem's costs associated with "appeal proofing" and (where it is possible to ascertain that appeals process should be used) on costs to third parties that submit evidence in support of the appellant or Ofgem are uncertain. Due to the lack of evidence, we have not quantified these costs.

Scenario A

Scenario A assumes that Ofgem's decision on which process to use is not challenged. Net benefits (to society) under Scenario A comprise of the following elements:

net costs of introducing an appeals system (as described for "Option 1" above) for the implementation of decisions in relation to the regulatory tasks arising from the Third Package only;

the costs of the current licence modification process for domestic obligations;

additional costs to Ofgem of deciding which process to use; and

additional costs to Ofgem of consulting separately on different elements of the same proposal.

Under Scenario A, the number of appealable decisions in relation to regulatory tasks imposed by the Third Package Directives would be fewer under the minimum implementation option (Option 3) than under our preferred option (Option 2), where the appeals process would apply to all licence modification decisions. As an illustration, assuming that 75% of Ofgem licence modification decisions are in relation to regulatory tasks imposed by the Third Package Directives, we would expect these costs under Scenario A to be 75% of the net costs for Option 1, i.e. costs of £7.0 million (present value). This figure assumes the CC still incurs the full one-off setup costs of £11k assumed for Options 1 and 2.

The costs of maintaining the current licence modification process for decisions in relation to domestic obligations are assumed to be 25% of the cost savings estimated above for Option 1, i.e. costs of £1.9 million.

Under Option 3, Ofgem will incur increased costs in deciding which process to use. Given the risk of legal challenge we assume that Ofgem may need to seek legal advice before deciding which process to use and that these additional costs could therefore be substantial. We have not monetised these costs, due to lack of firm evidence. However, it should be noted that these costs are not incurred under the other options. Hence, not including these costs risks underestimating costs under Option 3, relative to the other options.

Under Option 3, the total number of Ofgem decisions would be greater, if decisions that related to both domestic and European obligations were disentangled, as Ofgem would be required to consult separately on different elements of the same proposal. In this scenario, we would expect increased costs to both Ofgem and licence holders from the increase in consultations. We have not monetised these costs, due to lack of firm evidence. However, it should be noted that these costs are not incurred under the other options. Hence, not including these costs risks underestimating costs, including costs to business, under Option 3, relative to the other options.

Total monetised net benefits under Scenario A are £-9.0 million.

Scenario B

Scenario B is as Scenario A, but assumes that a certain proportion of Ofgem's decisions on which process to use (i.e. appeals system or current system) are challenged by way of judicial review. In Scenario B, the outcome of this litigation is that the process to be applied for the licence modification decision is settled.

Costs are as above for Scenario A, but with additional costs of litigation and possible costs of additional Ofgem consultations.

The number of judicial reviews brought in this scenario is uncertain. In general, a party might have an interest in challenging Ofgem's decision on which process to use if they expect to secure a better

outcome for themselves under the alternative process. It is possible that a judicial review could go some way towards clarifying which process is more suitable in a given context. As an illustration, we assume 0.1 judicial reviews per year, on average (equivalent to 2 challenges over the 20-year appraisal period).

Ofgem have advised that the cost of judicial review to them could be in the range of £35k to £200k. We assume a central estimate of £100k in costs to each of Ofgem, the judicial body and the business bringing the judicial review. We assume that third parties face costs of approximately £30k, in line with the ratio of third party to business costs assumed for Option 1. This results in additional costs of £0.5 million (present value), above those in Scenario A.

Once the hearing is complete, Ofgem would have to re-consult on its proposals. We have not monetised any costs associated with this.

Total monetised net benefits under Scenario B are £-9.4 million (present value).

Scenario C

This scenario involves challenge to both the process and the decision itself. In the event that Ofgem's decision on which process to use is challenged under judicial review, it is conceivable that the decision itself would also be subject to challenge.

In these cases, it would seem likely that costs of judicial review to business, Ofgem and the hearing body are similar to central costs assumed for Option 1. The number of judicial reviews brought in this scenario is uncertain. In effect, the potential to bring a judicial review adds an additional avenue for appeal of the decision itself, i.e. rather than "displace" appeals, it is possible that judicial review could be additional to any appeals under Scenario A. As an illustration, we assume an average of 0.05 judicial reviews per year – fewer than in Scenario B, to reflect the increased expense of these reviews, and the fact that these reviews would be more conclusive in nature, because they would provide a ruling on the decision itself as well as the process used. The effect of assuming 0.05 judicial reviews per year under this scenario is to bring the total average number of contested decisions per year to 0.8, the same as the average number of appeals per year assumed for Option 1.

This results in additional costs of £1.1 million (present value), above those in Scenario A. Total monetised net benefits under Scenario C are £-10.0 million (present value).

Consideration of policy design options

Structure of the appeals mechanism

We consulted on two possible options regarding the structure of the appeals mechanism – an adjudicative approach and investigatory approach.

In practice, both types of appeal follow similar processes in so far as the appeal body would consider evidence submitted by the appellant, Ofgem, and potentially other parties, and weigh up the arguments and evidence to reach a decision. The appeal body would have the power to require the submission of information and to hold hearings. However, an investigative appeal would be more in-depth and longer. Therefore there may be a greater cost on business, Ofgem and the CC as they may require more time, legal resources and documentation. There may also be further duplication of Ofgem's work due to additional analysis and consultation. However, an investigative appeal would allow for greater scrutiny of the economic considerations that underpin the regulator's decision, which go to the heart of a business operation.

Price control arrangements are mainly contained in special licence conditions and apply to individual network companies. Due to the complex nature of these decisions and the significant impact they have on companies, the government has decided that they should be subject more in-depth scrutiny. This was also the view of the majority of respondents to the consultation. 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 monopoly companies' financial positions. Appeals against standard licence condition modification decisions will follow an adjudicative process.

The government will allow parties to appeal individual elements of a price control as this may reduce the cost of appealing. However, as price control decisions are essentially a package of balancing measures, there is the potential that the upholding of an appeal on a single element could have a knock-on effect on other elements of the package and upset the balance of the package. The CC would therefore have discretion to consider additional elements or the whole package of the price control decision if the evidence submitted shows that reviewing individual elements is likely to upset the balance of the whole package.

The grounds for appeal

There are two options available for the grounds for appeal: an appeal mirroring judicial review grounds only, or in addition enabling scrutiny of the technical merits of the case.

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 more likely to be considered in scrutinising the decision. Allowing appeals on the merits of the case in relation to the specified grounds is likely to mean that more appeals are allowed, as compared with stricter grounds for appeal. 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. Respondents to the consultation document overwhelmingly supported an appeal on the merits of the decision.

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 intends to introduce a carefully defined right of appeal on the merits, in relation to the specified grounds. We believe that this balances the costs and benefits of the different options best. This grounds would be broadly similar to those contained in the Energy Act 2004 which provides the procedure for reviewing amendments to industry codes.

The appeal body

The government put forward two options in its consultation document for an appropriate appeal body: the Competition Commission (CC) and the Competition Appeals Tribunal (CAT). Our preferred option was the CC and almost all respondents to the consultation were in favour of the CC as the appeal body

Outcomes of an appeal

There are a range of possible remedies available to the appeal body, including the ability to confirm, quash, remit, give directions, vary the decision and substitute its own decision. The possible outcomes of an appeal are linked to the type of appeal. For an adjudicative process the possible remedies would be the ability to uphold, quash, remit, issue binding directions. An investigative approach would allow the appeal body to substitute the regulator's decision with its own decision, in addition to the remedies outlined above. Remitting a decision with directions is potentially less costly to the appeal body than substituting the decision because the appeal body is not replacing the decision with its own, but rather enabling the original decision-maker, who has greater expertise, to revise the decision in line with the directions of the appeal body.

The government intends to give the appeal body the power to confirm, quash, remit the matter back to the regulator, and give binding directions for ordinary licence modification decision appeals. However, for price control decision appeals the government intends to give the appeal body an additional power to substitute the decision.

Time limits for the process

Time limits for an appeals process are dependent on the structure of the appeal and the appeal body.

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

Respondents agreed with the government that price control decision appeals warrant greater scrutiny and may need longer to resolve. The government therefore intends to introduce a 6 month time limit for the CC to determine price control decision appeals and a 4 month time limit for it to determine other licence modification decision appeals.

Suspending decisions on appeal

The government considered in its consultation whether decisions subject to appeal should be suspended, particularly where the decision requires expenditure by companies.

In order to achieve the balance between the need to prevent unrecoverable costs to business and limit the effect of gaming by parties to delay licence modifications, the government has decided 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 unrecoverable costs that would be unnecessary if the appeal succeeded.

In addition the government proposes that each licence modification decision should be accompanied by a coming into force date. The decision will come into force only once the timescale for submitting an application for appeal has expired.

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 values.

Note that one might expect the average number of appeals (under Options 1, 2 and 3) and blocked licence modifications (under "business-as-usual") per year to depend on the number of licence modifications made per year. We have not attempted to forecast the number of licence modifications made per year. Instead, we have attempted to provide an estimate of the order of magnitude costs, based on historical data on the number of blocked licence changes per year, ignoring the ratio of blocked licence changes to total licence modifications. If there are significantly more or fewer licence modifications per year in the future, this method may result in an under- or over-estimate of both costs and benefits.

Distributional impacts and specific impact tests

Below we consider distributional and specific impacts of the proposals..

Net costs to business

Below we compare net costs to business under Options 1, 2 and 3. Table 3 and Table 8 above show the distribution of first-order monetised costs and benefits respectively between Ofgem, business and the CC under Option 1. Table 14 and Table 15 above show the distribution of first-order monetised costs and benefits respectively between Ofgem, business and the CC under Option 2.

A precise comparison of net costs to business is difficult, as:

it depends on assumptions on costs, numbers of contested licence modifications and distribution of costs; and

it ignores any difference in non-monetised costs and benefits between options.

With regards to the distribution of costs, for the purposes of this Impact Assessment, we have assumed that only costs borne by third parties constitute **direct** costs to business, for the purposes of One In, One Out ("OIOO"). We explain the reasoning in more detail below.

All options would result in costs and benefits to business, which are discussed in more detail in the main cost-benefit analysis section above. However, we do not consider that the bulk of these costs constitute **direct** costs to business as a result of the proposals, since companies can choose whether or not to appeal. More specifically:

We believe that it is reasonable to assume that companies would only appeal when it was in their interest. We would therefore expect 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.

If a licensee appealed, and was successful in its appeal, it is likely that the CC would decide to award costs to the licensee, assuming the costs incurred were reasonable – i.e. there would be no direct cost to the business from appealing.

If a licensee appealed, and was unsuccessful in its appeal, then it chose to incur appeal costs, even though its case against the proposed Ofgem licence modification was not strong enough, i.e. it incurred costs unnecessarily.

Similarly, cost savings to business, in moving from the current licence modification process, from avoided CC references, would not constitute savings in **direct** costs. Under business-as-usual, businesses also have the choice of whether to block an Ofgem licence modification.

However, it is difficult to argue that costs borne by third parties are borne voluntarily, in the same sense. Indeed, the CC may even require some companies to submit evidence. Table 17 below compares net costs to business under Options 1, 2 and 3, relative to a baseline of business-as-usual, under central assumptions on numbers and costs of appeals.

Table 17 Comparison of net costs to business

| | Option 1 | Option 2 | Option 3 |
|--|----------|----------|----------|
| Net present value (£ million, 2009 prices) | 0.7 | 1.0 | 0.7 |
| Equivalent annual costs (£'000s, 2009 prices) | 45 | 64 | 43 |

Source: Table 3, Table 8, Table 14, Table 15, DECC calculations, BRE Equivalent Annual Net Cost to Business Calculator, HMT GDP deflator series

Table 18 below compares net costs to business under Options 1 and 2, relative to Option 3 (strict implementation)

Table 18 Difference in net costs to business, relative to Option 3 (strict implementation)

| | | |
|---|------|------|
| Net present value (£ million, 2009 prices) | 0.03 | 0.31 |
| Equivalent annual costs (£'000s, 2009 prices) | 2 | 20 |

Source: Table 17

With regards to non-monetised costs, we believe it is unlikely that businesses would incur significant net direct costs associated with a licence modification, pending the outcome of an appeal:

The government proposes that each licence modification decision should be accompanied by a coming into force date. The decision will come into force only once the timescale for submitting an application for appeal has expired.

Appellants will be able to apply to the appeal body for the suspension of the effects of Ofgem's decisions pending the outcome of the appeal, in circumstances where implementation of the licence change would result in irreparable harm (see section on Option design above).

Businesses may incur costs in deciding whether or not to appeal. As discussed in the cost-benefit analysis section, we did not have any firm evidence on these, although it is likely that these would not be significant, compared to the appeal costs themselves. In addition, businesses would bear costs under the current system in deciding whether or not to contest a licence modification – these costs would not be borne under the proposed appeals process.

Impact on consumers

Any additional costs to licensees as a result of these proposals may be passed through to energy consumers. However, consumers may gain from these proposals, to the extent that they improve competition and help to further Ofgem's statutory duty to promote the interests of consumers. We have not quantified the impact on consumer bills arising from these proposals.

Administrative burden

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. See the discussion of "fairness and competition" in the cost-benefit analysis of Option 1 above for more detail.

Small firms impact test

The proposals reduce a competitive disadvantage faced by smaller industry participants under the current arrangements, by giving all licensees an equal right of appeal. Government proposes to give the appeal body discretion to award costs and in doing so to take into account the reasonableness of the costs incurred. This will help to prevent smaller companies being denied access to the appeals process because of the potential cost.

Equality Impacts

We do not consider that the impact of our proposals is likely to differ by race, gender or disability.

Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

Annex A: Licensed Market Participants

The electricity market framework

Under the Electricity Act 1989, it is illegal to generate, transmit, distribute or supply electricity without a licence or an exemption.

System Operator: National Grid acts as System Operator. The System Operator has the responsibility of overseeing and managing the flow of electricity across the whole GB transmission network. It must hold a licence from Ofgem.

Transmission Owner: The high voltage transmission system transmits electricity over long distances. National Grid owns the England and Wales transmission system, with Scottish Power Transmission Ltd (SPT) and Scottish Hydro-Electric Transmission Ltd (SHETL part of SSE) each owning a part of the transmission system in Scotland. As transmission owners, these companies are responsible for building and maintaining safe and efficient networks and must hold a licence from Ofgem.

Distribution Network Operator: The lower voltage distribution network brings electricity to most business and domestic consumers. There are 14 licensed electricity distribution networks owned and operated by seven different companies.

Generators: Generators have to have a licence from Ofgem unless they are subject to an exemption.

Suppliers: are the commercial interface between generators and most consumers. Electricity is sold by generators in the wholesale market to suppliers who then supply domestic and business consumers. Suppliers must hold a supply licence from Ofgem unless they are subject an exemption.

The gas market framework

Under the Gas Act 1986, a licence is required to convey gas through pipes to premises or to a pipe-line system operated by a gas transporter, to supply gas which is conveyed to premises through pipes, or to arrange for gas to be put into, conveyed on or taken out of a pipe-line system. Exemptions from the requirement to hold a licence are contained in various exemptions orders made under s.6 Gas Act 1986.

System Operator: National Grid acts as System Operator. The System Operator has the responsibility of overseeing and managing the flow of gas across GB transmission network. It must hold a licence from Ofgem.

Gas Transporter: Transportation is the activity of "conveying" gas, carried out by network companies engaged in long-distance transportation and in regional distribution. Gas networks transport gas from the point where the gas is landed in GB (whether from offshore production or

from an import route) or from a gas storage facility, to the point of use. Gas transporters, (unless exempt) must hold a licence from Ofgem.

Shipper: Shippers make arrangements with licensed Gas Transporters for the conveyance of gas. Shippers must hold a licence from Ofgem unless they are subject to an exemption.

Supplier: Suppliers are the contractual interface with consumers. They must hold a licence from Ofgem unless they are subject to an exemption.

| | |
|--|---|
| Title: Third Package: Transmission and Distribution Networks Lead department or agency: Department of Energy and Climate Change Other departments or agencies: | Impact Assessment (IA) |
| | IA No: DECC0005 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Legislation |
| | Contact for enquiries: Phil.Hicken@decc.gsi.gov.uk Richard.Davies1@decc.gsi.gov.uk |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Articles 9-11 of the Third Package Electricity and Gas Directives and Article 3 of the Electricity and Gas Regulations introduce new unbundling requirements on transmission system owners (TSOs). These articles affect existing electricity and gas transmission systems, interconnectors, and the new Offshore Transmission Operators (OFTOs). Article 26 of the Directives places further unbundling requirements on Distribution System Operators (DSOs). Provisions are also made for exemptions to be granted to Closed Distribution System (CDS) operators (Article 28).

All Member states have to comply with EU legislation and therefore GB needs to transpose the requirements into UK law.

What are the policy objectives and the intended effects?

The two primary network-related objectives of the Third Package are to:

- (a) Improve market competition through better regulation, unbundling and reducing asymmetric information; and
- (b) Improve security of supply by strengthening the incentives for sufficient investment in transmission and distribution networks.

In the area of transmission and distribution networks the GB gas and electricity arrangements are already largely compliant with the Third Package.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

The minimum compliance option has been assessed throughout. It represents the Government's preferred option, as it ensures compliance with EU law at minimum cost to Government, regulator and industry.

The preferred option will include the following measures:

- Legislation and licence changes to allow for Ofgem certification of TSOs, including derogations under Article 9. Some modifications might also be required with respect to interconnectors and OFTOs.
- The Ofgem certification process itself, which will apply to all existing TSOs, interconnectors and OFTOs.
- Licence modifications and additional information gathering powers for Ofgem to ensure full compliance with the new requirements.

| | |
|--|---------------------------------|
| When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved? | Please refer to over-arching IA |
| Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? | No |

Ministerial Sign-off For Final 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: 12/01/2011

Summary: Analysis and Evidence Policy Option 2

Description:

Implement the minimum-compliance option for all measures.

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 1 | Net Benefit (Present Value (PV)) (£m) | | |
|---|----------------------|---|---|---|----------------------|
| | | | Low: n/a | High: n/a | Best Estimate: -0.85 |
| COSTS (£m) | | Total Transition (Constant Price) | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) | |
| | | 1 Year | | | |
| Low | | n/a | n/a | n/a | n/a |
| High | | n/a | n/a | n/a | n/a |
| Best Estimate | | | | | |
| Description and scale of key monetised costs by ‘main affected groups’ | | | | | |
| Administration and legal costs to TSOs associated with the TSO certification process, particularly where derogations are requested. Small administrative cost likely to Ofgem but not costed. Certification process has been costed for 25 TSO applications and the expected three derogation applications. Licensees might also experience some administration costs in making an application which might be one to twenty times the application fee costs. These have been included in calculations. | | | | | |
| Other key non-monetised costs by ‘main affected groups’ | | | | | |
| Legal and administration costs associated with legislation changes and licence modifications to ensure compliance with TSO and DSO unbundling requirements. | | | | | |
| BENEFITS (£m) | | Total Transition (Constant Price) | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) | |
| | | 1 Year | | | |
| Low | | n/a | n/a | n/a | n/a |
| High | | n/a | n/a | n/a | n/a |
| Best Estimate | | | n/a | n/a | n/a |
| Description and scale of key monetised benefits by ‘main affected groups’ | | | | | |
| No monetised benefits expected. | | | | | |
| Other key non-monetised benefits by ‘main affected groups’ | | | | | |
| Minimal, as GB is already largely compliant. Full compliance could lead to small gains in terms of more efficient networks (less congestion, more investment), decreased market concentration leading to lower energy prices for consumers, and higher innovation in the energy sector. The likely extent of these benefits is small, as under 10% of GB transmission assets are not already fully ownership unbundled and the EC acknowledges that the GB system exceptions (e.g. electricity transmission in Scotland) function well. | | | | | |
| Key assumptions/sensitivities/risks | | | | Discount rate (%) | |

Assumption 1 That no significant adjustments to ownership structures are required.

Assumption 2: Interests of financial investors (including step in rights) are protected by approach to drafting.

Assumption 3: Prohibition on exercise of shareholder rights is dealt with in a proportionate way.

Key risk: That investors are deterred if they are not able to exercise their rights in transmission and distribution businesses in the ways that they would expect.

| | | | | |
|--|-------------|----------|--|-----------------|
| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | In scope |
| New AB: n/a | AB savings: | Net: n/a | | no |

Enforcement, Implementation and Wider Impacts

| | | | | | | |
|---|--------------|----------------|--------------|---------------|--------------|--------------------------------------|
| What is the geographic coverage of the policy/option? | | | | | | |
| From what date will the policy be implemented? | | | | | | 03/03/2011 |
| Which organisation(s) will enforce the policy? | | | | | | Ofgem, EC |
| What is the annual change in enforcement cost (£m)? | | | | | | Small administrative costs for Ofgem |
| Does enforcement comply with Hampton principles? | | | | | | Yes |
| Does implementation go beyond minimum EU requirements? | | | | | | No |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | | | | Traded: n/a |
| 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: |
| Annual cost (£m) per organisation (excl. Transition) (Constant Price) | | | | | | Benefits: |
| | Micro | < 20 | Small | Medium | Large | |
| Are any of these organisations exempt? | Yes | Yes | 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 duties ¹⁶ <u>Statutory Equality Duties Impact Test guidance</u> | No | |
| Economic impacts | | |
| Competition <u>Competition Assessment Impact Test guidance</u> | Yes | 10 |
| Small firms <u>Small Firms Impact Test guidance</u> | No | |
| Environmental impacts | | |
| Greenhouse gas assessment | No | |
| Wider environmental issues <u>Wider Environmental Issues Impact Test guidance</u> | No | |
| Social impacts | | |
| Health and well-being <u>Health and Well-being Impact Test guidance</u> | No | |
| Human rights <u>Human Rights Impact Test guidance</u> | No | |
| Justice system <u>Justice Impact Test guidance</u> | No | |
| Rural proofing <u>Rural Proofing Impact Test guidance</u> | No | |
| Sustainable development | No | |
| <u>Sustainable Development Impact Test guidance</u> | | |

¹⁶ 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 |
|----|---|
| . | |
| | DECC call for evidence: http://www.decc.gov.uk/en/content/cms/consultations/eu_energy_mkt/eu_energy_mkt.aspx |
| | EC Third Package Impact Assessment: http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/2007_09_19_impact_assessment.pdf |
| | Transmission Price Control Review 2007-12: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=191&refer=Networks/Trans/PriceControls/TPCR4/ConsultationDecisionsResponses |
| | DECC consultation: http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx |

+ 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 | 0.85 | | | | | | | | | |
| Annual recurring cost | - | | | | | | | | | |
| Total annual costs | 0.85 | | | | | | | | | |
| 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)

1. Issue

Articles 9-11 of the Third Package Electricity and Gas Directives and Article 3 of the Electricity and Gas Regulations introduce new unbundling requirements on transmission system owners (TSOs). These articles affect existing electricity and gas transmission systems, interconnectors, and the new Offshore Transmission Operators (OFTOs). Article 26 of the Directives places further unbundling requirements on Distribution System Operators (DSOs). Provisions are also made for exemptions to be granted to Closed Distribution System (CDS) operators.

All Member States have to comply with EU legislation and therefore GB needs to transpose the requirements into UK law.

The two primary network-related objectives of the Third Package are to:

- (a) Improve competition through better regulation, unbundling and reducing asymmetric information; and,
- (b) Improve security of supply by strengthening the incentives for sufficient investment in transmission and distribution capacities.

In the area of transmission and distribution networks, the GB gas and electricity arrangements are already largely compliant with the Third Package.

2. Articles and description of options considered

The minimum compliance option has been assessed throughout. It represents the Government's preferred option.

a) Transmission unbundling

The Third Package requires full ownership unbundling of transmission assets. However, article 9 allows for three derogation options:

- (a) The Independent System Operator (ISO) model: where, on 3 September 2009, the transmission system was part of a vertically integrated undertaking (VIU), the Member State may designate an ISO. Such an ISO would act as the system operator and would have, for example, independent responsibility for investment planning and management of third party access. The TSO would provide support, including through finance for investments identified by the ISO.
- (b) The Independent Transmission Operator (ITO) model: where, on 3 September 2009, the transmission system was part of a VIU, the TSO may remain part of the owning company. However, the TSO will need to comply with stringent rules on ring-fencing to ensure that it is completely independent from the rest of the VIU.
- (c) Arrangements providing greater independence than the ITO model: where, on 3 September 2009, the transmission system was part of a VIU and there are arrangements in place that guarantee more effective independence of the TSO than the ITO model, a Member State may decide to apply the ownership unbundling derogation.

There are a number of companies that might seek such derogations:

Scottish TSOs (SPET and SHETL): When the single GB energy market (BETTA) was created Scottish Power and SSE retained ownership of their transmission assets. These vertically integrated companies also own distribution, generation and supply businesses. There are, however, important regulatory safeguards to promote competition and efficient network operation including a single system operator (National Grid) and industry codes, overseen by Ofgem, governing such issues as investment and network access. Having multiple transmission owners provides the regulator with important comparators in agreeing network investment and pricing and a potential competitive element in delivering new infrastructure. Whilst transmission assets could not now be included in vertically integrated ownership structures we do not believe that they have been a barrier to the development of a competitive market.

Interconnector UK (IUK): Although no one has a controlling interest in the company, the unbundling text of the Directives still catches minority shareholders.

Certification

The derogations listed above will be granted by Ofgem, as National Regulatory Authority, but will also have to be approved by the European Commission. They will form part of the **TSO certification process** described in articles 10 and 11 of the Electricity and Gas Directives. Part of the certification process will need to be reflected in legislation with some of the detail included in licences.

The Government's final proposals are that:

- Ofgem will be the certification authority (and NIAUR in Northern Ireland).
- The ITO model will be made available for gas inter-connectors only. The Government's view is that this will provide important flexibility to enable Ofgem and the regulatory authorities in other Member States to arrive at consistent cross-border regulatory arrangements.

TSO certification will be required for existing electricity and gas TSOs, interconnectors and OFTOs.

b) Distribution unbundling

Article 26 of the Electricity and Gas Directives highlights some additional unbundling requirements for Distribution System Operators (DSOs). DECC and Ofgem's analysis together with the responses to the call for evidence suggest that GB is largely compliant in this area.

3. Benefits

a) Transmission unbundling

The EC Impact Assessment (pp. 33-45) highlights the following broad categories of benefits from full ownership unbundling:

- greater investment in the network – e.g. the EC IA finds that in markets with ownership unbundled TSOs, investment in interconnectors as a proportion of congestion revenues is double that in markets without full unbundling (33% compared to 17%), in turn leading to less congestion.
- reduced market concentration – “average market shares of the largest generator were in 2005 in Member States with legal unbundling 73% versus 47.7% in Member States with ownership unbundled TSOs”.

- lower energy prices for domestic and industrial consumers – for industrial consumers “the price difference between the two country samples over the entire period of nine years was thus 9% in favour of Member States with ownership unbundling”; for household electricity users the difference was 24% in favour of Member States with ownership unbundling.
- greater levels of research and innovation in the electricity sector – “while it is difficult to attribute increased research expenditures to single factors, open competitive markets seem to support innovation and research in energy”.

The association between ownership unbundling and these positive outcomes is therefore strong and significant. Caution, however, should be exercised in interpreting these results – whereas the EC Impact Assessment does demonstrate a strong association, it does not conclusively prove a causal link.

| Transmission Owner | Regulated Asset Value (RAV), at close 2006/07 | Share of total transmission RAV |
|---|--|--|
| National Grid Electricity Transmission (NGET) | £5,416m | 57.3% |
| National Grid Gas NTS (NGG) | £2,981m | 31.5% |
| Scottish Power Transmission Ltd (SPTL) | £288m | 3.0% |
| Scottish Hydro Electricity Transmission Ltd (SHETL) | £764m | 8.1% |

Source: Ofgem Transmission Price Control Review (2007-12)

However, even if GB transmission assets are not fully unbundled the extent to which the UK will benefit from the Third Package is limited by two factors. Firstly, the large majority of transmission assets are unbundled: the entire gas transmission network is fully ownership unbundled and the entire electricity network in England and Wales is ownership unbundled. It is only the Scottish electricity TSOs that are not ownership unbundled, representing less than 10% of the total transmission Regulated Asset Value (RAV). In the case of Scotland, the System Operator function is independent, ensuring access, charging and other activities take place on a non-discriminatory basis.

The effectiveness of the current arrangements in Scotland is also recognised in the EC Impact Assessment (p. 41).

“SP and SSE promote the ISO solution while NG, Ofgem and the UK Department of Trade and Industry express a more reserved position. A common criticism is that the ISO is only a second best solution to ownership unbundling and only functions reasonably well in Scotland because some particularities:

- (i) *The Scottish electricity market is relatively small and largely isolated from the rest of the UK. The grid is therefore relatively easy to manage;*
- (ii) *NG is an experienced, ownership unbundled TSO in the neighbouring area guaranteeing its independence and preventing “cross-border” problems and*
- (iii) *Ofgem is a strong regulator closely monitoring the relationship between the ISO and the asset owners.”*

Having said that, three responses to the call for evidence (from National Grid, one of the Big Six, and an independent DSO) support full unbundling, whereas only SSE and Scottish Power argued in

favour of the current system. This suggests that there might be some additional competition gains to be had from full unbundling in the GB market.

In DECC's consultation on implementation of the EU Third Package, the Government was minded not to make the ITO model available as it may not be compatible with GB market arrangements. The Government's view was that the ITO model does not guarantee independence as effectively as the arrangements in the GB on-shore system. As noted above, the onshore gas and electricity systems are either fully ownership unbundled or benefit from a separate System Operator function that ensures access, charging and other activities take place on a non-discriminatory basis.

However, consultees have made the case for the ITO model for gas inter-connection. These arguments are based on potentially higher costs of transition to other Third Package compliant models, as well as the need to ensure that regulators in each of the responsible Member States have maximum flexibility to reach agreement and ensure consistent cross-border regulatory arrangements. The Government agrees that there is a case for the ITO model to be available in these circumstances, and proposes to make the ITO model available for gas interconnectors only. Electricity interconnection is fully ownership unbundled.

b) Distribution unbundling

The EC Impact Assessment (pp. 57-58) suggests that "as with TSOs, the more effective unbundling of DSOs would in principle contribute to the creation of a level playing field at the retail level, mainly by eliminating incumbents' information advantages, preventing cross-subsidies and ensuring fair network access and transparent customer switching procedures... [It] would thus contribute to the contestability of the retail market and thus facilitate market entry by third party suppliers", leading to lower prices for consumers.

Article 26 of the Electricity and Gas Directives highlights some additional unbundling requirements for Distribution System Operators (DSOs). DECC and Ofgem's analysis together with the responses to the call for evidence suggest that GB is largely compliant in this area.

4. Costs

a) Transmission unbundling

Implementation costs

These relate to putting in place legal and administration arrangements to implement the Third Package.

There may be some small additional administration costs for Ofgem regarding certifying TSOs in line with the processes set out in the Package, enforcement costs or costs associated with facilitating the consultation of system users. These costs are unlikely to be material, although Ofgem will be in a better position to assess these costs after transposition of the Directive.

There would be additional administration costs to licensees. Application fees for licences, as charged by Ofgem, tend to cost between £350 and £1,050.¹⁷

¹⁷ <http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasnd0electricityapplications.pdf>.

In addition to the cost of the licence, licensees might also experience some administration costs in making an application which might be one to twenty times the application fee costs. (This is based on the estimated cost of applying for a gas transporter licence.) Applying these costs to the approximately 25 companies that may require TO certification (including current gas and electricity TOs, interconnectors and OFTOs), would imply an additional administrative burden to the private sector in the range of £17,500 to about £550,000.

For those seeking derogations we expect costs to be higher, potentially in the range of £100k per derogation – a cost broadly equivalent to that assumed for existing OFTOs to engage in the development of the new offshore regime in the March 2009 Offshore Electricity Transmission Impact Assessment. As three TOs are expected to seek derogations, the derogation costs are estimated at £300,000.

Therefore, the total cost of the certification process is estimated at around £850,000.

Enforcement and monitoring cost issues

On transmission ownership unbundling we would expect a low level of enforcement/monitoring post-certification. The areas that could arise are changes in ownership (not strictly enforcement, but will need monitoring) and transmission companies' compliance with undertakings that they give, such as rights in other energy interests. On the latter, we think there will be little or no activity as previous experience has indicated that once the governance and separation is established at the outset, then compliance rates are very high.

Other cost issues

In their response to the call for evidence, SSE suggested that there are potential costs in terms of additional risk and uncertainty for required transmission investments associated with moving towards a different ownership unbundling regime as part of Ofgem's certification process.

However, the evidence of recent European experience in ownership unbundling presented in the EC Impact Assessment suggests that the commercial and investment risks associated with unbundling tend to be overplayed. The EC find (p. 35) that "shareholders have in fact in almost all cases benefited from increasing share prices during and after the ownership restructuring". Moreover, there is "some evidence against the common view that the predictable revenue stream of the network business makes a vertically integrated companies [sic] less risky than a company without network assets, allegedly giving it cheaper access to investment capital".

Overall, the Commission do not find any negative impact on security of supply as a result of reduced network investment likely to arise from the proposed measures. It is worth restating the caveat that this conclusion is reached without having established a robust counterfactual – in other words, we do not know whether these companies would have done even better in terms of their value and credit-worthiness in the absence of unbundling.

b) Distribution unbundling

As distribution unbundling is an existing requirement and has already been implemented, there should not be any additional costs. All companies are compliant so we do not envisage any monitoring or enforcement activity.

5. Competition impact

The Office of Fair Trading's guidance, "Completing competition assessments in impact assessments", suggests answering the following four questions to determine whether the proposal will have a significant impact on competition.¹⁸ Will the proposal:

- Directly limit the number or range of suppliers?
- Indirectly limit the number or range of suppliers?
- Limit the ability of suppliers to compete?
- Reduce suppliers' incentives to compete vigorously?

The unbundling proposals for transmission and distribution systems in the EU Third Package, does not limit the number of suppliers, limit the ability of suppliers to compete nor reduce their incentives to compete vigorously.

As the large majority of transmission assets are already unbundled, the extent to which the UK can benefit is limited. It is only the Scottish electricity TSOs that are not ownership unbundled, representing less than 10% of the total transmission Regulated Asset Value.

However, three responses to the call for evidence (from National Grid, one of the Big Six, and an independent DSO) support full transmission unbundling, whereas only SSE and Scottish Power argued in favour of the current system. This suggests that there might be some additional competition gains to be had from full unbundling in the GB market.

The EC Impact Assessment (pp. 57-58) suggests that like TSOs, the more effective unbundling of DSOs could contribute to the creation of a level playing field at the retail level. This would be through eliminating incumbents' information advantages, preventing cross-subsidies and ensuring fair network access and transparent customer switching procedure. This would contribute to the contestability of the retail market and thus enable market entry by third party suppliers, leading to lower prices for consumers.

6. Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

7. Risks

A number of call for evidence responses raise concerns about the fact that the Third Package precludes undertakings with ownership of energy supply, generation or production from owning shares in an unbundled TSO and any subsequent voting rights associated with that share ownership.

National Grid, for example, "is particularly concerned about the efficacy, costs and complexity of any rules which might be used to implement the unbundling regime, in the manner contemplated", by the Commission. "It is not clear how shareholders of network operators might

¹⁸ http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft876.pdf

be identified as being, for example, suppliers, or how they might be prohibited from voting. It would seem [...] sub-optimal to impose obligations on such shareholders and is not in keeping with the transmission independence which already exists in GB”.

We plan to implement these provisions in a way that is as light touch as possible. Please refer to Chapter 3 in the Government Response.

| | |
|---|--|
| Title: Third Package: Gas Storage and LNG Facility Impacts Lead department or agency: Department of Energy and Climate Change Other departments or agencies: n/a | Impact Assessment (IA) |
| | IA No: DECC0006 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU <small>Type of measure: Legislation</small> |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The EU Third Energy Market Package (the 'Third Package') came into force on 3 September 2009 and includes Directives and Regulations on gas and electricity. The Directives will need to be transposed into GB law and the Regulations will be directly applicable from 3 March 2011. This impact assessment forms part of a suite of impact assessments on the Third Package and focuses on the parts of the Package that are targeted at gas storage and liquefied natural gas (LNG) facilities. All Member States have to comply with EU legislation and therefore GB needs to transpose the requirements into UK law.

What are the policy objectives and the intended effects?

For gas storage and LNG, the high-level objectives of the Third Package are to increase the access to, and transparency of, gas storage and LNG facilities in a consistent way throughout the European Union. These changes will allow all market participants to stay informed of the current status of individual storage and LNG facilities, while ensuring they have access to these flexible supply sources when needed. By doing so, the Package should enhance investment signals, as well as creating greater security

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

There is a choice between implementing the key provisions through the Gas Act 1986 (legislation) or through the introduction of licences for Storage System Operators. The consultation document contained both options and these were discussed with stakeholders during the consultation. Following responses to our consultation, the preference of most stakeholders was to implement the provisions through legislation.


The key reasons cited by respondents for preferring legislation, were uncertainty of a licensing approach and the risk to investment, duplication of provisions with other licensing schemes, increased administrative burden, and the perceived potential for regulatory creep under a licensing regime. Some respondents also mentioned that the current regulatory framework was tried, tested and should be trusted going forward.

| | |
|--|---------------------|
| 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 |
| Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? | Yes |

Ministerial Sign-off For Final 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: 12/01/2011

Summary: Analysis and Evidence Policy Option 3

Description:

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|--|----------------------|---|---|---|-----------------------|
| | | | Low: | | Best Estimate: -£0.99 |
| COSTS (£m) | | Total Transition (Constant Price) | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) | |
| Low | | Year | | | |
| High | | | | | |
| Best Estimate | | N/A | | | |
| <p>Description and scale of key monetised costs by ‘main affected groups’</p> <p>Implementation through legislative change avoids the licence fee and the administrative costs of applying for the licence. Businesses will still need to ensure compliance, and this may require legal and auditing services, although no evidence has been provided to suggest that these would be in addition to companies’ existing arrangements.</p> <p>Costs to Ofgem are presented above. They have been provided by Ofgem and relate to additional costs to powers of enforcement. Costs of processing TPA exemptions, and information handling and disclosure, have been assessed as marginal.</p> | | | | | |
| <p>Other key non-monetised costs by ‘main affected groups’</p> <ul style="list-style-type: none"> - Any loss of economies of scope due to any restrictions on the ability of vertically integrated firms to coordinate activities across different functions (for example shared services) - Any changes to the access requirements and services offered by storage sites with negotiated third-party access (nTPA) - Additional information provided by LNG and storage facilities | | | | | |
| BENEFITS (£m) | | Total Transition (Constant Price) | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) | |
| Low | | Year | | | |
| High | | | | | |
| Best Estimate | | N/A | N/A | N/A | |
| <p>Description and scale of key monetised benefits by ‘main affected groups’</p> | | | | | |
| <p>Other key non-monetised benefits by ‘main affected groups’</p> <p>The changes to storage and LNG practices due to the Third Package will increase competition, create greater movement of gas between markets, and will reduce the market power of certain market participants. Benefits will be perceived by investors, through greater regulatory certainty; storage users, through greater transparency and non-discriminatory access; and end consumers, through greater security of supply and competitive pricing as highlighted in the European</p> | | | | | |
| Key assumptions/sensitivities/risks | | | | Discount rate (%) | 3.5 |

The consultation responses contained little firm evidence to inform DECC's estimate of the costs and benefits of implementing the Third Package obligations in respect of obligations on gas storage and LNG operators. The loss of economies of scope could be more significant than judged here depending on the size and diversity of operations the vertically integrated unit (VIU) is engaged in. DECC has not attempted to assess the impact on future facilities, as this would require predicting the number and timing

| | | | | |
|--|-----------------|----------|--|-----------------|
| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | In scope |
| New AB: N/A | AB savings: N/A | Net: N/A | Policy cost savings: N/A | No |

Enforcement, Implementation and Wider Impacts

| | | | | | |
|---|--------------|----------------|--------------|----------------|--------------------|
| What is the geographic coverage of the policy/option? | | | | | |
| From what date will the policy be implemented? | | | | | |
| 03/03/2011 | | | | | |
| Which organisation(s) will enforce the policy? | | | | | |
| Ofgem | | | | | |
| What is the annual change in enforcement cost (£m)? | | | | | |
| 0.067 | | | | | |
| Does enforcement comply with Hampton principles? | | | | | |
| Yes | | | | | |
| Does implementation go beyond minimum EU requirements? | | | | | |
| No | | | | | |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | | Traded: | Non-traded: |
| | | | | N/A | |
| 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: |
| | | | | N/A | N/A |
| 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 duties ¹⁹ <u>Statutory Equality Duties Impact Test guidance</u> | No | |

¹⁹ 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.

| | | |
|---|-----|----|
| Economic impacts | | |
| Competition <u>Competition Assessment Impact Test guidance</u> | Yes | 10 |
| Small firms <u>Small Firms Impact Test guidance</u> | No | |
| Environmental impacts | | |
| Greenhouse gas assessment | No | |
| Wider environmental issues <u>Wider Environmental Issues Impact Test guidance</u> | No | |
| Social impacts | | |
| Health and well-being <u>Health and Well-being Impact Test guidance</u> | No | |
| Human rights <u>Human Rights Impact Test guidance</u> | Yes | 11 |
| Justice system <u>Justice Impact Test guidance</u> | Yes | 11 |
| Rural proofing <u>Rural Proofing Impact Test guidance</u> | No | |
| Sustainable development | No | |
| <u>Sustainable Development Impact Test guidance</u> | | |

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 |
| . | |
| | <u>European Commission Impact Assessment on Third Legislative Package</u> |
| | <u>DECC's Call for Evidence</u> |
| | <u>Consultation on the Implementation of the EU Third Internal Energy Package</u> |
| | |

+ 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 | - | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring cost | - | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 |
| Total annual costs | - | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 |

| | | | | | | | | | | |
|----------------------------------|---|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Transition benefits | - | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring benefits | - | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual benefits | - | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

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

Evidence Base (for summary sheets)

Strategic Overview and Rationale for Intervention

The EU Third Energy Package (the 'Third Package') came into force on 3 September 2009 and includes Directives and Regulations on gas and electricity. The Directives will need to be transposed into GB law and the regulations will be directly applicable from 3 March 2011.

This impact assessment forms part of a suite of impact assessments on the Third Package; it focuses on the parts of the package that are targeted at gas storage and liquefied natural gas (LNG) facilities.

There are a range of requirements in the Third Package which are intended to have the effect of reducing market power, increasing competition, increasing efficient investment and the use of assets, helping gas to flow where it is needed most, and enhancing security of supply. The UK wholesale gas market is already one of the most competitive in Europe, and many of the measures in the Third Package are already in place. Since 2004, the UK has returned to being a net importer of gas, and a significant amount of gas now comes to the UK from the EU. These links with Europe, allied with declining indigenous production, mean that it will become increasingly important for the UK's security of gas supply and the affordability of our gas supplies that the UK can source sufficient gas at competitive prices from the EU. Greater access to storage and LNG facilities throughout the EU will help the UK achieve this by increasing the gas potentially available to the UK market.

Background and Assessment of the Relevant Articles

This impact assessment is for the articles in the Gas Directive and Gas Regulation which specifically target storage and LNG operations (for example, the measures which affect transmission system operators are considered in a separate impact assessment). The key requirements of the Gas Directive and Regulation (and whom they might apply to) are as follows:

1. Legal and functional unbundling is required for those vertically integrated storage and LNG operators that are technically and economically necessary (TEN) for the efficient running of the system. The TEN requirement is already the test as to whether negotiated Third Party Access (nTPA) is required for gas storage; therefore for this impact assessment it has been assumed that if nTPA is presently required then legal and functional unbundling would also be required under article 15 of the Gas Directive.

Of the nine commercially operational gas storage sites, two are required to have nTPA - Rough and Hornsea, both of which are already legally unbundled.

DECC is aware that Centrica Storage Limited (the legally unbundled company that owns the Rough gas storage facility), whilst separate from the vertically-integrated parent company's operations, also operates the York field in the middle North Sea, around 8km north of Rough. Because the York field deals with the production of gas, Centrica Storage Limited is in the process of separating it from Rough.

2. Commercially sensitive information needs to be treated appropriately. The UK's common law of confidence already prevents the disclosure by an undertaking of confidential information that is not their own. However, all vertically integrated storage and LNG facilities need to ensure that certain information which could be commercially advantageous is not shared with other part of the business.

3. The arrangements for access to storage for gas storage facilities with nTPA have been altered. These arrangements would presently apply to the Rough and Hornsea storage

facilities. Ofgem has recently issued a guidance document on the third party access regime for gas storage facilities²⁰, on which it is seeking stakeholder views.

4. Under the Gas Regulation, all storage and LNG facilities operators must provide a range of data that must be made publicly available. LNG and storage operators of TEN facilities are required to facilitate the trading of capacity to ensure that the storage capacity is being utilised. Storage operators must ensure that a range of storage services are available at TEN storage facilities.

Table 1: Summary of Articles with Significant Potential Impact

| Article | Key Requirements | Who It Applies to* |
|---|--|---|
| 15 of the Directive: Legal and functional Unbundling | <ul style="list-style-type: none"> Create a separate legal company Separate management structure at the operational level Separate remuneration packages Common services, where unavoidable, must be contracted at market rates Compliance Program must be put in place | TEN SSOs & LNG SOs |
| 16 of the Directive: Commercially Sensitive Information | <ul style="list-style-type: none"> Confidentiality must be ensured Non-disclosure of activities to other parts of business Information necessary for competition should be made public | <ul style="list-style-type: none"> All LNG SOs & SSOs VIU LNG SOs & SSOs All LNG SOs & SSOs |
| 33 of the Directive: Access to Storage | <ul style="list-style-type: none"> Regulatory authority to determine and publish criteria for access regime Storage facilities available for third party access must be published by the regulatory authority and/or by the SSOs System users must be consulted on the proposed criteria | <ul style="list-style-type: none"> Ofgem Ofgem/ TEN & SSOs Ofgem/ System Users |
| 15 of the Regulation: Access Services | <ul style="list-style-type: none"> Information on access services to be made publically available Potentially provide a range of services (e.g. interruptible services, long and short term services, and bundled and unbundled service) Network users must offer guarantees as a pre-requisite for access Capacity limits should be justified on the basis of technical constraints | <ul style="list-style-type: none"> TEN SSOs & LNG SOs TEN SSOs & LNG SOs All network users TEN SSOs & LNG SOs |
| 17 of the | Maximum storage capacity will be made available to the market | TEN SSOs & |

²⁰ Ofgem, November 2010: "Guidance on the Third Party Access regulatory regime for gas storage facilities in Great Britain"

| | | |
|---|--|--|
| Regulation: Capacity allocation | Capacity allocation mechanisms must be non-discriminatory and transparent; these must be published Measures must be taken to avoid capacity hoarding | LNG SOs |
| 19 of the Regulation: Transparency Requirements | Data, in quantified terms, on contracted, available, and total storage must be published Data must be published in a non-discriminatory way and must be meaningful Make public information on the inflows, outflows and available capacity, in a manner consistent with how services are offered Information on derivation of tariffs must be published | TEN SSOs & LNG SOs TEN SSOs & LNG SOs All SSOs and LNG SOs TEN SSOs & LNG SOs |
| 22 of the Regulation: Trading of Capacity Rights | Capacity must be freely tradable Trading must take place in a transparent and non-discriminatory manner. Contracts and procedures must be harmonised; details of which must be passed to the regulator Secondary market for trading must be available. | TEN SSOs & LNG SOs |

***TEN = technically and economically necessary for providing efficient access to the system; VIU = Vertically integrated Undertakings; SSOs = Storage system operators; LNG SOs = LNG storage operators.**

Table 2 summarises the other articles which apply specifically to LNG or storage facilities where either GB is either already compliant or the potential impact of the measure is immaterial. These articles are not considered further in this impact assessment.

Table 2: Summary of Other Articles in the Gas Directive

| Article | Key Requirements | Who It Applies to* |
|---------|---|----------------------------------|
| 4 | Non-discrimination in authorising the construction/operation of gas facilities. | DECC / Ofgem |
| 8 | The development of technical rules where required (such as safety requirements), for natural gas facilities. | Various government organisations |
| 13 | Non-discrimination between users and provision of sufficient information to TSO and system users. | SSOs and LNG SOs |
| 32 | LNG facilities must publish tariffs for the purposes of third party access, and these must be applied without discrimination between users. | LNG SOs |
| 36 | New Infrastructure may be granted, for a predefined period, exemption from offering third party access. | LNG SOs & TEN SSOs |

* **TEN = technically and economically necessary for providing efficient access to the system; VIU = Vertically integrated Undertakings; SSOs = Storage system operators; LNG SOs = LNG storage operators.**

Options considered

Two policy options were presented at consultation stage, neither of which goes beyond the minimum implementation of the measures:

Option 1: Implement the measures solely through the legislative changes (with no new licensing regime) which would be enforced by Ofgem.

This option would see the Gas Directive and relevant provisions of the Gas Regulation be implemented into GB law through changes to legislation. Designation of SSOs and LNG SO would be fulfilled by DECC / Ofgem listing these operations. Ofgem would be given sufficient powers to enforce the requirements of the Gas Regulation and Gas Directive where present powers are judged insufficient.

Option 2: Implement the measures and introducing a licensing regime to be administered by Ofgem.

This option would see the Gas Directive and relevant provisions of the Gas Regulation be implemented into GB law through changes to legislation and the introduction of licences. Designation of SSOs and LNG SOs would be fulfilled by a licensing regime administered by Ofgem. This would involve Ofgem having sufficient powers to enforce the requirements of the Gas Regulation and Gas Directive and, ultimately, to remove undertakings' licence to operate.

Option 1: Implement the measures solely through the legislative changes (with no new licensing regime) which would be enforced by Ofgem.

Costs

The present value of costs to Ofgem is estimated to be £0.99m. This relates to additional costs to powers of enforcement, which have been estimated by Ofgem at £67,000 per annum. Using a 3.5% discount rate over 20 years, this equates to a present value of just under a million pounds in 2010 prices. Processing TPA exemptions, and information handling and disclosure, have been assessed by Ofgem as marginal.

Where costs to business are concerned, the consultation responses contained little firm evidence to inform DECC's estimate. The following section provides a qualitative assessment of such costs broken down for each relevant Article of the Directive.

Impact on Business

Article 15 of the Directive: Few changes would be needed to current arrangements in order to comply with this article.

Article 16 of the Directive: As regards to limiting the amounts of information that can be shared between different parts of a vertically integrated firm, there may be some costs in terms of reduced economies of scope (for example, from the loss of shared services).

Article 17 of the Regulation: Few changes would be needed to current arrangements in order to comply with this article. Some costs are likely to be incurred due to the requirement to publish details on capacity allocation mechanisms. These costs are assumed to be small.

Article 19 of the Regulation: This is an extension of the existing rules on what information SSOs and LNG SOs must make publically available, and compliance costs are likely to be small. Some SSOs and LNG SOs currently publish detailed information that at least in part complies with the article. For

others, or where certain information requirements are not currently met by any SSO or LNG SO, such information should be collected as part of normal commercial operations; making this information publically available is unlikely to involve significant expenditure.

Article 22 of the Regulation: This pertains to the trading of capacity rights. Presently, secondary trading is expected under nTPA for both storage and LNG, while other specified trading requirements should also be practiced by all under the current market arrangements. Only where companies do not collect adequate information on market trading are costs likely to be incurred. Otherwise, the sole cost under this article should involve providing information to the regulator in an appropriate format. These costs are assumed to be small.

Benefits

Changes to storage and LNG practices, due to the Third Package, will increase competition, create greater movement of gas between markets, and will reduce the market power for certain market participants. In the UK, benefits will be perceived by investors, through greater regulatory certainty; storage users, through greater transparency and non-discriminatory access; and end consumers, through greater security of supply and competitive pricing as highlighted in the European Commission's own impact assessment.

Implementation Benefits

The benefits of implementation through changes to legislation (and without using licences) are considered relative to the option of introducing licences, below.

- Legislation currently exists in the form of the Gas Act 1986 that can be amended in order to implement the provisions of the Third Package
- Legislation provides regulatory certainty, which is important for investors

Option 2. Implement the measures and introducing a licensing regime to be administered by Ofgem

This option also sees the introduction of the Third Package and therefore the costs and benefits of the measures themselves are relative to the first option.

However, in this option a licensing regime would be used to designate storage and LNG system operators and as a vehicle to enforce the relevant measures. The disadvantages and advantages of this are set out below and considered relative to option 1.

Cost

Implementation Costs

- a licence regime could increase regulatory risk and have an adverse effect on long-term investment in LNG and gas storage infrastructure;
- it could be seen as an overly elaborate method of implementing a number of relatively light touch requirements;
- much of the material that would go into a licence already exists in legislation; this could be amended to meet the requirements of the Third Package, or it may be necessary to extract it to avoid being duplicated in a licence;
- the introduction of a new licence regime would require legislation; and
- potentially some duplication as offshore gas storage projects are already required to hold a

licence from DECC (which were introduced under the Energy Act 2008 to simplify the consents regime for offshore gas infrastructure).

There would also be an additional administrative cost to licensees. Application fees for licences, as charged by Ofgem, cost between £450 and £1,050²¹. In addition to the cost of the licence, licensees might also experience some administration costs in making an application which might be one to twenty times the application fee (this is based on the estimated cost of applying for a gas transporter licence). Applying these costs to the 15 storage and LNG facilities that are existing or under construction would imply an additional administrative burden to the private sector in the range of £13,500 to £330,750 as detailed in Table 3 below.

Table 3: Costs to private sector from a licence regime administered by Ofgem

| Cost range calculation (£) | Low | High |
|---|---------------|----------------|
| Licence fee | 450 | 1,050 |
| Admin cost (1 to 20 times licence fee) | 450 | 21,000 |
| Total cost per licensee | 900 | 22,050 |
| Total cost to private sector (to account for 15 storage sites) | 13,500 | 330,750 |

Benefits

Implementation Benefits

- a licence would provide clarity on the new requirements in the Directive for LNG and gas storage operators while ensuring that Ofgem have the appropriate means of enforcement;
- future changes such as those required to address EU network codes (which are binding) or to implement other changes could be easier to implement via licensing rather than legislation; and
- a licence would consist of standard conditions that could be switched-on and off to reflect the size and type of each facility being licensed.

Risks and assumptions

DECC does not hold detailed information on the precise working and operations of all LNG and storage sites, and the consultation responses contained little firm evidence to inform DECC's estimates of the costs and benefits of implementing the Third Package obligations. **It is possible, therefore, that there is a greater or lesser impact on market participants than assumed in this impact assessment. Specifically, the loss of economies of scope could be more significant than judged here depending on the size and diversity of operations the VIU is engaged in.** Also, DECC has not attempted to assess the impact on future facilities, as this would require predicting the number and timing of projects as well as which measures would be relevant to them.

Consultation responses

Table 4: Summary of responses to Question 6 in the Consultation Document

²¹ Ofgem, September 2010: "Promoting Choice and Value for all Gas and Electricity Customers: Guidance for Gas and Electricity Licence Applications"

Should the Gas Directive requirements for storage and LNG operators be introduced through a new licence regime or by amending existing legislation?

| | |
|------------------------------------|-----|
| In favour of legislation | 61% |
| In favour of license regime | 29% |
| Indifferent | 11% |

In response to the Government's question as to whether the new requirements on gas storage and LNG operators should be implemented through amending legislation or through a new licensing regime, the majority of respondents supported amending legislation. The key reasons which were cited were uncertainty of a licensing approach and the risk to investment, duplication of provisions with other licensing schemes, increased administrative burden, and the perceived potential for regulatory creep under a licensing regime. Some respondents also mentioned that the current regulatory framework was tried and tested.

Some organisations supported the view that any new requirements from the Third Package should be implemented via a new licensing regime. However, these organisations also expressed the view that any new licence regime should not be onerous for the industry and should not discourage new investment.

Finally, a small proportion of respondents did not see much distinction between a licensing regime and legislation and simply called for clarity, fairness, and proportionality in the approach.

Preferred option

There are merits to both legislation and a licensing regime as described in detail in this impact assessment. DECC has selected to implement the obligations of the Third Package through legislative change, which is in line with the majority view expressed in the consultation responses.

Competition Assessment: Specific Impact Test

As per Office of Fair Trading (OFT) guidelines on assessing the impacts of regulation on competition in affected markets, the following section seeks to respond to four specific questions.

1. In any affected market, would the proposal directly limit the number or range of suppliers?

No. The proposals are designed to increase competition in the provision of storage and LNG capacity. As such, the number of suppliers will not be directly or indirectly limited by the proposals. Greater regulatory certainty will enhance investment prospects, and make entry to the market easier by requiring legal and functional unbundling of established VIUs. Players in the wholesale market will benefit from the Regulations through provisions for non-discriminatory third party access to storage capacity, and non-discriminatory access to information relating to LNG and storage inflows, outflows, available capacity, and tariff derivation.

2. In any affected market, would the proposal indirectly limit the number or range of suppliers?

No. See above.

3. In any affected market, would the proposal limit the ability of suppliers to compete?

No. See above.

4. In any affected market, would the proposal reduce suppliers' incentives to compete vigorously?

No. See above.

Social Impacts – Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

Social Impacts – Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

| | |
|---|-------------------------------------|
| Title: Third Package: Articles concerning customers right to switch energy supplier within 3 weeks and receive final account closure within 6 weeks of switching Lead department or agency: Department for Energy and Climate Change Other departments or agencies: | Impact Assessment (IA) |
| | IA No: DECC0003 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Legislation |
| Contact for enquiries: Marina.Pappa@decc.gsi.gov.uk Luke.Davison@decc.gsi.gov.uk | |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Article 3(5a) of the Electricity Directive and Article 3(6a) of the Gas Directive requires Member States to ensure that where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected within three weeks. In addition, Annex 1 (j) of both the Electricity and Gas Directive require that consumers receive a final closure account following any change of natural gas/electricity supplier no later than six weeks after the change of supplier has taken place.

There is currently no obligation on suppliers to ensure these requirements are met. It is therefore necessary for Government to put in place new Licence Conditions in order to comply with these new requirements.

What are the policy objectives and the intended effects?

These measures are designed to improve the switching process for consumers. High levels of switching are associated with greater competition in the market, which should result in better outcomes for consumers and suppliers. Eventually we would expect higher levels of switching to be associated with more innovation and a greater number of products on offer leading to greater efficiency in the market.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Two main options have been considered: Option 1 involves requiring suppliers to specify in contracts with customers a period of 14 calendar days for domestic accounts (from the date the contract has been agreed) in which customers can decide whether they want to proceed with the contract. The contract will specify that unless the customer cancels or there are extenuating circumstances, the supplier will be obliged to switch the customer within 21 days of the end of that period. Energy suppliers, guided by Ofgem, will be required to make some improvements to their systems and processes to ensure that progressively more people are able to switch within 21 days. Ofgem's guidance on system improvements should ensure a reasonable balance between switching times and overall customer benefit. Option 2 involves requiring suppliers to stipulate in contracts with customers that they will switch customers within three weeks, starting from the day the customer receives the terms and conditions (i.e no cooling off period is included).

Our preferred option is Option 1 as this option achieves a similar level of benefits as Option 2 while maintaining consumer protection, and imposing lower costs on industry. Both options include a new Licence Condition and an additional requirement on suppliers to close a customer's account within six weeks after they have switched to a new supplier.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

Please refer to overarching IA

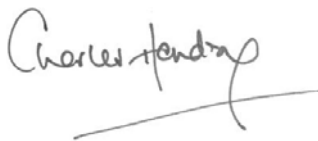
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

No

Ministerial Sign-off For Final 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:



12/01/2011

Summary: Analysis and Evidence Policy Option 4

Description:

Licence condition to require suppliers to include in the contract with customers a term to say that unless there are extenuating circumstances, they will start supplying electricity or gas to the new customer within three weeks of the end of the cooling off period. Suppliers to be required to make improvements to their systems and processes to ensure that as many people as possible are able to

switch within these timescales.

| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 1 | Net Benefit (Present Value (PV)) (£m) | | |
|---|--|------------------------|--|--|---------------------|
| | | | | High: -1 | Best Estimate:-1.75 |
| COSTS (£m) | Total Transition (Constant Price) | | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) | |
| Low | 1 | 1 | | 1 | |
| High | 2.5 | | | 2.5 | |
| Best Estimate | 1.75 | | | 1.75 | |
| Description and scale of key monetised costs by ‘main affected groups’ | | | | | |
| We would expect this option to impose some administrative costs on gas and electricity suppliers in order to improve their systems and processes. There will also be a small administrative costs in amending their standard terms and conditions. None of these exact costs are known. However, the costs of improving systems are estimated at around £1.5m to cover initial system changes and ongoing costs arising from increased information checking at early stages of the switching process ²² . We would expect the cost of amending terms and conditions to be no more than £0.5m. This upper bound estimate is based on an assumption of a one-off increase in costs of £0.01 per customer bill. | | | | | |
| Other key non-monetised costs by ‘main affected groups’ | | | | | |
| There will be some costs to Ofgem from monitoring the Licence Condition and working with the suppliers on guidance setting out what changes need to be made to the current systems and processes. | | | | | |
| BENEFITS (£m) | Total Transition (Constant Price) | | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) | |
| Low | | N/A | | | |
| High | | | | | |
| Best Estimate | | | | | |
| Description and scale of key monetised benefits by ‘main affected groups’ | | | | | |

²² Estimates were made based on data provided by energy companies in relation to complying with other obligations

Other key non-monetised benefits by ‘main affected groups’

It has not been possible to fully quantify the benefits of faster switching. However, we would expect there to be a direct benefit to switching customers who could take advantage of their new gas and/or electricity tariff in a reduced time although we recognise that this would be a transfer. As an illustrative example, a customer moving from a standard tariff to some of the best direct debit tariffs around could reduce their annual bill from £1190 to £950. Therefore a consumer could save an additional £4.60 for every week gained in the faster switching process.

There may be additional, intangible benefits to consumers as these measures are designed to improve the switching process for consumers which could lead to greater competition in the supply industry.

Key assumptions/sensitivities/risks**Discount rate (%)**

3.5

There is a risk that suppliers do not improve their systems and processes fast enough or that despite changes the percentage of customers who are switched within three weeks does not improve or does so only marginally.

Impact on admin burden (AB) (£m):**Impact on policy cost savings (£m):****In scope**

Yes

Enforcement, Implementation and Wider Impacts

| | | | | | | | | |
|---|--|--|--|--------------|----------------|----------------|--------------------|--------------|
| What is the geographic coverage of the policy/option? | | | | | | | | |
| From what date will the policy be implemented? | | | | | | 03/03/2011 | | |
| Which organisation(s) will enforce the policy? | | | | | | Ofgem | | |
| What is the annual change in enforcement cost (£m)? | | | | | | | | |
| Does enforcement comply with Hampton principles? | | | | | | Yes | | |
| Does implementation go beyond minimum EU requirements? | | | | | | No | | |
| 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 duties²³ <u>Statutory Equality Duties Impact Test guidance</u> | No | N/A |
| Economic impacts Competition <u>Competition Assessment Impact Test guidance</u> Small firms <u>Small Firms Impact Test guidance</u> | Yes | 6 |
| Environmental impacts Greenhouse gas assessment <u>Greenhouse Gas Assessment Impact Test guidance</u> Wider environmental issues <u>Wider Environmental Issues Impact Test guidance</u> | No | |
| Social impacts Health and well-being <u>Health and Well-being Impact Test guidance</u> Human rights <u>Human Rights Impact Test guidance</u> Justice system <u>Justice Impact Test guidance</u> Rural proofing <u>Rural Proofing Impact Test guidance</u> | No | |
| Sustainable development <u>Sustainable Development Impact Test guidance</u> | No | N/A |

²³ 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 |
|----|--|
| . | |
| | European Commission Impact Assessment on Third Legislative Package |
| | Consultation on the Implementation of the EU Third Internal Energy Package |
| | EU Third Package Consultation Stage Impact Assessment |
| | DECC's Call for Evidence |

+ 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 | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring cost | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual costs | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Transition benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

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

Evidence Base (for summary sheets)

Issue

Article 3(5a) of the Electricity Directive and Article 3(6a) of the Gas Directive require Member States to ensure that where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected within three weeks.

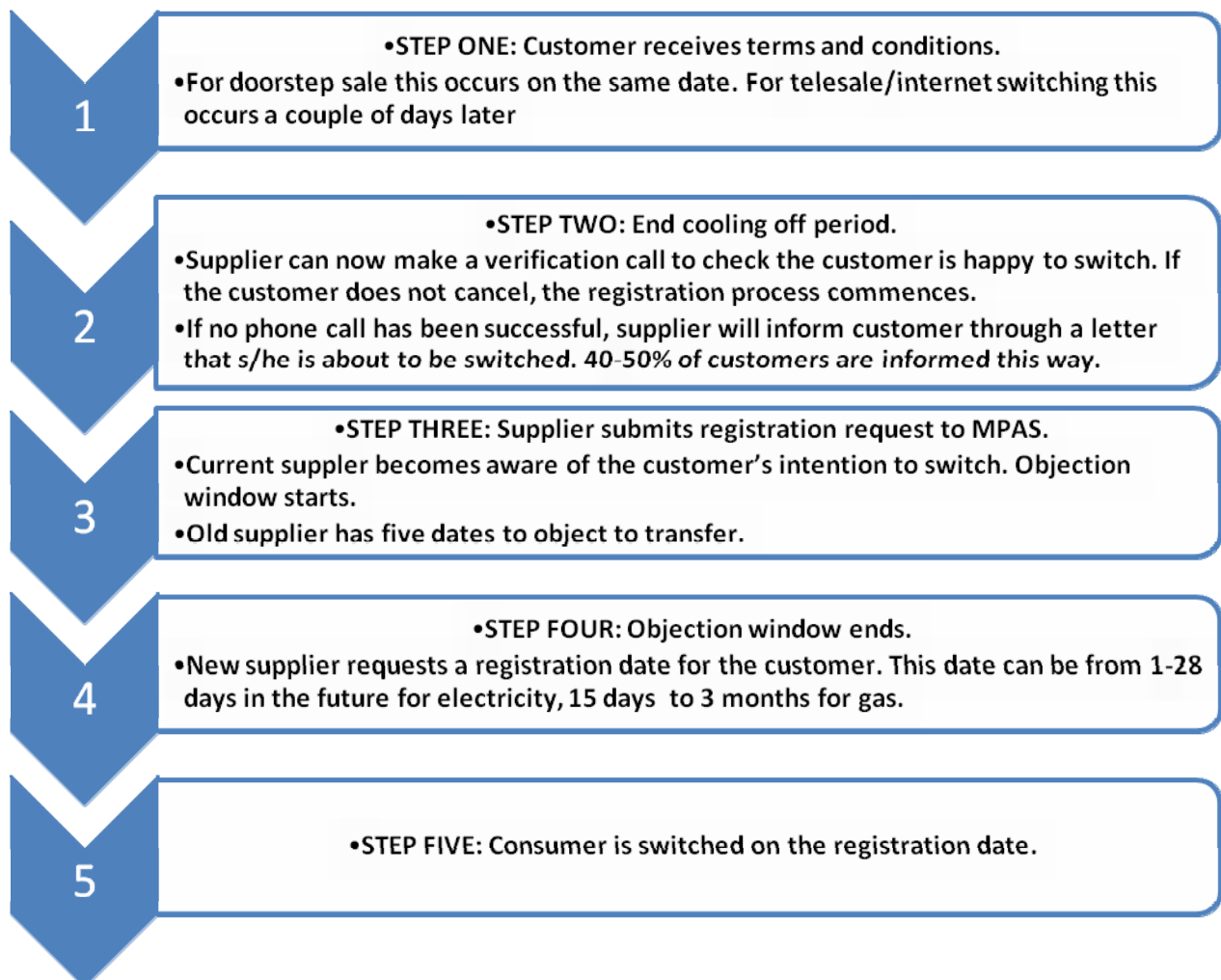
In addition, Annex 1 (j) of both the Electricity and Gas Directives require that consumers receive a final closure account following any change of natural gas/electricity supplier no later than six weeks after the change of supplier has taken place.

These measures are designed to improve the switching process for consumers. High levels of switching are associated with greater competition in the market, which should result in better outcomes for consumers.

Background

The UK currently has the most competitive market in Europe with high levels of customer switching per month. Evidence suggests that, on average, 400,000 electricity and 300,000 gas customers switch supplier every month. Most customers are switched within 4-6 weeks of receiving terms and conditions.

The process for switching currently looks like this:



Options

Two main options have been considered:

- Option 1: Licence Condition requiring suppliers to give customers a contractual right specifying that following a period of up to 14 calendar days (from the date the contract has been entered into, meaning agreed with the supplier), customers will be switched within 3 weeks unless the following extenuating circumstances apply;
 - the former supplier has prevented the Proposed Supplier Transfer because of outstanding debt as part of the Customer transfer blocking
 - the customer has initiated, and has not withdrawn, a request for a Supplier Transfer in respect of another supplier
 - the supplier does not have all of the information required in order to complete the Supplier Transfer and:
 - (i) the supplier has taken all reasonable steps to obtain the missing information from the Customer and the Customer has not provided that information, or the information provided is incorrect; and
 - (ii) that information is not readily available to the supplier from another source; or
 - the supplier is prevented from completing the Supplier Transfer due to any other failure /circumstance caused by the Customer.
- Option 2: Licence condition to require suppliers to give customers a contractual right that they will be switched within three weeks of the day the customer receives the new terms and conditions (ie. no cooling off period is included)

In addition, both options will include a Licence Condition requiring suppliers to send their customers a final bill within six weeks of the date the customer has transferred to a new supplier. As this measure already occurs in practice, we expect the costs and benefits to be minimal and have not explored any further options with this requirement.

The preferred option is Option 1. We believe this option achieves a similar level of benefits as Option 2 while imposing lower costs on industry compared to Option 2. This is because Option 1 requires the industry to make some changes to their systems and processes rather than overhauling them, as longer term the introduction of Smart Meters will capture most of the benefits of these measures.

Benefits

For the purposes of evaluating costs and benefits a baseline of no action taken is used. Great Britain has an active energy supply market, and the level of consumer participation is amongst the highest in the world. Switching has been allowed in Great Britain since the opening of energy supply markets for domestic and small business consumers in the late 1990s. These measures are designed to ensure quicker switching, rather than to enable greater amounts of switching. The measures apply to both domestic and non-domestic consumers. For non-domestic customers where a cooling off period is agreed as part of the contract (unlike the domestic contracts, suppliers are not required to offer a cooling off period to non-domestic customers), the 21 days begins at the end of that cooling off period, which should not exceed 14 calendar days. Otherwise for non-domestic consumers the 21 days begins once the contract is entered into. Although the impact assessment focuses on the benefits to domestic consumers, we would expect the same benefits to apply to non-domestic consumers as well.

There are two sources of benefit from these measures to improve switching. Firstly, there is a direct benefit to consumers who are switched faster than they would have been otherwise. Assuming that these customers switch to a more beneficial tariff, these customers then receive a direct benefit in

terms of the energy and service received under their new tariff earlier than they would have otherwise, although we recognise that this is mostly a transfer since while the customer benefits the previous energy company loses. Some part of this saving may be a resource cost saving if a cheaper tariff is offered because of some cost advantage in providing that tariff. Option 2 will have a larger benefit to consumers as it will result in faster switching. The benefits of Option 1 are lower as switching takes longer than with Option 2.

It is difficult to quantify the size of this direct benefit. Evidence from Ofgem's Energy Supply Probe (2008) suggests that approximately 60%²⁴ of consumers reduce their bills as a result of switching and achieve an average net saving range from 1 to 2 per cent for gas customers and 3 to 4 per cent²⁵ of electricity customers. However this suggests that 40% of consumers do not switch to more favourable tariffs. This is further complicated by the fact that under current arrangements most customers are switched within 4-6 weeks of receiving their terms and conditions. We are unable to estimate what percentage of customers would receive any benefits and the evidence suggests that the overall direct benefit to consumers from these measures could be small. To illustrate: if a consumer moved from a standard tariff to one of the best available direct debit tariffs their annual bill would change from £1190 to £950. The consumer would save an additional £4.60 for each week earlier that the switch was completed.

The second source of benefits which may arise from a quicker switching process are the more intangible benefits associated with improved competition.

The questions for a competition impact test provided by the OFT are, whether the proposed policy would:

5. Directly limit the number or range of suppliers?
6. Indirectly limit the number or range of suppliers?
7. Limit the ability of suppliers to compete?
8. Reduce suppliers' incentives to compete vigorously?

We do not consider that our proposals would restrict competition, therefore a full competition impact test has not been completed. However, this policy could have positive competition impacts.

Consumer switching is a powerful driver of competitive energy supply markets. By switching suppliers, consumers can act as a competitive constraint on suppliers' pricing and provide strong incentives on suppliers to reduce costs, improve service and develop innovative products. The options will reduce the time it takes to switch for some customers; however the overall effect on the level of switching is expected to be small.

Any increase in the level of switching could also have an effect on prices, although in this case this will be very small. Overall, we would expect there to be downward pressure on prices as firms attempt to hold on to their existing customers who are now more likely to switch. However, they may also be less willing to offer low prices to attract new customers. This is because they are less likely to be able to prevent them from switching again in the future, limiting the rents that can be extracted.

It is important to note that some of the benefits associated with these measures are going to be realised with the introduction of smart meters in the next few years regardless of the implementation of these measures.

²⁴ Ofgem Supply Probe, Paragraph 4.18

²⁵ Ofgem Supply Probe, Paragraph 4.19

Costs

The majority costs of these measures will depend on the option taken forward, as such each option will be examined separately in this section.

- Option 1: Licence Condition requiring suppliers to give customers a contractual right that following a period of up to 14 calendar days (from the date the contract has been entered into, meaning agreed with the supplier), customers will be switched within 3 weeks unless there are the extenuating circumstances

Responses to the Call for Evidence and the subsequent consultation have suggested that suppliers and bodies involved in the switching process could adjust their switching process to accommodate switching within three weeks of the end of the cooling off period at some considerable cost, especially for gas customers. As discussed, there will also be a requirement on suppliers to make some changes to their systems to increase the number of people who switch suppliers within 3 weeks. There may also be monitoring and enforcement costs to Ofgem.

As this option represents lower cost to suppliers compared to Option 2 but similar benefits to consumers, this is our preferred option and has been covered in more detail in the ‘Summary: Analysis and Evidence: Policy Option 1’ section of this impact assessment. As some of the benefits of these measures will be realised in the next few years with the introduction of smart meters, it is important to attempt to reduce the cost on suppliers at this stage.

- Option 2: Licence condition to require suppliers to give customers a contractual right that they will switch customers within three weeks of the day the customer receives the new terms and conditions (ie. no cooling off period is included).

Option 2 would require a substantial change to the switching computer system (MPAS) including the suppliers’ computer systems and those of other agents involved in the switching process. Responses to the Call for Evidence and consultation have suggested that these changes are likely to impose a one-off cost of several million pounds to suppliers, and we would expect these costs to ultimately be passed on to consumers in the form of increased bills. The industry is already committed to putting in place changes for the roll-out of smart meters and there is a risk that an option requiring them to overhaul their systems with a new one could lead to delays in this process, when ultimately smart meters will facilitate consumer switching.

However there may be additional costs to starting the process without a cooling-off period. Around 8-10% of customers cancel their contract during the cooling-off period. There is a greater risk that without a cooling off period, there will be a higher rate of people who subsequently cancel. These requests will then need to be cancelled manually. Therefore there is an increased chance of erroneous switches. Responses to the Call for Evidence and consultation suggest that there could be increased numbers of erroneous switches (which have to be resolved manually at some expense) and increased numbers of customer complaints. This could lead to deterioration of the customer experience and may disincentivise customers to switch in the future. However, the scale of these effects is unclear.

For both options, there will be operational costs to suppliers from changing their systems (which are higher under Option 2). There will be an additional administrative cost to suppliers who will have to alter their standard terms and conditions to reflect the changes; however, we are assuming that this would be done as part of regular upgrades and therefore at little extra cost.

As mentioned above, a Licence Condition requiring suppliers to close a customer’s account within six weeks of switching is not expected to have significant costs. It is already industry practice to close a customer’s account within 6 weeks after switching and therefore there are no significant changes. There will however be a cost to Ofgem to monitor compliance with the Licence Conditions and, in

respect of the requirement on switching, preparing guidance to energy suppliers. We anticipate that this will mainly involve extra administrative costs.

Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

| | |
|--|---|
| Title: Third Package: Articles concerning the National Regulatory Authority (NRA) Lead department or agency: Department for Energy and Climate Change Other departments or agencies: | Impact Assessment (IA) |
| | IA No: DECC0007 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Legislation |
| | Contact for enquiries: Marina.Pappa@decc.gsi.gov.uk Vikram.Balachandar@decc.gsi.gov.uk |

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

There are requirements in Articles 35 to 38 of the Electricity Directive and Articles 39 to 42 of the Gas Directive regarding national regulatory authorities (NRAs) where more action is needed from the UK to become fully compliant. These relate to the independence and impartiality of the NRA and include designation of the NRA; representing the UK at the Agency for Co-operation of Energy Regulators (ACER); a requirement on Member States to ensure that staff of the regulatory authority are able to act independently of market interest. Other measures include some new duties on the NRA, especially monitoring and a requirement that the National Regulatory Authority has the necessary powers to carry out certain these duties.

All Member States have to comply with EU legislation and therefore GB needs to transpose the requirements into UK law.

What are the policy objectives and the intended effects?

These provisions are intended to increase the independence and transparency of the regulator and promote co-operation with other European regulators. It is difficult to quantify the benefits associated with these measures. However we would expect the intangible benefits arising from these measures to increase the integrity of the regulator and the better functioning of the EU internal market by applying regulation more consistently. This could lead to better market outcomes and overall reduced costs for consumers.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Only one option has been considered, as this option ensures compliance at minimum cost to Government, the regulator and industry. The option includes the following measures, but are not limited to:

- Confirm Ofgem's designated position as single NRA in GB (with NIAUR the NRA for NI).
- Impose an obligation on Ofgem to ensure that all staff employed by it have neither financial interests nor take instructions that might compromise their independence.
- Provide for a formal rotation scheme for GEMA's board
- Amend legislation so that the Article 36 objectives are expressly included as matters which Ofgem must pursue when undertaking regulatory tasks. This would include a further duty to ensure the reference to close consultation with other relevant national authorities.
- A number of new duties as a result of Article 38 and 42 of the Electricity and Gas Directives, respectively.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

Please refer to the over-arching IA

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

No

Ministerial Sign-off For Final 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: 12/01/2011

Summary: Analysis and Evidence Policy Option 5

Description:

Implement Option 1 (minimum compliance option) for all measures

| Price Base Year N/A | PV Base Year N/A | Time Period Years N/A | Net Benefit (Present Value (PV)) (£m) | | |
|------------------------|---------------------|--------------------------|---------------------------------------|-----------|--------------------|
| | | | Low: N/A | High: N/A | Best Estimate: N/A |

| COSTS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) |
|---------------|--|-----|--|-------------------------------|
| Low | N/A | N/A | N/A | N/A |
| High | N/A | | N/A | N/A |
| Best Estimate | N/A | | N/A | N/A |

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

N/A

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

The majority of the costs associated with these measures are associated with a one-off transition cost of making changes to the regulations. These costs to Government and Ofgem are covered in the overarching IA.

We expect the costs associated with individual measures to be small. Ofgem may also have additional monitoring costs.

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

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

N/A

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

It is difficult to quantify the benefits associated with these measures. However we would expect the intangible benefits arising from these measures to increase the integrity of the regulator and the functioning of the EU internal market. This could lead to better market outcomes for both industry and consumers.

Key assumptions/sensitivities/risks

N/A

N/A

| | | | | | |
|--|-----------------|----------|--|--|-----------------|
| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | | In scope |
| New AB: N/A | AB savings: N/A | Net: N/A | Policy cost savings: N/A | | No |

Enforcement, Implementation and Wider Impacts

| | | | | | | | | |
|---|--|--|--|--------------|----------------|-----------------------|---------------------------|--------------|
| What is the geographic coverage of the policy/option? | | | | | | | | |
| From what date will the policy be implemented? | | | | | | 03/03/2011 | | |
| Which organisation(s) will enforce the policy? | | | | | | DECC/Ofgem | | |
| What is the annual change in enforcement cost (£m)? | | | | | | N/A | | |
| Does enforcement comply with Hampton principles? | | | | | | Yes | | |
| Does implementation go beyond minimum EU requirements? | | | | | | No | | |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | | | | Traded: N/A | Non-traded: N/A | |
| 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: N/A | Benefits: N/A | |
| 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 duties ²⁶ Statutory Equality Duties Impact Test guidance | No | N/A |
| Economic impacts | | |
| Competition Competition Assessment Impact Test guidance | Yes | 11 |
| Small firms Small Firms Impact Test guidance | No | N/A |
| Environmental impacts | | |
| Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance | No | N/A |
| Wider environmental issues Wider Environmental Issues Impact Test guidance | No | N/A |
| Social impacts | | |
| Health and well-being Health and Well-being Impact Test guidance | No | N/A |
| Human rights Human Rights Impact Test guidance | Yes | 11 |
| Justice system Justice Impact Test guidance | Yes | 11 |

²⁶ 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.

| | | |
|--|----|-----|
| Rural proofing Rural Proofing Impact Test guidance | No | N/A |
| Sustainable development Sustainable Development Impact Test guidance | No | N/A |

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 |
|----|--|
| | European Commission Impact Assessment on Third Legislative Package |
| | DECC's Call for Evidence |
| | Consultation on the Implementation of the EU Third Internal Energy Package |
| | Impact assessment for proposals for implementation of the EU Third Energy Market Package |

+ 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 | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring cost | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual costs | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Transition benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Annual recurring benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Total annual benefits | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

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

Evidence Base (for summary sheets)

Issue

Articles 35 to 38 of the Electricity Directive and Articles 39 to 42 of the Gas Directive deal with the National Regulatory Authority. These include:

- Article 35 of the Electricity Directive (and Article 39 of the Gas Directive) requires the designation of a single National Regulatory Authority, to act as a representative at the Agency for Co-operation of European Regulators (ACER). The Directives also require Member States to guarantee the independence of the regulatory authority and ensure that it exercises its regulatory tasks impartially and transparently.
- Article 36 of the Electricity Directive (and Article 40 of the Gas Directive) requires that the NRA takes all reasonable measures in pursuit of objectives laid out in the article, in close consultation with other relevant national authorities. The objectives include promoting close cooperation with the Agency, developing competitive and properly functioning regional markets within the Community, eliminating restrictions on trade in electricity/natural gas between Member States.
- Article 37 of the Electricity Directive (and Article 41 of the Gas Directive) sets out the regulatory authority's duties, a number of which are monitoring.
- Article 38 of the Electricity Directive (and Article 42 of the Gas Directive) sets out the regulatory regime for cross-border issues.

While the UK is broadly compliant with these requirements a number of changes need to be made to become fully compliant. The detail of these changes is covered in below.

These measures are designed to improve competition in the internal market, through greater cooperation between European regulators and greater independence and transparency of the national regulator.

Articles and Associated Options

This section explores the specific articles within which the UK is currently non-compliant and the options available to ensure compliance with the Third European Package.

Article 35 - Independence

Designation of regulatory authorities

Article 35 (1) of the Electricity Directive and Article 39 (1) of the Gas Directive require the designation of a single national regulatory authority, to act as a representative at Community level within ACER.

- Option: Confirm Ofgem's designated position as the NRA for GB. Impose an obligation on Ofgem to, when performing its representation role, work closely with NIAUR for the purposes of representing the UK at ACER.

Article 35 (3) of the Electricity Directive and Article 39 (3) of the Gas Directive allow Member States to designate regulatory authorities for small systems in geographically separate regions.

- Option: NIAUR (the Northern Ireland regulator) will be designated by NI as a separate regulatory authority for Northern Ireland in accordance with this provision.

Independence of regulatory authorities

Article 35 (4b) of the Electricity Directive and Article 39 (4b) of the Gas Directive require Member States to ensure that the regulatory authority ensures that its staff and the persons responsible for its management:

- i) have neither financial interests nor take instructions that might compromise their independence; and
 - ii) do not seek or take direct instructions from any person or body that might compromise their independence
- Option: Impose an obligation on Ofgem to ensure that all staff employed by it have neither financial interests nor take instructions that might compromise their independence and do not seek or take direct instructions from any person or body that might compromise their independence.

Appointments to Board and Rotation Scheme

Article 35.5b of the Electricity Directive and Article 39.5b of the Gas Directive require Member States to ensure that members of the board of the regulatory authority or, in the absence of a board, the regulatory authority's top management are appointed for a fixed term of five up to seven years, renewable once. The articles also require Member States to ensure an appropriate rotation scheme for the board or the top management.

- Option: Amend legislation to reflect the above requirements.

Article 36 – General objective of the regulatory authority

Article 36 of the Electricity Directive and Article 40 of the Gas Directive require that the regulatory authority shall take all reasonable measures in pursuit of objectives laid out in the article, in close consultation with other relevant national authorities.

- Option: Amend legislation so that the Article 36 objectives are expressly included as matters which Ofgem must pursue when undertaking regulatory tasks. This would include a further duty to ensure the reference to close consultation with other relevant national authorities.

Article 37- Duties and powers of the regulatory authority

Article 37 of the Electricity Directive (and Article 41 of the Gas Directive) sets out the regulatory authority's duties and powers. New explicit duties in the Third Package (when compared to the Second Package) include ensuring that undertakings comply with their obligations; that there are no cross-subsidies between transmission, distribution and supply (also storage and LNG); that those operating under the unbundling models in the Third Package comply with their duties; that there is transparent access to networks and cross-border infrastructures; that the NRA consults with Transmission System Operators and, as appropriate co-operates with other relevant national authorities when carrying out these duties.

New specific monitoring duties include monitoring the investment plans of the Transmission System Operators; monitoring network security, competition and market transparency including supply prices; monitoring the roles and responsibilities of the Transmission System Operators; investment in generating capacity; the implementation of safeguard measures in the event of an critical incident in the energy market; and technical co-operation between Community and third-country Transmission System Operators.

Member States are required to ensure that regulatory authorities are granted the powers enabling them to carry out these duties in an efficient and expeditious manner. The new duties and powers are already reflected to a large extent in the domestic framework and are consistent with Ofgem's current activities. However, there are areas where Ofgem's current duties need to be extended. In addition, the Third Package is broadening the scope of obligations on undertakings and therefore Ofgem's enforcement regime in respect of these new obligations.

- Option: Amend legislation to include any new duties which are not currently reflected in the GB framework and give Ofgem the requisite powers to carry them out.

Enforcement

Article 37 (4) (d) requires the NRA to impose effective, proportionate and dissuasive penalties on undertakings not complying with their obligations under the Third Package.

- Option: Amend legislation to enable Ofgem to require information for all relevant European law requirements.

Implementing binding decisions

Article 37 (1) (d) in the Electricity Directive and 41(1) (d) in the Gas Directive places an additional duty on the regulatory authority to comply with, and implement any relevant legally binding decisions of the Agency and of the Commission. Article 37(17) and 41(17) requires Member States to ensure that suitable mechanisms exist at national level under which a party affected by a decision of a regulatory authority has a right of appeal to a body independent of the parties involved and of any government.

- *Option: Replace the current collective licence modification process with a process that allows Ofgem to reach its decisions subject to appeal to an appropriate body.*
- ***We consider the costs and benefits of implementation of these provisions in the separate Impact Assessment of Proposals for implementation of licence modification appeals under the EU Third Package.***
- *Option: Ofgem to be able to initiate code modifications where they are essential for the implementation of ACER or Commission decisions. The usual industry process will then take effect including provision for industry parties to raise alternative approaches with Ofgem reaching a final decision subject to appeal. However any such process by the industry would need to respect the timescales set by ACER or the Commission to implementing a decision.*

Complaints to the NRA

Article 37 (10) of the Electricity Directive and 41 (10) of the gas Directive extends the scope of complaints that may be made to the NRA against transmission system operators, distribution system operators, interconnectors, exempt distributors and independent system operators.

- Option: Extend regulations to include complaints in relation to the above undertakings.

Annual reporting on fulfilment of its duties

Article 37 (1) (e) of the Electricity Directive and 41(1) (e) of the Gas Directive, places a duty on the regulatory authority to report annually on its activities and the fulfilment of its duties to the relevant authorities of the Member States, the Agency and the Commission. Such reports shall cover the steps taken and the results obtained as regards each of the tasks listed in this Article.

- Option: Amend legislation to ensure Ofgem reports annually to the Commission and ACER.

Article 38 – Regulatory regime for cross-border issues

Articles 38 of the Electricity Directive and 42 of the Gas Directive set out the regulatory regime for cross-border issues. This includes:

- i) requiring regulatory authorities to closely consult and co-operate with each other and the Agency with any information necessary for the fulfilment of their tasks under the Third Package;
- ii) a requirement on the NRA to coordinate the development of all network codes for the relevant transmission system operators and other market actors;

- iii) a requirement on the NRA to coordinate the development of the rules governing the management of congestion; and
 - iv) a requirement that actions referred to in paragraph 38 (2) shall be carried out, as appropriate, in close consultation with other relevant national authorities and without prejudice to their specific competencies.
- Option: Amend legislation to include:
 - o a general duty to cooperate and consult with other NRAs and the Agency in the performance of Third Package regulatory tasks and a duty on Ofgem to share information, as necessary for the fulfilment of its regulatory tasks, with other NRAs and the Agency, and to hold information received from other NRAs or the Agency in pursuance of regulatory tasks with the appropriate level of confidence.
 - o A duty to ensure Ofgem is empowered to engage with the Agency under Article 6 (2)
 - o A duty on Ofgem to co-operate on certain matters with other NRAs in any region which is i) identified by the Commission under Article 12(3) of the Electricity Regulation, ii) includes the UK. We intend that the implementation will leave it open to Ofgem to co-operate in other regions not specified in article 12(3) of the Electricity Regulation, as appropriate.

Summary of Options considered

We propose to implement all the options described in the above section. This option ensures compliance at a minimum cost to Government, the regulator and industry.

Costs and Benefits - summary

We expect that the majority of the costs associated with these measures are associated with a one-off transition cost of making changes to legislation. These costs fall predominantly on Government and Ofgem and would be included as part of the costs to Government and Ofgem associated with making changes in order to comply with the Third European Package (please see over-arching IA). In general we would expect these costs to be relatively small. We examine the costs associated with each measure in more detail in the next section.

These provisions are intended to increase the independence, accountability and transparency of the regulator and promote co-operation with other European regulators. It is difficult to quantify the benefits associated with these measures. However we would expect the intangible benefits arising from these measures should increase the integrity of the regulators and the functioning of the EU internal market. This could lead to better market outcomes and overall reduced costs for consumers. We examine the benefits of each measure below in more detail in the next section.

Costs and benefits - detail

There may be some additional costs and benefits associated with each measure. These are detailed below. Where relevant, we refer to responses given to the consultation. We did not receive substantial new evidence from our main consultation to inform the quantitative assessment of costs and benefits. Table 19 below summarises the costs and benefits associated with individual measures.

Table 19 Summary of costs and benefits of individual measures

| | Costs | Benefits |
|---|---|--|
| Designation of regulatory authority | Costs to Ofgem of attending ACER meetings; costs to Ofgem and NIAUR of co-operating | Benefits to UK of ensuring that UK interests are represented at ACER |
| Independence of regulatory authority | Possible enforcement costs | Possible increase in Ofgem's credibility as independent regulator |
| Rotation scheme | Negligible | Negligible |

| | | |
|---------------------------------------|--|--|
| General objective of the NRA | Small additional compliance costs | |
| Duties and powers of the NRA | Small additional compliance costs | |
| Enforcement | Costs to Ofgem and industry if there is a breach | Enhanced ability to carry out regulatory tasks |
| Implementing binding decisions | Costs to Ofgem from initiating licence and code changes to implement these decisions | Timely implementation of EU legislation |
| Complaints to the NRA | Possible costs if number of complaints increase | Helping to ensure that operators act in the interests of existing and future consumers |
| Annual reporting | Negligible | Negligible |
| Cross-border issues | Costs of consulting and sharing information with other regulatory authorities and ACER | Ensuring consistency of regulation and avoiding regulatory uncertainty |

Article 35

Designation of regulatory authorities

- Option: Confirm Ofgem's designated position as the NRA for GB. Impose an obligation on Ofgem to, when performing its representation role, to work with NIAUR (the NI regulator).

There are no membership costs associated with membership of ACER. Therefore the only costs that Ofgem will incur from its membership are the costs associated with attending meetings (including travel costs and opportunity cost of time) and advising ACER staff. It is impossible to quantify these costs yet as it is unclear how often meetings will take place. Membership of ACER may also create secondment opportunities at ACER for Ofgem employees, allowing them to gain experience of energy market regulation at an EU level.

There may be some additional benefits of Ofgem's membership of ACER. ACER focuses on cross-border issues, monitoring and advising the European Commission on key issues such as 10-year Network Development Plans in electricity and gas and the legally-binding EU-wide Network Codes. ACER will be able to issue binding decisions regarding cross border infrastructure disputes. It is therefore vital for Ofgem to be involved in ACER as its decisions and advice to the Commission will have a direct impact on UK markets and actors.

There may be additional costs, in particular to Ofgem and NIAUR, associated with consulting with other regulatory authorities. We have not quantified these costs. However, Ofgem already work closely with other regulators.

Some responses to the consultation supported the designation of Ofgem as the UK's representative to ACER, and the obligation on Ofgem to work closely with the NIAUR. However, responses also noted that the Single Electricity Market (in Northern Ireland and the Republic of Ireland) is different to the GB market. We expect that Ofgem and NIAUR will co-operate to ensure that the UK position is adequately represented at ACER.

Independence of regulatory authorities

- Option: Impose an obligation on Ofgem to ensure that all staff employed by it have neither financial interests nor take instructions that might compromise their independence.

Ofgem may experience some additional enforcement costs due to this measure, as there will now be a formal duty to ensure that all staff have neither financial interests nor take instructions that might

compromise their independence when carrying out regulatory tasks. We have not monetised these costs, but they will depend on how Ofgem choose to comply with this duty. Ofgem advises that costs could be material, should problems arise. This measure may have the impact of strengthening Ofgem's credibility as an independent, impartial regulator.

Rotation Scheme

- Option: Amend legislation to reflect the five year minimum and seven year maximum term length Provide for a formal rotation scheme.

An informal rotation scheme is already in place for Ofgem, however these arrangements will need to be formalised. Ofgem advise that there should be no added cost to introducing these arrangements formally. Correspondingly, we expect the benefits of this measure also to be limited.

Article 36 - General objective of the regulatory authority

- Option: Amend legislation so that the Article 36 objectives are expressly included as matters which Ofgem must pursue when undertaking regulatory tasks. This would include a further duty to ensure the reference to close consultation with other relevant national authorities in Article 36 is given effect.

While Ofgem may require additional resources to ensure compliance with these additional objectives, Ofgem anticipate that the cost will be marginal. Ofgem already closely engage with NRAs; this particular duty will just require Ofgem to take decisions in close consultation with them.

Article 37- Duties and powers of the regulatory authority

- Option: Amend legislation to include any new duties which are not currently reflected in the GB framework and give Ofgem the requisite powers to carry them out.

Ofgem may require additional resources to ensure compliance with these additional duties. According to the European Commission IA (page 46):

The Commission services estimate the additional powers granted to regulators may lead them to increase their staff by 5 to 10%.

However, costs to Ofgem are likely to be small, because the GB framework is largely compliant with the requirements of the Third Package. Substantive costs arising from Ofgem's new explicit duties under the Third Package are examined separately in the other individual Impact Assessments of GB implementation of the Third Package.

Enforcement

- Option: Amend legislation to make all relevant European law requirements as conditions for which Ofgem may require information.

The direct costs of these measures are implementation and enforcement costs which will be experienced by Ofgem. We believe Ofgem would only exercise this option in cases where the benefit to consumers outweighed the cost. There may be an indirect administrative cost of these powers on industry as Ofgem is enabled to collect more information.

Implementing binding decisions

- *Option: Ofgem to be able to initiate code modifications where they are essential for the implementation of ACER or Commission decisions. The usual industry process will then take effect including provision for industry parties to raise alternative approaches with Ofgem reaching a final decision subject to appeal. However any such process by the industry would need to respect the timescales set by ACER or the Commission to implementing a decision.*

The principal impact of this option will be timelier implementation of code modifications where they are essential for the implementation of ACER of Commission decisions. The precise costs and benefits of this will vary depending on the code modification under consideration.

Complaints to the NRA

Option: Extend regulations to include complaints that may be made to the NRA against transmission system operators, distribution system operators, interconnectors, exempt distributors and independent system operators.

This may increase Ofgem's operational costs as they see an increase in the number of complaints. While this is difficult to anticipate, Ofgem advise that they do not expect a significant increase in the number of additional complaints, and suggest the cost increase will be marginal. This may strengthen the degree of oversight that Ofgem have over transmission system and distribution operators, and help to ensure that these operators act more in line with Ofgem's statutory duties to existing and future consumers.

Annual reporting on fulfilment of its duties

- Option: Amend legislation to ensure Ofgem reports annually to the Commission and ACER.

As Ofgem currently reports to the Secretary of State on its activities we do not anticipate that this action will pose much additional cost on Ofgem.

Article 38 – Regulatory regime for cross-border issues

- Option: Amend legislation to include:
 - o a general duty to co-operate and consult with other NRAs and the Agency in the performance of Third Package regulatory tasks and a duty on Ofgem to share information, as necessary for the fulfilment of its regulatory tasks, with other NRAs and the Agency, and to hold information received from other NRAs or the Agency in pursuance of regulatory tasks with the appropriate level of confidence.
 - o A duty to ensure Ofgem is empowered to engage with the Agency under Article 6 (2).
 - o A duty on Ofgem to cooperate on certain matters with other NRAs in any region which is i) identified by the Commission under Article 12(3) of the Electricity Regulation, ii) includes the UK. We intend that the implementation will leave it open to Ofgem to co-operate in other regions not specified in article 12(3) of the Electricity Regulation, as appropriate.

The costs of these measures fall primarily on Ofgem. These costs include the additional costs of consultation and administrative costs involved with sharing information and engaging with the Agency. We have not quantified these costs. However, Ofgem advise that they do not anticipate a significant increase in the number of meetings, as ACER meetings will largely replace ERGEG (European Regulators' Group for Electricity and Gas) meetings. There may be some additional costs of travel, however, which will depend on the locations of the meetings. Possible benefits include ensuring consistency of regulation and avoiding regulatory uncertainty, and helping to improve competition across member states.

Competition Impact Assessment

As outlined above, the main set of measures likely to have an impact on competition are those relating to the regulatory regime for cross-border issues. We do not believe that the measures will directly limit the number or range of suppliers; nor would they affect the number of licensees. According to the European Commission Impact Assessment (see "references" section above), the "...segmentation of the European market increases the effect of the dominance of a small number of suppliers". Increased cross-border co-operation could lead indirectly to an increase in the number of market participants in GB, to the extent that it reduces barriers to entry to participants resulting from

inconsistent regulatory arrangements between Member States. To the extent that the measures reduce barriers to entry and facilitate cross-border trade, they will increase the ability of market participants to compete. The proposals are unlikely to affect firms' incentives to compete vigorously, as they are unlikely to facilitate collusion between firms, or affect the ability of consumers to switch between suppliers.

Human rights

To the extent that human rights may be engaged, we consider our approach to be compatible with the Human Rights Act 1998.

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

| | |
|--|---|
| Title: Provision of third party access to licence exempt electricity and gas networks Lead department or agency: Department of Energy and Climate Change Other departments or agencies: Ofgem | Impact Assessment (IA) |
| | IA No: DECC0013 |
| | Date: 14/01/2011 |
| | Stage: Final |
| | Source of intervention: EU |
| | Type of measure: Secondary legislation |
| Contact for enquiries: Steve.davies@decc.gsi.gov.uk Richard.davies1@decc.gsi.gov.uk | |

Summary: Intervention and Options

| | |
|--|---------------------------------|
| What is the problem under consideration? Why is government intervention necessary? Many businesses distribute and supply energy as an associated part of their core activities. In most cases these businesses are exempt from the requirement to hold and comply with a licence. The exempt energy sector is, however, still required to comply with certain obligations of EU law. Following the European Court of Justice (ECJ) ruling on the Citiworks case, these proposals aim to ensure that licence exempt electricity and gas distribution networks offer third party access as required under the Electricity Directive and the Gas Directive. The Government has taken the minimum cost implementation option for these businesses. All Member States have to comply with EU legislation and therefore GB needs to transpose the requirements into UK law. | |
| What are the policy objectives and the intended effects? The policy's objective is to ensure third party access to licence exempt energy distribution networks. This will ensure energy customers benefit from competition in the energy supply market. | |
| What policy options have been considered? Please justify preferred option (further details in Evidence Base) The main proposal is to provide third party access to licence exempt networks. In doing so the self-certified class exemption regime for licence exempt distribution networks will be retained. The requirement that third party access must be provided to these networks will be set out in legislation. Guidance will be published describing how compliance might be achieved. (Please see section on "Options for Compliance".) | |
| When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved? | Please refer to over-arching IA |
| Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? | No |

Ministerial Sign-off For final 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: 12/01/2011

Summary: Analysis and Evidence Policy Option 6

Description: Provision of third party access to licence exempt electricity and gas networks

| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | | |
|---|---|-------------------------|--|--|----------------------|--|
| | | | Low: -£49m | High: £645m | Best Estimate: £133m | |
| COSTS (£m) | Total Transition (Constant Price) Year | | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) | | |
| Low | n/a | n/a | £3.45m | £49m | | |
| High | n/a | | £5.3m | £75m | | |
| Best Estimate | n/a | | | £75m | | |
| Description and scale of key monetised costs by ‘main affected groups’ | | | | | | |
| <p>The main costs associated with providing third party access to these networks are those associated with metering. These costs will vary substantially across the options. The commercial agreement and ‘deemed’ metering implementation models are estimated to carry the lowest implementation costs (additional meter reconciliation and administration costs only), whereas the ‘opt in / opt out’ model is expected to be twice as costly (as a result of having to add the costs for the provision of full settlement meters for customers opting out).</p> <p>The best estimate on costs, using the opt in/opt out model, has a present value of £75m , which includes £1m for Ofgem approving tariffs and methodologies.</p> | | | | | | |
| Other key non-monetised costs by ‘main affected groups’ | | | | | | |
| Reduced incentives to build networks and sizeable start-up costs. | | | | | | |
| BENEFITS (£m) | Total Transition (Constant Price) Year | | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) | | |
| Low | n/a | n/a | 0 | 0 | | |
| High | n/a | | £50.7m | £720m | | |
| Best Estimate | n/a | | £14.65m | £208m | | |
| Description and scale of key monetised benefits by ‘main affected groups’ | | | | | | |
| <p>The main potential benefit from ensuring third party access is that consumers could benefit from lower energy prices. The top end of the range of benefits is given by assuming all customers switching would have price savings of 6% estimated by Ofgem in their Energy Supply Probe if they switch to a more beneficial tariff. An assumption of a switching rate of 13% is made, consistent with the Ofgem Energy Supply Probe findings for small businesses. The £720m high estimate includes both environmental and price benefits.</p> <p>For the best estimate scenario, there will be energy savings estimated at around 155,000 MWh. This is the ‘opt in / opt out’ option with 13% of customers switching with no price benefit but saving 2.55% energy consumption. These environmental benefits are based on the use of advanced smart meters. The estimated present value of £208m only includes the environmental benefits and no price benefits.</p> | | | | | | |
| Other key non-monetised benefits by ‘main affected groups’ | | | | | | |
| None. | | | | | | |
| Key assumptions/sensitivities/risks | | | | Discount rate (%) | 3.5 | |
| We are making key assumptions regarding the size of the licence exempt network market, potential switching rates, energy consumption saving and electricity prices. The key sensitivities used to produce the range of cost-benefit estimates are the implementation model chosen and the potential price saving for customers switching. | | | | | | |

| | | | |
|--|--|--|-----------------|
| Impact on admin burden (AB) (£m): | | Impact on policy cost savings (£m): | In scope |
| | | | 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? | | 2011 | | | |
| Which organisation(s) will enforce the policy? | | DECC, Ofgem, EC | | | |
| What is the annual change in enforcement cost (£m)? | | £71,000 for Ofgem | | | |
| Does enforcement comply with Hampton principles? | | Yes | | | |
| Does implementation go beyond minimum EU requirements? | | No | | | |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | Traded: 1.227 | Non-traded: 0 | | |
| 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 duties ²⁷ Statutory Equality Duties Impact Test guidance | Yes | 14 |
| Economic impacts | | |
| Competition Competition Assessment Impact Test guidance | Yes | 9 |
| Small firms Small Firms Impact Test guidance | No | |
| Environmental impacts | | |
| Greenhouse gas assessment | Yes | 11-12 |
| Wider environmental issues Wider Environmental Issues Impact Test guidance | Yes | 11-12 |

²⁷ 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.

| | | |
|--|-----|----|
| Social impacts Health and well-being <u>Health and Well-being Impact Test guidance</u> Human rights <u>Human Rights Impact Test guidance</u> Justice system <u>Justice Impact Test guidance</u> Rural proofing <u>Rural Proofing Impact Test guidance</u> | No | |
| | Yes | 13 |
| | Yes | 14 |
| | No | |
| Sustainable development <u>Sustainable Development Impact Test guidance</u> | No | |

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 |
|-----|---|
| | Ofgem, 2008 Energy Supply Probe: http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf |
| | DECC, July 2010 Non-domestic Smart Meter Roll-out Impact Assessment: http://www.decc.gov.uk/assets/decc/Consultations/smart-meter-imp-prospectus/222-ia-smart-roll-out-non-domestic.pdf |
| | DECC call for evidence: http://www.decc.gov.uk/en/content/cms/consultations/eu_energy_mkt/eu_energy_mkt.aspx |
| | EC Third Package Impact Assessment: http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/2007_09_19_impact_assessment.pdf |
| | Transmission Price Control Review 2007-12: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=191&refer=Networks/Trans/PriceControls/TPCR4/ConsultationDecisionsResponses |
| | DECC consultation: http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx |

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 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 |
| Total annual costs | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 |
| Transition benefits | - | - | - | - | - | - | - | - | - | - |
| Annual recurring benefits | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 |
| Total annual benefits | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 | 14.65 |

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

Evidence Base (for summary sheets)

Purpose

To ensure the GB electricity and gas markets comply with the European Court of Justice (ECJ) ruling on the Citiworks case on third party access, as well as the EU Third Package more broadly.

Background: the Citiworks case and the EU Third Energy Package

The requirement to provide for third party access to energy systems is set out at article 32 of the EU Directive concerning common rules for the internal market in electricity²⁸ (the “Electricity Directive”), and article 32 of the EU Directive concerning common rules for the internal market in natural gas²⁹ (the “Gas Directive”). These provisions require Member States to ensure the implementation of a system of third party access to gas and electricity transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users. Tariffs, or the methodologies underlying them, are required to be approved prior to their entry into force by Ofgem, as the national regulatory authority. In addition, tariffs and methodologies are required to be published.

In May 2008, the European Court of Justice’s ruling in *Citiworks AG*³⁰ clarified that the requirement to provide for third party access applied in respect of all transmission and distribution systems (as defined in the Directives), and that it was not open to Member States to exempt certain types of transmission or distribution systems from the requirement. The complaint in *Citiworks* had been brought by an electricity supplier seeking to compete with a monopoly supplier at Leipzig airport. The ECJ ruled that the German law which exempted the owners of certain systems from the requirement to provide third party access contravened the requirement to provide for third party access to distribution systems. The judgement made it clear that all distribution networks must be open to third party access so that customers connected to those networks have the option to choose their own electricity and gas suppliers.

²⁸ Directive 2009/72/EC. This Directive must be implemented into domestic law by 3 March 2011 and replaces Directive 2003/54/EC, which contained a similar requirement.

²⁹ Directive 2009/73/EC. This Directive must be implemented into domestic law by 3 March 2011 and replaces Directive 2003/55/EC, which contained a similar requirement.

³⁰ Case C-439/06

The objective of the Directives is to ensure fair competition, which ultimately protects consumer choice and also to improve productivity and efficiency of the market.

Under the Electricity Act 1989, it is illegal to generate, transmit, distribute or supply electricity without a licence or an exemption. A system of exemptions in Great Britain was formalized by the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001 (the “Class Order 2001”). Amongst other things, an entity which operates under a distribution exemption is currently exempt from the requirement (present in distribution licences) to provide third party access to the system.

Similarly, under the Gas Act 1986, a licence is required to convey gas through pipes to premises or to a pipe-line system operated by a gas transporter, to supply gas which is conveyed to premises through pipes, or to arrange for gas to be put into, conveyed on or taken out of a pipe-line system. Exemptions from the requirement to hold a licence are contained in various exemptions orders made under s.6 Gas Act 1986. An entity which distributes gas under an exemption from the requirement to hold a gas transporter’s licence is, like an exempt electricity distributor, exempt from the requirement to provide third party access to the system.

In light of the *Citiworks* ruling, the Government needs to make provision for third party access to licence exempt systems.

Data availability

The potential costs and benefits of ensuring third party access to licence exempt distribution networks is highly uncertain. Precisely because these networks are licence-exempt, the evidence base is thin. This means that it is difficult to know how wide the sector is, the degree to which they already provide third party access, the likelihood of customers switching and the potential savings to be achieved. The Call for Evidence preceding the current consultation³¹ on providing third party access has delivered some anecdotal evidence which in some cases varies considerably between consultees and for the most part highlighted the limited information about this sector. This is shown in the table below.

³¹ This is the consultation on the provision of Third Party Access to licence exempt electricity and gas undertakings. published by DECC in 2010.

| Issue | Call for evidence responses |
|---|--|
| Scale of the Licence Exempt Sector | <p>The scale and range of the networks is vast. Their type and scale vary considerably.</p> <p>Intuitively large (station, airport, universities, retail and office environments).</p> <p>Examples: Network Rail supplies 130,000 MWh at over 1,000 supply points per annum; Bristol Port supplies 40,000 MWh per annum.</p> <p>65% of commercial property is rented. The majority of offices and retail units are multi-let, and therefore have private wire networks with the building used to supply energy to those occupiers.</p> <p>In the domestic sector the majority of social occupiers and private renters would be able to choose their energy supplier.</p> |
| Evidence of prices charged by licence exempt electricity network operators relative to suppliers commercial tariffs | Variable. Some operators use the exempt network to generate additional profits. |
| Revenue levels and profitability | <p>Across all sectors this is unknown.</p> <p>Example: Network Rail £10 million revenue (£10,000 per annum per supply point)</p> |
| To what extent is third party access already provided | <p>Variable. Opt in / opt out application can already exist. Other operators can provide full settlement metering.</p> <p>Fairly limited at the moment.</p> <p>Bristol Port already grants third party access to two large consumers.</p> |
| How many customers in a licence exempt network would consider switching and what would be the costs | <p>The number of customers that would opt out is difficult to estimate. The costs cannot be estimated as these would vary considerably with the complexity of the engineering works and admin burden.</p> <p>Unknown – hopefully none.</p> <p>Unlikely as they would lose on-site benefits.</p> |
| What are the potential cost savings to consumers from switching | <p>It would vary from case to case (up to 15%).</p> <p>None, only cost disbenefits.</p> <p>Smaller customers would benefits, but level unknown.</p> <p>Near zero. Unit cost of electricity may be lower.</p> <p>Ofgem review of distributed energy suggested there would be considerable cost disadvantages in bringing schemes under full governance arrangements and the same might be expected to apply in this case.</p> <p>Savings would be negative.</p> |
| Impact on current business operation | <p>Solutions do not seem to bring any tangible business opportunity for suppliers.</p> <p>Expand the need for metering.</p> <p>Increased management, metering and administration costs for operators.</p> <p>Example: Network rail - £750k-£1.5m in meter installation costs plus £75k per annum additional operational costs.</p> |

Based on the evidence gathered, we have used the following basic assumptions on the scale of the sector:

- Of 93TWh of non-domestic, non-industrial electricity consumption (DUKES 2010) half is supplied through private networks. The total electricity supplied via licence exempt distribution networks is therefore assumed to be 47TWh. This assumption is consistent with the evidence presented by the British Property Federation that 65% of all commercial property is rented and that the majority of this relies on private wires for the supply of electricity.

- The average annual consumption per supply point is 90 MWh, in line with the evidence presented by Network Rail. The total number of supply points is therefore assumed to be 520,000.
- The price of energy (excluding network costs) for these consumers is the average price paid by consumers in the 20-500MWh per annum bracket. The Eurostat average for 2008-2010 of £98 per MWh excluding taxes is used.
- A simplified assumption of a switching rate of 13% is made, consistent with the Ofgem Energy Supply Probe³² (paragraph 10.3) findings for small businesses. This rate may be a bit low as the introduction of Green Deal and smart meters could increase the switching rate. However, customers in a private network may find it more difficult to switch than customers in a licensed network. Therefore, on balance we have maintained the 13% switching rate.
- Customers switching supplier are estimated to receive an estimated 6% price savings through increased competition. This is in line with evidence from Ofgem's 2008 Supply Probe, which showed that this is the average saving customers could make switching away from the incumbent regional supplier.
- An assumption has been made that those customers switching would receive an advanced smart meter rather than a standard meter. The Government's roll-out of smart meters is implemented through a modification of licences, so licence exempt distribution networks would not be covered by the smart meter roll-out programme. However, given the Government's roll-out programme of smart meters, we believe it is reasonable to assume that standard meters are unlikely to be provided going forward, and that switching consumers would receive a smart meter. The advanced smart meter is more expensive than the normal smart meter (see "costs" below), so this would provide an estimated maximum cost. It may be likely that some customers may choose an ordinary smart meter than an advanced one so costs may be lower. The DECC Smart Meter impact assessment³³ has a central case that assumes smart/advanced meters will bring savings through a reduction in energy consumption of 2.8%. However, in that impact assessment when calculating the energy savings from the smart meter roll out, the 2.8% savings was not applied directly to initial energy consumption. A deduction of 0.25% was made to take account of the existence of better billing policies, so the net saving from smart meter installation is actually 2.55%. Therefore, we have applied 2.55% energy savings in this IA³⁴ where we assume that full settlement meters are installed.

Options for compliance

The Government has proposed the following models for compliance with the requirements:

- (1) Commercial agreement – the customer's chosen supplier enters into a commercial agreement with the private network operators.

³²

<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf>

³³ <http://www.decc.gov.uk/assets/decc/Consultations/smart-meter-imp-prospectus/222-ia-smart-roll-out-non-domestic.pdf>

³⁴ Note that, in the consultation-stage Impact Assessment, we assumed 2.8% energy savings, where full settlement meters are installed

- (2) ‘Deemed’ metering – without installing a full settlement meter for any customer, an administrator deems readings for each customer, which are then used by suppliers to charge.
- (3) Opt in / opt out – customers are able to switch to a supplier of their choice or default to existing arrangements if not. For ‘opt out’ customers a full settlement meter would be installed.
- (4) Full settlement metering – installation of full settlement metering for all end customers within the private network.

It is for the customer, supplier and distributor to agree which is the most practical option depending on individual circumstances. Not all of the options will work in all of the cases – e.g full settlement metering may not be possible in a multi-tenancy building where one customer’s rented space isn’t easily physically separate. These options are attempts to offer different ways of demonstrating that third party access has been properly applied and that between them cover all possible scenarios. If there are any disputes over the third party options between the network owner and a customer, then it would be for Ofgem to resolve this dispute.

Approach to costing

The proposed approach to ensuring compliance does not go beyond the minimum requirements of the Citiworks ruling. Providing businesses with a menu of compliance options will enable them to choose the lowest cost option depending on their circumstances and risk profile. This impact assessment aims to assess the costs of compliance and so measures costs and benefits against a counterfactual whereby the Citiworks ruling had not been made.

The benefits from competition (i.e from customers switching to new suppliers, with lower energy tariffs) are treated as a resource saving. In reality they are a mix of a transfer from producer to consumer surplus and a resource saving associated with a reduced deadweight loss. In the case of relatively inelastic electricity demand the transfer component will account for a larger share of the gains from competition. However, there are also likely to be allocative efficiency savings from the transfer from producer to consumer surplus. Increased competition will also lead to lower costs and improved productivity within firms. This increased productivity comes from “within firm” effects (increased managerial incentives to bear down on costs) and “between firm” effects (exit from the market of lower productivity firms and the entry of higher productivity firms).³⁵ It is therefore reasonable to treat these benefits as a resource saving. Note that our best estimate of costs and benefits, however, assumes no benefit to consumers from switching.

Finally, the impact assessment only attempts to cost the impact on licence exempt electricity networks. However, the ruling also applies to licence exempt gas networks. The informal Call for Evidence undertaken prior to our October consultation included questions on the extent of licence exempt gas networks and likely impacts of the Citiworks ruling on them. The conclusion is that electricity licence exempt networks are much more pervasive (only two out of twenty respondents owned or represented parties owning licence exempt gas networks) and most of the costs and benefits of complying with the Citiworks ruling will fall on them.

Distributional effects

Evidence received from Ofgem suggests that as business and commercial energy customers are diverse, the distribution of consumption among non-domestic, non industrials is likely to be

³⁵ The theoretical and empirical literature is summarised in *Productivity and competition : an OFT perspective on the productivity debate*, January 2007.

skewed to the right. This means that the analysis of impacts for the average consumer is fairly unrepresentative of the impacts on most non-domestic and non-industrial customers. It could overstate the size of any impact for most customers since they use less than average energy in a skewed distribution. They are likely to have different motivations with regards to the effort they make in managing and reducing energy costs.

The impacts of third party access will fall differently across customers depending on their characteristics. However, due to the lack of an evidence base around customer segmentation it is difficult to explore some of these distributional impacts within non-domestic and non-industrial groups further.

Costs

The main costs associated with providing third party access to these networks are those associated with metering. These costs would vary substantially across the compliance models above.

Member States are required to ensure the implementation of a system of third party access to gas and electricity transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users. Tariffs, or the methodologies underlying them, are required to be approved prior to their entry into force by Ofgem, as the national regulatory authority. Ofgem estimate that the annual cost of having to approve tariffs and methodologies is about £71,000 in current prices and £1m present value to 2030. This is based on average estimated annual instances. This £1m has been included in the costs for each of the options below.

In line with the evidence included in DECC's impact assessment on the roll out of smart and advanced meters to small and medium sized businesses in July 2010³⁶, the cost of installation of an advanced smart meter for full settlement metering across all supply points would be £383 per meter. This cost is likely to be an overestimate, as a large proportion of consumers within licence-exempt networks are unlikely to need advanced meters and could choose to have the cheaper standard smart meter installed instead. Asset and installation costs of standard non-domestic smart-meters are expected to be just £72. It seems appropriate to use the conservative higher-cost assumption, particularly in light of the fact that the only respondent providing a cost estimate for meter installation quoted a figure of at least £500 per meter. However, it is worth highlighting that the installation of meters is not a necessary requirement for compliance, but is merely an option open to the network owners and its customers (the latter would be expected to bear the costs of the meters).

The cost of full installation of advanced meters then gives a cost estimate of £200m. We assume across the board full settlement metering would not lead to any additional operational costs.

The commercial agreement and 'deemed' metering models would incur additional operational costs for those customers demanding supply from a third party. Network Rail's response to the call for evidence assumes these to be about £50 per annum. Assuming 13% of customers wanted to switch suppliers, the additional cost of these models would be £3.45m per annum - £49m in present value terms to 2030.

³⁶ <http://www.decc.gov.uk/assets/decc/Consultations/smart-meter-imp-prospectus/222-ia-smart-roll-out-non-domestic.pdf>

The costs associated with the “opt in / opt out” model are in between these two estimates. Full settlement metering would be required for those customers wanting to switch (and only for those customers wanting to switch) and the additional operational costs would still be incurred. Thus, the costs associated with this model would be the £49m above plus the cost of providing full settlement meters for customers demanding third party supply, estimated at £26m – a total cost of £75m in present value terms.

Other cost issues

Reducing incentives to build networks

The costs associated with providing third party access to licence exempt networks would, other things being equal, reduce the incentives to build the networks. This could result in additional resource costs to society as alternative, more costly, arrangements for energy supply might have to be made. However, given that these networks are generally provided as part of a broader package of services we assume for the purpose of this impact assessment that this impact is negligible.

Sizeable start-up costs

Two of the options: the opt in/opt out and full settlement metering, are proven and market ready therefore the costs are more easily identified. The other two options: contracting and deeming, have not been tested and could be subject to some significant transaction costs that need to be agreed between parties. The ad hoc nature of these alternative arrangements, along with the lack of certainty suppliers have about the licence exempt systems they are trying to gain third party access to, will probably mean that any such contracts or non-standard arrangements could be very case specific. This would suggest that they would have some sizeable start up costs as well as ongoing operational costs, which we cannot quantify due to lack of data.

Possible network upgrade costs

In their evidence, several ports authorities raised the issue of the increased cost of having to upgrade the private distribution network to make it IDNO (Independent Distribution Network Operator) compliant if a customer switches and a third party supplier is allowed access.

They stated that private networks do not currently have to be compliant to IDNO standard, but if third party suppliers are to be allowed to supply over their private network it is likely that such suppliers will require the network to be IDNO compliant, which would be extremely costly.

Ofgem has confirmed that private network owners would not be obliged to update their networks or become licensed distributors in order to allow third party access. Industry codes have requirements on distributors and the supplier/distributor relationship but as these private wire networks are not licensed then they wouldn't have to meet code requirements. The wires would still have to meet any safety requirements in legislation outside of industry codes and the distribution licence.

If private wire owners were unlicensed, then we assume their relationship with suppliers would be on a commercial basis. Suppliers are required, under the supply licence, to offer to supply a customer that requests it, unless it isn't reasonable for them to do so. Also, suppliers may refuse to make an offer to supply a customer if they have significant safety concerns. If a supplier doesn't have any safety concerns and is able to negotiate reasonable third party access terms with the private wire network owner, then a customer on this network should be able to receive an offer from this supplier.

Benefits

The main potential benefit from ensuring third party access is consumers could benefit from lower energy prices. The call for evidence responses are ambiguous on the extent to which these benefits are likely to be achieved.

A number of responses, mainly from licence exempt network operators, state that price savings to customers will be negative. Other responses suggest smaller businesses could benefit, with an energy supplier estimating savings of up to 15% would be available for those customers switching.

For the purposes of this impact assessment the range of price benefits from increased competition are therefore estimated to range from zero to 6% for those switching suppliers, estimated to be £37.4m per annum or £512m in present value terms to 2030. The 6% assumption is in line with evidence from Ofgem's 2008 Supply Probe, which showed that this was the average saving customers could make switching away from the incumbent regional supplier. The assumption is that licence exempt network owners might behave in a similar way to former regional incumbents. As discussed above, these benefits from competition are treated as a resource saving to society for the purposes of this impact assessment.

In our "best estimate" scenario, however, we do not include any benefits from price savings to those customers switching supplier. This is a conservative assumption, based on the uncertainty over whether these savings would be achieved in practice. Those customers already receiving a good price for their energy may be less likely to switch supplier.

Smart meters are also expected to play a role in enabling businesses to save energy. In order to be consistent with the impact assessment on the roll out of smart and advanced meters to small and medium sized businesses, this impact assessment assumes that smart/advanced meters will bring net savings through a reduction in energy consumption of 2.55% (the Smart Meter IA central case). See the "assumptions" section above for more detail on this.

Environmental Benefits

Please note that our estimates of monetised benefits arising from energy consumption reduction (resulting from meter installation) differ from those made in the consultation-stage Impact Assessment. We have revised our estimates, in line with DECC/HMT appraisal guidance. In particular, we now value energy savings at the long-run variable cost of energy supply (rather than at the retail price) and also include benefits from reduced traded-sector emissions and improved air quality.

For the best estimate scenario, which is the 'opt in / opt out' option with 13% of customers switching with no price benefit but net saving of 2.55% energy consumption, there will be energy savings estimated at around 155,000 MWh per year. The net change in energy use, net change in emissions and net air quality impact have been included in the Net Present Value (NPV) figures.

| TRADED SECTOR (EU ETS) | (£ 2009, PV 2009) |
|-------------------------------|-------------------------------|
| | <i>minus indicates a cost</i> |
| Net change in energy use | £182,903,013 |
| Net change in emissions | £21,940,938 |
| Net air quality impact | £3,200,526 |
| TOTAL | £208,044,477 |

CHANGES IN CO2 EMISSIONS

(minus indicates an emissions saving)

Total appraisal period

(Mt CO₂)

| | |
|--|--------|
| Net emissions CO ₂ in the traded sector | -1.227 |
| Net emissions CO ₂ in the non-traded sector | 0.000 |

Carbon Budgets

UK GHG EMISSIONS

(minus is a reduction in emissions)

(Mt CO₂)

| | 2008-2012 | 2013-2017 | 2018-2022 |
|--|-----------|-----------|-----------|
| Net change in CO ₂ (traded) | -0.183 | -0.305 | -0.305 |
| Net change in CO ₂ (non-traded) | 0.000 | 0.000 | 0.000 |

Policies that save energy (such as insulation), reduce energy bills and increase consumers disposable income, may in turn have the effect of leading to a greater consumption of energy. This is known as the “rebound effect”. We have used in this IA the assumption of 2.55% net savings through a reduction in energy consumption, which has been taken from DECC’s Smart Meter Impact Assessment. There were no assumptions made in the Smart meters IA about the rebound effect connected with the roll out of smart meters, so therefore we have not estimated the rebound effect in this IA.

The reasons for not applying any rebound effect to the energy savings from smart metering were:

- the assumed saving is at the lower range of savings from trials and international evidence it is derived from in the first place, and hence is deemed to be conservative enough;
- in contrast with other “measures” such as insulation, where a rebound effect is appropriate as no action is required from the household, the energy saving from smart metering actually relies on behavioural change and hence demands customer action, which means that the rebound effect argument does not directly apply to the same extent.

Net Present Value

Overall, the range for the NPV of these proposals goes from a net cost of £200m (with full settlement metering costs and zero benefits being delivered) to a net benefit of £1,230m (with the commercial and/or ‘deemed’ metering models being applied and maximum potential benefit of 15% price savings being achieved from competition).

Both these extremes appear unlikely. Firstly, because existing licence exempt networks will not choose the option of providing full settlement metering across the board (although new networks might choose this model). Secondly, because the 15% price saving seems like a potential maximum saving for some consumers, but not for the average consumer.

The range for the NPV presented in the summary sheets of this impact assessment is therefore given by the following scenarios (also summarised in the table below):

- (1) A low benefit estimate given by the commercial/deemed metering model with no benefits being achieved. This results in costs of £49m in present value terms to 2030 or £3.45m per annum in current prices;
- (2) A medium benefit estimate given by the ‘deemed’ metering and/or commercial agreement models with an average price saving of 6% per customer switching. This provides a present value cost of £49m and a benefit of £512m in present value terms or £37.4m per annum in current prices. This provides a net benefit of £463m in present value terms to 2030;
- (3) A high benefit estimate given by the scenario in which the costs are equal to those of the opt-in/opt-out model and switchers achieve gains from competition resulting in 6% reduction in bill prices plus a 2.55% saving in energy consumption and environmental benefits. This results in costs to 2030 of £75m in present value terms or £5.3m per annum in current prices and benefits of £50.7m per annum in current prices and £720m in present value terms to 2030. A net present value of £645m to 2030;
- (4) A best estimate of the net present value is given by the scenario where the costs are equal to those of the opt-in/opt-out model, with switchers receiving no price benefit but saving 2.55% in energy consumption and environmental benefits. This results in the best estimate for costs of £75m in present value terms and a best estimate for total benefits of £208m in present value terms, or £14.65m per annum in current prices. Thus, our point estimate for the NPV of these measures is a net benefit of £133m to 2030. In our “best estimate” scenario, we do not include any benefits from price savings to those customers switching supplier. This is a conservative assumption, based on the uncertainty over whether these savings would be achieved in practice.

| Costs and benefits, Present Value, £ million, 2010-30 | | | |
|--|-------|----------|-------|
| | Costs | Benefits | NPV |
| Low benefit scenario: Commercial/deemed metering, switchers achieve no reduction in bills | 49.0 | 0 | -49.0 |
| Medium benefit scenario: Commercial / deemed metering, switchers achieve 6% reduction in bill prices | 49.0 | 512.0 | 463.0 |
| High benefit scenario: Opt in / opt out, switchers achieve 6% reduction in bill prices and 2.55% saving in consumption | 75.0 | 720.0 | 645.0 |
| Best estimate scenario: Opt in / opt out, switchers achieve no price benefit but save 2.55% in energy consumption | 75.0 | 208.0 | 133.0 |

Competition impact

The Office of Fair Trading's guidance, "Completing competition assessments in impact assessments", suggests answering the following four questions to determine whether the proposal will have a significant impact on competition.

http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft876.pdf

- Directly limit the number or range of suppliers?
- Indirectly limit the number or range of suppliers?
- Limit the ability of suppliers to compete?
- Reduce suppliers' incentives to compete vigorously?

The Citiworks Provision of Third Party Access to Licence Exempt Networks proposals for the EU Third Package, does not limit the number of suppliers, limit the ability of suppliers to compete nor reduce their incentives to compete vigorously.

The provision of third party access to private networks may lead to an increase in competition because customers will be able to switch supplier. Based on evidence from Ofgem's 2008 Supply Probe, we have made an assumption of 6% price savings from increased competition for those customers switching supplier. Ofgem found that this was the average saving customers could make switching away from the incumbent regional supplier. The assumption is that licence exempt network owners might behave in a similar way to former regional incumbents. Further details have been set out in the benefits section of this impact assessment.

Forth Ports have also informed us in their evidence that they undertake regular competitive tendering of energy supply contracts for its private electricity networks. They believe that this provides a good deal for their customers, as they are able to obtain cheaper energy. Therefore, because their customers receive a good deal on energy prices, they may be less likely to switch to another supplier.

Due to the uncertainty over whether any price savings would be achieved in practice, we have decided not to include any benefits from price savings to those customers switching supplier in our best estimate scenario.

Human Rights

To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

Justice System

The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

Equality

We are not requiring exempt suppliers to provide information to their customers in a format that caters for the disabled, blind people or speakers of other languages. This info is intended to assist them. Consumer Focus is available to assist consumers on energy related issues. Energy customers are also able to switch to another energy supplier.

Specific Impact Tests

Competition, environmental benefits, human rights, justice and equality impacts have been considered. No additional impacts are expected on small firms, gender, health, legal aid, sustainable development or the rural economy.