A Review of Ofgem Regulatory Impact Assessments

Introduction

Ofgem has, for some time, been preparing regulatory impact assessments ("RIAs") in areas of its activity judged sufficiently important to merit such an exercise. In the course of the development of the Energy White Paper, Ofgem committed to produce RIAs for significant new policy proposals from the end of June 2003. In December 2003, section 6 of the Sustainable Energy Act 2003 placed a duty on the Gas and Electricity Markets Authority ("the Authority") to carry out impact assessments ("IAs") by inserting section 5A into the Energy Act 2000. Thus, in all cases where the Authority is proposing to do anything for the purposes of, or in connection with, the carrying out of its functions under Parts 1 of the Gas or Electricity Acts and it appears to the Authority that the relevant proposal is "important", the Authority must carry out and publish an IA, or publish a statement setting out the reasons that it considers that it is unnecessary for it to carry out an IA.

These recent developments codify and make more systematic requirements for evaluation exercises in which Ofgem and its predecessors were already engaged in periods prior to the more general development of RIAs throughout government. For example, consultation, one of the major aspects of RIAs, has been a well-embedded regulatory activity for many years now. A more systematic and consistent approach to evaluation does, however, have obvious potential advantages, since assessment of impacts is an integral and important part of policy development.

In December 2002 the Cabinet Secretary invited the Comptroller and Auditor General to undertake a new ongoing role of evaluating the quality and thoroughness of a sample of RIAs each year, with the aim of identifying positive and negative learning points, and the first of the NAO's annual reports, *Evaluation of Regulatory Impact Assessments Compendium Report 2003-04*, was published on 4 March 2004. Much in that report is of relevance to Ofgem's work, but there are also distinctive features of Ofgem's position, arising in particular from the specific statutory duties of the Authority, that indicate that a more targeted assessment is in order.

This purpose of this review, then, is to assess Ofgem's performance in conducting RIAs over the recent period, against the background of the Authority's statutory

duties. In doing so it will treat RIAs and IAs as similar activities, on the basis that the general aim of the exercise is, in the words of the Cabinet Office general guidance, *to inform policy decisions.*

The review is an 'internal' exercise, motivated by an Ofgem desire to improve its own performance, and emphasis is therefore placed on the identification of current weaknesses and on areas where there is significant scope for improvement. In this it differs from assessment exercises that are concerned, for example, with identifying good practice benchmarks on the basis of a widely drawn sample of RIAs, or with assessing comparative performance of policymakers across government(s); and it should be read and interpreted accordingly.[1]

Initial remarks

Regulatory impact assessments pose a challenge for Ofgem, arising from the tension between the general purposes of RIAs and the specific position of, and specific duties imposed upon, the Authority. The position of Ofgem is different from that of a government department serving a Minister, whose objectives may not be clearly differentiated from those of general government as a whole. The Authority's objectives are explicitly and intentionally differentiated, by statute, and it is a particular set of duties/objectives that is intended to drive decisions. The first important conclusion of this review follows almost immediately from this centrality of statutory duties: the appropriate approach to RIAs will depend upon how the Authority and Ofgem see their broad policy strategies, driven by statutory duties, going forward. In particular, it will depend upon how the Authority and Ofgem translate statutory duties into a regulatory strategy for the energy sector. The point is explained and developed more fully in what follows.

Like most government initiatives, RIAs have a mixed pedigree. They tend nowadays to be seen in the context of a general aspiration for "better regulation". Thus RIAs, together with associated Cabinet Office guidelines, can be interpreted as one means of improving the "quality" of regulation.

[1] There is a weak analogy here with the analysis of 'market failure', which likewise focuses on seeking to identify aspects of a process (competition) that fall short of an aspirational ideal.

Behind this general statement, however, lies an obvious, contemporary concern about potential over-regulation, as manifested in emphases in Cabinet Office work on the importance of fully exploring 'do nothing' options and on 'smarter', less intrusive regulation. Such undercurrents are of considerable significance for Ofgem, which has not been exempt from criticisms of over-intrusiveness, consultation overload, and the like.

An immediate issue is that, whilst a general pressure in the RIA process toward less 'policy activism' might (arguably) be appropriate at the level of the UK economy as a whole -- for example, to counterbalance any perceived bias toward ever more intrusive control of market behaviour -- the specific circumstances of energy regulation stand somewhat apart from the day-to-day concerns of many government departments. From the outset, Ofgem's statutory duties have pushed it towards a more activist and, in relation to regulation, a more ‘two-sided’ stance than might generally now be the norm:

- On the one hand, there has been an extensive programme of de-regulation/ liberalisation in the energy sector, associated with the removal of restrictions embedded in earlier market structures; whilst

- On the other hand, there has been a tendency toward to increased regulation associated with (a) the need to establish and police new governance structures for liberalised markets (captured by the notion that "freer markets need more rules") and (b) increased complexity in the regulation of monopolistic network services, serving multiple users, in a changing economic environment.

Lack of regulatory action in such circumstances might, therefore, not necessarily be as advantageous for public policy as it could be in some other parts of government. In the context of EU energy market liberalisation, for example, a ‘do nothing’ option might be the one associated with the greatest market distortions.

In more practical terms, it is apparent that, if inappropriately handled, the RIA process could easily absorb significant internal resources and, in consequence, potentially hinder better policymaking or desirable change, or, alternatively, simply raise regulatory costs. The immediate, impact effect of requirements for RIAs is to add to bureaucracy and to the regulatory burden. Unless, therefore, there are

counterbalancing advantages, the net effect of RIAs on the quality and/or cost of decision-making will tend to be adverse.

Adverse effects could, for example, arise in the event of:

- A lack of clear internal guidance on the proper conduct and use of RIAs;

- A defensive, internal mentality whereby RIAs are seen as a necessary, but imposed, encumbrance that is to be dealt with by providing "justification" for decisions, not least so as to inhibit potential challenges/appeals.

It is difficult to over-stress the importance of striving to avoid the second of these two situations. It could lead to outcomes in which nothing substantive will have changed in terms of decision-making, but regulatory costs will have risen. The more important point, however, is that a 'self justificatory' approach to RIAs is liable to degradation in the quality of regulatory analysis itself.

The history of the use of cost-benefit analysis (CBA) in government serves as a warning here. It is nearly always possible to come up with sets of assumptions and arguments to justify a particular decision, and the CBA record illustrates the creativity that can be applied in this direction.[2] The substantive damage caused is not just that extra resources are absorbed and nothing changes -- though that is a real enough effect -- but rather that, in the process, evidence and reasoning become stretched. Lines taken to justify one particular decision can then become inconsistent with lines taken to justify another decision (perhaps made within a different part of the same organisation, by different people). Perhaps worst of all, a culture of 'stretched' approaches to analysis, and of inattentiveness to inconvenient facts and evidence, can take hold.

[2] A similar point holds in relation to the treatment of evidence. The current vogue for 'evidence-based' approaches in the public sector (e.g. health policy) can easily collapse into procedures that amount simply to finding and citing facts and evidence that support preferred positions. Uncomfortable evidence is quietly ignored, buried or left 'undiscovered'.

The end point of this process can be an organisation that, in effect, applies different, and relatively arbitrary, criteria in evaluating trade-offs in different circumstances. In one situation particular emphasis/weight might be given to environmental effects in justifying a decision, in another it might be security of supply, in yet another it might be competition. In such an eventuality, the coherent application of principle is lost, organisational effectiveness is reduced, the regulatory agency becomes 'a law, or polity, unto itself', and regulation becomes uncertain (because those affected have no basis on which to predict likely regulatory responses to changing circumstances).

These points are put starkly because the stakes are high, and the global record of regulation is sufficient to demonstrate that such outcomes can, not infrequently, eventuate. Indeed, arguably, the above description fits, all too well, the situation in the UK prior to the development of delegated, independent regulation.

At this point it is possible to draw together some general implications of the discussion thus far:

- *Unless the RIA process leads to positive changes in decision-making, the process itself will add negative value (because extra resources are absorbed without producing any consequential effects/impact).*

- *Given that "justification" is a back-end activity in the policy development cycle, in order to inhibit its take-over of the RIA process it is important to initiate impact assessments very early in the wider policy development process, a point that is heavily stressed both by the NAO in its general assessment of these exercises, and by Cabinet Office guidelines. It is in the initial stages that structured thinking can contribute most to policymaking, and leaving assessments until later will increase the risk that self-justification will predominate in the assessments.*

- *RIAs should embody a reasonably systematic and coherent (across the organisation) approach to evaluation, driven by statutory duties and by the translation of those statutory duties into an appropriate regulatory strategy for the relevant period.*

It will be the third of the above outcomes that will likely be the most difficult to attain, but Ofgem has, compared with a number of government departments, one major

advantage in achieving it. Notwithstanding the accretion over time of new statutory duties, and of some resulting reduction in clarity of objectives -- by virtue of requirements to exercise more discretion in determining weights to be allocated to different objectives when confronted with policy trade-offs --, those duties continue to be hierarchically ordered.

Clarity, simplicity, and hierarchy in objectives have proved to be of central importance in the success of 'independent', delegated regulation, not just in the energy sector and not just in the UK. Together, they can, or should, bring coherence to regulatory decision-making and a higher level of 'regulatory certainty' to the market. It is therefore important that RIAs properly reflect Ofgem's objectives, as set down in statute and as translated into regulatory policy at the strategic level, and that they do not become confused by the intrusion of other objectives ('goal displacement').

Again, some general implications for Ofgem's approach to RIAs follow immediately:

- *RIAs should not be treated as simple exercises in CBA. That is, it cannot be a matter of adding up costs, adding up benefits, and then choosing the option that maximises the net benefit. If that were the case, the objective of the Authority would be the maximisation of economic efficiency (total benefits less total costs), and that is not what the statutes say.*[3]

- *The primacy of the duty to protect consumers, wherever appropriate by promoting effective competition, can, if translated into the operational conduct of RIAs, provide the desired cross-organisational coherence (even in relation to decisions concerning regulated networks, there will typically be potentially important implications for competition in related markets).*

[3] Nor is it what Cabinet Office guidance says: "A Regulatory Impact Assessment (RIA) is a tool which informs (my emphasis) policy decisions." That is, whilst costs and benefits are certainly to be assessed where possible, there is no implication that the resulting totals should be determinative. EU documents are also clear on the point: "RIA should be an integral part of the policy making process at EU and national levels and not a bureaucratic add-on. It does not replace the political decision: rather it allows that decision to be taken with clear knowledge of the evidence" (Mandelkern Group Final Report 2001). "An impact assessment will not necessarily generate clear-cut conclusions or recommendations. It does, however, provide an important input by informing decision-makers of the consequences of policy choices" (European Commission Communication on Impact Assessment, 2002).

- *The primacy of consumer and competition considerations suggests that Ofgem's approach to RIAs should be relatively closely aligned with the approach taken by the Office of Fair Trading when conducting investigations of markets subject to substantial regulation (the OFT being one of the few other parts of government that is primarily focused on issues of consumer protection and competition).*

The significance of these points will be developed further below.

The Review

This Review is similar in approach to that of the NAO in its first annual report on RIAs. Specifically, it is based upon assessment of a sample of recent Ofgem RIAs, and the evaluation is structured around the major components that can be expected to be found in a RIA.

The RIAs included in the sample are summarised in the following documents:

- Testing domestic consumer take-up of energy services: direction to initiate trial suspension of 28 day rule;
- Electricity Distribution Price Control Review. Policy document;
- Regulatory Impact Assessment for Registered Power Zones and the Innovation Funding Incentive;
- National Grid Transco - Potential sale of network distribution businesses. Allocations of roles and responsibilities between transmission and distribution networks - Regulatory impact Assessment;
- Transmission Investment for Renewable Generation. Initial Proposals
- Making markets work for consumers - the regulation of gas and electricity sales and marketing proposals for the amendment of standard licence condition 48;
- The review of top up arrangements in gas. Conclusions Document; and

- Connection and Use of System Code Proposed Amendment CAP047 – "Introduction of a competitive process for the provision of mandatory frequency response": Impact Assessment.

Unlike the NAO Report, however, I have decided not to highlight individual documents, for example in the form case studies. The reason for this is that, as is manifest from the documents, the individual RIAs were produced at different stages of wider policy development and consultation processes, and each has its own particular context. For example, there may be other associated documents on the same issues (e.g. initial consultations, initial proposals, preliminary decisions/ conclusions, final decisions/conclusions, etc.) Alternatively, the RIAs may relate to measures that have been the subject of substantial, non-documentary consultation and discussion.

It is clear that the position of each RIA within the more general process has partly shaped its style and structure. Assessment of individual case studies, to be helpful, would need to take account of each particular context, which would be a far larger task than contemplated for this review. This did not, therefore, seem to be a constructive approach.

On the other hand, on reading through the sample documents it becomes clear that the differences among the documents, in terms of style, length, structure, etc. (of which there are many), were not simply the result of contextual differences, but that they pointed also to a number of *generic* issues and problems in the way RIAs have been handled by Ofgem in this early stage of their more systematic adoption.

These generic issues appeared to be clustered on apparently different interpretations, by the different authors, of the purposes of RIAs in general, and of the purposes and relevancies of the specific sections of RIAs in particular. It therefore seemed more useful to structure the review around these purposes, and around the variations in approaches revealed by the documents in relation to particular sections of a RIA, than to adopt a document-by-document approach to evaluation.

The implicit criteria used in making an assessment on this basis are the Cabinet Office's five principles of good regulation. RIAs are, after all, just one type of

regulatory activity, and there is no obvious reason why they should not be assessed on the same basis as other regulatory activities. These principles are: accountability, transparency, proportionality, consistency and targeting.

Of the five, transparency and accountability are probably the least important in the current context, because Ofgem is already geared up on this front, for example through its tradition of extensive consultation. The criteria that are of greater significance for this review, together with the sorts of questions that might be raised in connection with them, are therefore:

- Proportionality: what difference do the RIAs make to decision-making? If they have little effect on decisions and absorb significant resources, they are clearly disproportionate in their current manifestations.

- Consistency: are similar principles applied across the RIA exercises? For example, do they take similar approaches to, say, the specification of objectives, the analysis of risks and unintended consequences, the assessment of competition?

- Targeting: are RIAs done when the relevant issues are 'important' enough, to justify such assessments (as now required by the Energy Act), but not otherwise? (This is another way of putting the "importance" question identified in the legislation – see the opening paragraph of this review.) Do RIAs focus on the right issues and questions, or do they tend to neglect certain factors that may be highly relevant to the assessments?

These principles and questions are clearly of direct relevance to current, 'macro' concerns about the scope and quality of regulation. Disproportionality tends to lead to an excessive regulatory burden; inconsistency tends to lead to regulatory uncertainty; and poor targeting tends to lead to both ineffective and inefficient regulation.

Notwithstanding the above comments on the specific position of the Authority and Ofgem, many of the findings and recommendations of the NAO Report are of direct relevance to Ofgem in developing its RIAs. Rather than simply repeat them here, however, this review focuses on issues that are of more direct and specific relevance

to the Authority and Ofgem (i.e. it is more targeted on specific, distinguishing factors). It is, therefore, best read alongside the NAO Report, to which it is intended to be complementary.

Sections of the RIAs

Objectives

Principles

There are probably two main purposes of the objectives section of an Ofgem RIA:

- To provide a reminder of general statutory duties, or of the relevant duties/criteria in the case of code modifications, so as to help achieve consistency of approach amongst RIAs (and in policy development more generally).

- To set out more specific, 'proximate' or intermediate objectives, for use in assessing each of the various, and possibly relatively detailed, options that might be identified.

Although the NAO Report focuses on the second of these purposes, the first is equally, and arguably more, significant in the Ofgem context. It is of particular importance as a counter-weight to some of the biases that can otherwise creep into the process, such as a tendency to think that the RIA process is simply an exercise in CBA, or that proposals need *only* be assessed against a narrowed objective, to the exclusion of consideration of their wider impact on the carrying out of statutory duties.

As already stated, RIAs are, of course, concerned with the evaluation of costs and benefits (the economic valuation of 'impacts'), but, in order to counter a common misconception, *there is great advantage in posting a very early, if implicit, reminder that, given the Authority's statutory duties, decisions are not, and should not be, driven by a simple weighing of costs and benefits*. Estimated costs and benefits are considerations to be taken into account: *they inform decisions, rather than determining them*.

Since this is often misunderstood, there may be advantage in providing internal Ofgem guidance to staff required to undertake RIAs. It should be recognised quite explicitly that there will be cases when a RIA points, on a balance of probability basis, to the attribution of negative, overall net benefits to a particular measure, but when, given statutory duties, it would be right for that measure to be adopted. Otherwise there is a danger that staff will believe that there is a *requirement* that a RIA should be able to show that the preferred option is the one with the largest net benefit, with the almost inevitable result that the evaluation process will be biased.[4]

RIAs are, or should be, objective assessments of the impacts of various possible measures, including, as the Cabinet Office guidelines emphasise, doing nothing. Such assessments should, where possible, seek to quantify effects, but an early statement of statutory objectives helps to put the quantification issues into perspective. Given the relevant objectives, decisions will frequently not hinge on a fine balance between quantified costs and benefits, and, in reality, precise and comprehensive quantification is rarely feasible, at least at anything approximating an acceptable cost. It can, therefore, be disproportionate to devote substantial resources to a search for highly detailed quantification. Recognition of this reality would also help to avoid the even greater danger (e.g. to organisational credibility) of 'reverse engineering' in the assessment, motivated by an attempt to show that, quantitatively, the benefits of a preferred proposal exceed its costs.

Further, a clear statement of statutory duties would assist in establishing the importance of the competition assessment. The issue of effects on competition has an uneasy position within the RIA process: in the early stages of development of guidelines for RIAs, consideration of competition effects was absent, and it was only added at a later stage: the OECD reference checklist of questions for regulatory evaluations contains no reference to competition; and the NAO did not identify assessment of competition as one of the main areas it sought to examine.

This is a weakness of the RIA process generally and, arguably, creates inconsistencies with developing European law (see later). Whatever the general position, however, for the Authority and Ofgem the competition assessment is

[4] As implied earlier, in an uncertain world it is often not difficult, by making some apparently modest adjustment to assumptions, to bring estimated net benefits in line with a preferred decision.

central, by virtue of the relevant statutes. Early statement of statutory objectives, with their explicit reference to competition, helps to set the appropriate context.

In relation to the more specific objectives, there is a decision for Ofgem to make. Currently, the RIAs tend to include, after 'objectives', a section on 'key issues'. This appears to have emerged from Ofgem custom and practice in the development of policy documents, rather than from a RIA 'boiler-plate' based upon Cabinet Office guidelines (although it can be noted that this section serves purposes similar to those labelled 'background' or 'definition of the problem' in general formulations of guidelines). 'Key issues' tends, at the moment, to contain discussion that encompasses the relevant 'specific objectives' issues -- although the approach is by no means consistent across documents (see below).

The detailing of more specific objectives could, therefore, be brought forward into the objectives section, more in line with the standard boiler-plate, or it could continue to be dealt with under the 'key issues' heading. In the latter case, there would be merit in including, in the 'objectives' section, not only a statement of statutory duties, but also an indication of which of those duties are considered to be of particular relevance in the specific context. For example, if a proposal was concerned chiefly with security of supply issues, specific reference could be made to the relevant duty, and to its positioning relative to other duties. (E.g. "the aim of the measures being contemplated/assessed is better to carry out the Authority's statutory duty in relation to security of supply, taking account of the Authority's obligations regarding its other statutory duties"). Further development of the purposes of the potential measures could then be contained in the key issues section.

The recommendation of this review is that the second of these alternatives be adopted (i.e. discussion of the narrower purposes of particular measures to be included in 'key issues'). The reason for this is that, otherwise, the specific objective set out could, all too easily, come out of thin air. Notwithstanding the arguments in favour of SMART objectives (see the NAO Report), there is a prior issue of how any given SMART objective contributes to the over-riding duties and strategic objectives of the Authority and Ofgem. Put another way, any specific objective with SMART characteristics is likely itself to be a matter of discretionary choice. In the interests of accountability, transparency and better regulation in general, it is appropriate for that choice to be reasoned and explained. The 'key issues' section, following on as it

does from 'objectives', appears to be the place in the assessment where that is most appropriately done.

Finally, it goes without saying that, the opening 'objectives' section of any RIA should avoid discussion of the potential measures (to be evaluated) themselves. If and when this occurs, it is a reasonable bet that what follows will not be an objective evaluation of the options, but rather an exercise focused on providing a justification for a preferred measure.

The sample RIAs

The sample RIA documents are a very mixed bag, incorporating a variety of approaches to the specification of objectives. This is, by and of itself, an unsatisfactory situation, since it signals a potential lack of consistency within Ofgem in respect of both aims and of standards of evaluation.

In three of the nine cases, there appears to be no clear specification of objectives, albeit in one of these three a short summary of the document does make reference to the objective of the measure.

In two of the others there is no statement of general objectives (statutory duties) and, although there is coverage of more specific aims, these are not clearly linked back to the general context. One of the two opens the discussion of options in the objectives section; in the other the statement is in some ways admirably brief and clear, but it begs question of whether the specific aim is appropriately derived from statutory duties in the relevant context.

In one document, the objective is stated in terms of 'consultation', rather than in terms of the effects of the measures being consulted upon.

In one document, both general and specific objectives are set out, but are separated by intervening text and with little connected reasoning.

Only in one of the nine RIAs is there a clear statement of statutory duties, along with identification of the particular duties and responsibilities of direct relevance to the

measures in contemplation (NGT DN Sales, section 2, which might serve as an initial benchmark).

In its Report, the NAO stated that: "A clear statement of objectives at the outset is therefore an important feature of a good quality RIA. It enables the reader to judge how far the risk assessment is relevant and how far the options considered address the objectives." It went on to say that: "Only half of our sample contained a reasonably clear statement of objectives and only one fulfilled SMART criteria. SMART criteria may not always be appropriate, but objectives should nevertheless be clear. Where they were poorly defined, the lack of clarity fed through to other areas of the RIA such as the consideration of options. They also gave the reader little clear idea of what the Government aimed to achieve by introducing the regulation or which parts of the problem were dealt with in part or wholly by other regulations. Indeed one RIA contained no statement of objectives at all. Others stated vague wider Government policy objectives without clearly informing the reader of the specific objectives of the regulation with which the RIA was concerned."

These NAO points of criticism are, on the evidence, clearly applicable to the Ofgem RIAs, and, for the reasons given by the NAO, this is an important area where substantial, and relatively simple-to-achieve, improvements can be made.

Key issues

As already noted, the key issues section is a distinctive feature of Ofgem RIAs, which appears to have developed as a matter of custom and practice from the Office's consultation processes. For, reasons given, it is a potentially valuable section in which, among other things, the development of more specific objectives can be linked back to statutory duties. If well done, this should be an improvement on the boiler-plate approach, which, in my view, is still lacking in this area.[5]

To be more specific, key issues might incorporate two important steps in an RIA:

- Development of the relevant, specific objectives (e.g. why achievement of a particular proximate or intermediate objective might be expected to contribute to

[5] The regulatory assessment process is very much a work in progress that will be subject to development and refinement over time.

the carrying out of statutory duties). Again, it is important not to fall into self-justification mode here: one of the purposes of the RIA is to test out whether an intermediate objective does in fact serve the general purposes, and whether there might be other specifications of the objective that would be more appropriate. One question to address is: is Ofgem right in seeking to pursue this particular, 'narrowed' goal?

- Preliminary assessment of the 'do nothing' option. This is desirable at an early stage, in order to identify whether or not there is a problem. There is little point in going forward to the next stage of the assessment, concerned with options, if there is no prospect of a problem arising on a 'do nothing' basis. Pre-judgements (e.g. "something must be done about this" are to be avoided: the issue at stake at this point is whether or not there appears to be a significant risk that a material problem might eventuate if nothing is done, not whether or not there clearly is a problem calling for action. Whether or not there is an issue that is best addressed by appropriate measures is a question that can only be settled after analysis of available options, including a more in-depth analysis of 'do nothing'. On the other hand, it is relevant in this section to provide some preliminary, broad-brush quantification, in order to help assess the materiality of potential problems.

The position is, however, somewhat different in relation to code modification decisions. In these latter cases, the Authority and Ofgem are in a somewhat different position, sitting in judgement of proposals that have been put forward by other parties. The key issues section would appear to be less significant in such cases, and the evaluation might, after setting out relevant objectives/criteria, reasonably go straight to options.

Perhaps the major danger to avoid in the key issues section is the outcome in which it becomes a rather discursive essay on 'concerns', reflecting a presumptive, Ofgem view-of-the-world. As in other sections of the evaluations, the aim should be drafting that is crisp and to the point.

The sample RIAs

The content of the key issues sections of the RIAs is generally much more satisfactory than is the case for 'objectives', which probably reflects the longer Ofgem tradition of drafting this particular type of section.

Only two of the documents omitted the section, and one of those concerned a code modification where, for reasons given, that was an entirely appropriate action.

Three of the remaining documents contained some quantification, at a broadly appropriate level, aimed at indicating the materiality of the issues, and in at least one of the others quantification would have been redundant in the light of the matters to be assessed.

Only two of the documents can be seriously faulted: one because the section was excessively brief and, whilst the key point made was almost certainly correct, it could clearly be held to be unreasoned; the second because the discussion quickly spilled over into consideration of options, thus conflating the various issues that need to be addressed in the course of the RIA. In this second document, the weakness contributed to the general impression that what was being presented was simply a justification for doing what Ofgem had decided to do.

More generally, there was significant variability in the way that material was presented. Although not a major fault in itself, this is not as helpful as it might be to readers. More significantly, it may be an indication of a certain lack of consistency in the way in which proposals are evaluated.

Particularly given this latter possibility, *there would be merit in providing more definitive internal guidance on what material should typically be included, and on what questions should be addressed, in the key issues sections of RIA documents.*

Options

The 'options' element of an impact assessment is difficult because, in general, there might be a whole range of feasible alternatives, and it would be disproportionate in terms of resource costs to evaluate all of the possibilities in detail. Some judgement

is therefore required in narrowing down the list to manageable proportions. Sequencing in option development – for example, developing the detail ('micro' options) of proposals only after some other, relatively broad options have been discarded – is also typically required, although this is as aspect of analysis upon which general guidance is as yet relatively undeveloped.

In assessing this particular part of the RIA exercise, the following points may be relevant:

- If, as suggested in this review, strong emphasis is placed upon starting assessments and publishing initial documents very early in the policy development process, the option identification problem is partly eased. Ofgem can present a preliminary list of the options that it believes should be assessed, and invite suggestions, amendments and/or submission of options radically different from those initially identified, as part of the normal consultation process. This process can be greatly facilitated if there is a clear statement of objectives in the early parts of the RIA document, so that the invitation is explicit in seeking alternatives that might better meet the *stated* objectives (and not 'pet proposals' from respondents, directed at some other ends).

- Openness to new alternatives is particularly important in view of a natural bias toward over-constraining the options considered, and it can be noted that, in its study, the NAO found that the range of alternative measures considered by government departments was often highly restricted. This 'tendency to restrict' is not only related to a sensible desire to control administrative costs but also to a tendency found within most large organisations to develop a particular view of the world/market/sector. Since such views can sometimes simply be wrong, or can become outdated in changing circumstances, it is desirable that Ofgem be open to alternative views, so as to make better use of the diverse information that is potentially available from a wide range of sources and perspectives.

- In relation to the 'do nothing' option, it should be noted that this is not equivalent to 'do nothing indefinitely'. Thus, there may be circumstances in which the preferred alternative turns out to be "do nothing now, monitor the situation, and then act if the new evidence accumulated so indicates." That is, doing nothing has an 'option value' in the technical sense: there is potential value in waiting

and collecting new evidence, and this value should properly be reflected in the assessment.

- In the case of code amendments, the options available are typically limited and are developed outside of Ofgem. This raises difficulties in relation to the assessment of the 'do nothing' (i.e. reject the modification) alternative. Whereas 'waiting and seeing' might, in other circumstances, lead to subsequent action that is under Ofgem's control, in the case of modifications Ofgem cannot necessarily rely on a subsequent, appropriate proposal being developed and brought forward. In economic terms, this tends to reduce the (technical) 'option value' of do nothing, other things equal. This is obviously a difficult area, involving legal as well as economic issues.

- The evaluation of options has characteristics similar to many other "information search" activities, of which R&D is one. In this type of problem, efficient approaches are often characterised by a relatively long list of initial alternatives, followed by a subsequent weeding out process in which less attractive alternatives are de-selected as evidence suggesting that particular options are likely dominated by others is gathered. This suggests that, in initial RIAs, the opening list of alternatives should often be relatively broad.

The sample RIAs

Six of the eight sample RIAs explicitly identified multiple alternatives to the status quo, and the range of alternatives considered did not, in any of these cases, appear to be excessive. In this area, then, the Ofgem RIAs, considered as a group, score significantly better than those considered by the NAO in its own evaluation exercise.

In two of the eight cases, the alternative to the status quo had effectively been narrowed to one as a result of previous consultations, consistent with an efficient weeding out process described above. However, given that more formal RIAs are a relatively recent development, it is not possible to say whether a sufficient number of alternatives were considered at earlier stages.

It is also not possible to assess the full extent to which new options were brought forward by other parties and evaluated in the policy development process. The

documents indicate that, in some cases, NGT played a substantial role in the development of options, and that feedback from industry workgroups was also influential. The contribution of other parties remains relatively obscure, however, and this is an aspect of the RIA process that may be worth monitoring more closely in the future. In regulation generally there is an ever-present concern that policy may be unduly influenced by entrenched interests who, quite apart from defending their own commercial positions, may have developed views-of-the-world that are not necessarily shared by others. Part of the function of the RIA process is to ensure that policy making is kept open to influence by outside interests and new information.

The most serious fault that could be identified was a statement in one of the documents to the effect that it was not appropriate to consider the 'do nothing' option. This must have been a drafting error in that the 'do nothing' option was in fact considered and assessed in the document. The concern that it raises is therefore not so much that Cabinet Office guidelines were flouted, but rather that the drafting error might reflect an underlying pre-judgement about the appropriate course of action to be followed ("something must be done").

Costs and benefits

The evaluation of costs and benefits poses a series of challenges in the RIA process, and the historical record of the application of cost-benefit analysis in the public sector is not entirely comforting. Precise quantification is difficult because it depends upon information of a quality that is often not available, and upon painstaking, detailed and frequently time consuming analysis. There is, as a result, a strong tendency to take short cuts that do violence either to sound and consistent reasoning or to the assessment of evidence or to both. Good regulation requires the development of resistance to such temptation.

There are, on the other hand, a number of more positive factors at work, including:

- As argued above, the purpose of RIAs is to inform regulatory decision making, not to introduce a specific decision criterion that is highly sensitive to the quantification (such as, "choose the option with the highest, quantified net benefit").

- As in other spheres of economic policy (egs. monetary policy and competition policy), decision-making can be simplified by the consistent application of sound principles and presumptions that are aligned with statutory duties (egs presumptions in favour of competition, cost-reflectivity in pricing, etc.)

- *The principle function of quantification in the RIA process is to test for proportionality.* For example, there may be circumstances in which the strict application of a well established principle or presumption would lead to disproportionately harmful effects, in which case the analysis of costs and benefits might lead to the setting aside of the principle/presumption in a specific case.

Thus, whilst the RIA process requires that attempts be made to quantify the costs and benefits associated with identified impacts, the analysis will most frequently be necessarily broad-brush in its scope and partial in its quantification (as is clear from all evaluations of RIAs, including the March 2004 Report of the NAO). In general, it is better to accept this reality, and to focus on the assessment of likely ranges of (uncertain) costs and benefits, than to pretend that precise quantification is feasible and to strive for misleading 'point estimates' of the economic values of the various, identified impacts of regulation. As the NAO Report critically concluded about the RIAs surveyed: "All but one of the RIAs in the sample contained some form of quantified estimate of costs and all acknowledged a level of uncertainty about the data used for the estimates But the uncertainties were not always reflected in the costs and benefits, which presented single point estimates rather than ranges. Only one gave the results of sensitivity tests showing the consequences of changes in key assumptions."

There is one further point about the assessment of costs and benefits that is highly relevant: the scope of the assessment will necessarily depend upon the stage of the policy development process at which the RIA is undertaken. If, as argued above (consistent with the views of the NAO), it is particularly important to make evaluations at an early stage, so as to increase the chances that the analysis will actually affect decisions and reduce the risk that it will turn into a cosmetic, ex post exercise in self-justification, it will almost necessarily be the case that the quantification of impacts will be highly limited. At the early stage of the process, the principal focus will be on identifying problems that may need to be addressed, possible options for doing so,

and their possible effects. The more detailed evaluation of all of these things will come later, as the policy development exercise progresses. By the closing stages of the process, when final decisions are to be taken, the actual RIA document will become much more of a reporting exercise, summarising the information and evaluations that have taken place in the course of the policy development work.

The Sample RIAs

Only one of the documents lacks an explicit section on costs and benefits, which appears to be a consequence of the nature of the document (i.e. its role in the wider process). Most of the others make some attempt at quantification, although the extent to which this is done varies, and in no case is the quantification more than highly partial.

Although there is a push for greater quantification in RIAs across government, my judgement is that insufficient quantification is not a generic weakness in the Ofgem RIAs. Indeed, in at least two of the documents (NGT Distribution Network sales, Top-up) the assessments of costs and benefits are about as good as analysis can be expected to get in this area, taking account of the inevitable constraints on internal resources.

To the extent that there are general weaknesses, they are more subtle and to do with the conceptual and technical approaches taken to the assessment of costs and benefits. That is, any problem is less to do with the "degree of quantification" question that features so prominently in discussion of RIAs more generally, and more to do with the type or style of quantification and fact-finding that is employed. In this context, the following points can be made, remembering that these are generalisations and do not necessarily apply to each and every one of the documents:

1. There is a defensive quality about some of the analysis: "this is an exercise that has to be done, so let's tick the boxes." This leads to an unstructured or 'flat-list' approach to evaluation, which does not focus the information gathering and analysis on aspects of the issues where they can be expected to be most valuable.

2. There is little sense that anything new was *discovered* in the course of the analyses, and therefore no indication that minds or decisions were, or were likely to be, changed as a result.

3. Some of the documents suggest a tendency towards responding to pressures for quantification by taking a "let's find a number to put it" approach. The NAO comments, cited above, on the tendency to opt for point estimates of costs and benefits, rather than ranges of costs and benefits, are therefore relevant to some of the Ofgem RIAs.

4. There is little sense that the assessment of costs and benefits is, at bottom, about *proportionality*, and that therefore what is required is a more structured approach that asks: are the costs of this measure disproportionate relative to its perceived benefits on account of either (a) one or two disproportionately large impacts or (b) an accumulation of a substantial number of small, adverse impacts? In many cases, to address these questions it would be sufficient to determine simple bounds on the likely magnitudes of identified impacts, a less demanding task than more precise quantification.

All these points lead back to what was said at the outset. RIAs themselves will amount to no more than increased bureaucracy unless they actually change things, somewhere, sometime. At best, RIAs can provide policy makers with a structured approach to discovery and learning, and the assessment of costs and benefits is an important component of that approach. An unstructured, box-ticking approach will likely not yield such benefits.

Risks and unintended consequences

Cabinet Office guidance states that RIAs should include a risk assessment discussing the risks the regulations aim to address. However, such an analysis should already have been completed if a correct approach has been taken to the assessment of the 'do nothing' option (what the NAO refers to as the counterfactual).

The assessment of risks, as a separate identifiable aspect of an RIA, is therefore better seen as part of an exercise encompassing the exploration of possible, unintended consequences. The heart of this exercise is a form of devil's advocacy or institutionalized scepticism: the favoured view of likely regulatory impacts should be tested out against alternative views. For example, good questions are: "what could go wrong if we have got this (the favoured) assessment wrong?" and "how sure are we that we have not missed any likely, substantial effects/impacts?"

Consultation can, if properly utilized, be a great help here. There tends to be an inbuilt bias toward placing more weight on evidence that corroborates, or is consistent with, a maintained position than on evidence that tends to contradict it. However, it is often the contradictory evidence that is the more informative, and that therefore merits particularly close attention (as in the old proverb, it is the exception that 'proves' (i.e. tests) the rule). Consultation is a process through which such evidence can be obtained.

The risk assessment exercise is important because unintended consequences (unidentified impacts) are ubiquitous. Indeed, a large part of the academic study of regulation is taken up with the exploration of unintended consequences at the empirical level and with the analysis of policy targeting at the theoretical level (a closely related issue in that poorly targeted policies tend to be associated with more significant, unintended impacts).

The sample RIAs

Only half of the documents contained identifiable sections on risks, and the level of analysis in those that did was, on average, inadequate. For example, one of the stronger documents on this score does no more than list a set of risks, with no assessment of whether they are likely to eventuate or of the significance of the consequences if they did.

The position in relation to the consideration of unintended consequences is weaker still. There is virtually no recognition that there might be views on the likely impacts of regulatory options other than the views taken by Ofgem, and that it is appropriate to say something at least of the consequences if those other views are right, even if, in the event, it is judged that those views are unlikely to be right.

It is possible that this neglect of risks is associated with the effort that Ofgem devotes to consultation processes. That is, the view might be taken that alternative views are fully aired and evaluated as a result of consultation, and that they play no part in the RIA process.

If that is the case, however, it betrays a misunderstanding of the nature and purposes of RIAs, suggesting again that they might be being seen as a stand-alone exercise in accounting or justification, largely divorced from the policy development process. In reality, the RIA process in its later stages is a means of integrating the results of consultation with other strands of policy development and, for Ofgem, this should be one of the strongest and most easily written sections of a (final, not initial) RIA document.

At the moment, therefore, it does not appear that the RIAs are making full and appropriate use of information available, or potentially available, during consultation.

Competition

For reasons explained at the outset, the competition assessment is the most important aspect of the RIA process that will need to be considered going forward. It is also an area that requires 'high-level' decisions to be made, either explicitly or implicitly. For this reason, the normal sequence of this review is reversed at this point, and comments will first be made on the sample documents.

The sample RIAs

For an organisation whose primary duty is to protect the interests of consumers (existing and future) wherever appropriate by promoting effective competition, the competition assessments in the documents can only be described as weak. The consistency of that weakness – and only one (Top up) of the eight documents contains a recognisable competition assessment of normal standard – indicates a structural/organisational failure, rather than a quality of analysis failure; although there are individual instances of somewhat eccentric views being taken of possible effects on competition.

This is corroborated by the positioning and length of the sections, which follow the 'boiler-plate' in treating the competition assessment almost as an afterthought, to be done after the real work has been completed.

Discussion

Logically, the competition assessment should follow the identification of options and appear before the assessment of costs and benefits. That is, the sequence should be: objectives, key issues, options, competition, costs and benefits … This is because impacts on the various market participants will depend in part, and (particularly in the longer term) often in large part, on the effects that regulatory measures have on the competitive process.

This logic applies to RIAs in general, and not just to those undertaken by Ofgem. Statutory duties simply provide further reasons why Ofgem should seek to change the existing ordering (and there is no substantive obstacle to a change in the sequencing of the analysis: what the Cabinet Office and the NAO are concerned about is that the relevant points are covered and that the analyses are sound, not the fine detail of the layout of documents).

Beyond the question of the order of sections in documents lies the much deeper issue of the relative status/weight to be given to the competition assessment in policy decisions in general and in RIAs in particular. Here there are a number of factors that indicate that effects on competition should, with the exception of impacts on consumers, be afforded some priority over other considerations:

- Statutory duties, which place consumers and competition at the top of the hierarchy.

- Ofgem experience – for example, the transforming effect on the NETA programme when the priority of competition was clearly and unambiguously articulated.

- The UK position on Services of General Economic Interest in the Lisbon process, which favoured strict limitation of exemptions from European competition law for the relevant regulations (Ofgem produced the first draft of

the relevant guidelines for the UK Competition Act, which drafting reflected a common governmental position on these matters).

- The developing application of European Law – for example the *Fiammiferi* case, in which the Italian competition authority challenged national regulations covering the production, distribution and sales of matches, which included an anti-competitive quota system. The matter was referred to the European Court of Justice, which ruled that national legislation must be disapplied if it requires or facilitates conduct contrary to EC law against anti-competitive agreements (i.e. conduct in violation of Article 81).

- A recent speech by the Chairman of the OFT, suggesting that, consistent with Article 81 of the Treaty and with the developing application of that legislation, "a good test for a regulation shown to be anti-competitive is whether it achieves, and *is indispensable to the achievement of* (my emphasis), identified public interest benefits that outweigh the detriment from restricted competition."

What all this suggests is that a key, substantive question to be addressed first in the option evaluation process is:

"Does this measure (including 'do nothing') have the effect of preventing, restricting or distorting competition and, if so, are the restrictions indispensable/necessary for the achievement of valid (i.e. in conformity with statutory duties) regulatory objectives."

In practice, indispensability/necessity often reduces to a proportionality test in applications of Article 81. Thus, the decision criterion is, roughly: opt for the least restrictive regulation, unless it can be expected to impose costs that are disproportionately higher than the next best alternative; where the burden of proof required to establish disproportionality is a high one (i.e. it is not just a matter of higher costs relative to benefits: costs must be substantially higher).

Whilst this may look like a minor shift of emphasis, it can potentially have a very major impact on the conduct of RIAs and, more generally, on the policy development process, for a number of reasons:

- First, as the legislative underpinnings make clear, we are not dealing here with CBA. There is a presumption in favour of competition, which can be overturned, but only if the evidence meets a higher burden of proof than conventional CBA. *This reinforces the general message, which is valid in its own right, that cost and benefit assessments are not to be considered determinative.*

- Second, by virtue of the burden of proof required, it puts the onus on those who would argue for measures that restrict competition. For example, in cases where Ofgem has determined that a restriction of competition exists by virtue of existing regulation, and that the restriction is unnecessary in current circumstances, the burden of proof falls on those favouring the regulation to show that removal of the regulation would have disproportionate, adverse effects. On the other hand, in cases where Ofgem itself is tending toward the introduction of new regulations that have restrictive effects, it would be for Ofgem to discharge the burden of proof regarding indispensability.

- Third, such structured evaluation simplifies and reduces the administrative costs of performing RIAs (alternatively it allows more options to be explored with given resources). For example, if certain measures are found to have restrictive effects, and subject only to leaving open the possibility that some party could bring forth convincing evidence that the relevant costs of all other options would be disproportionate, relatively modest levels of further fact-finding and evaluation in relation to impacts might be sufficient in order to arrive at a decision..

- Fourth, the application of a simple, general principle facilitates policy coherence and consistency at several levels: within Ofgem itself; between regulation and competition law in the UK; within government as a whole; and, potentially most significant in the longer term for the effectiveness of regulation, amongst Member States of the European Union (because the principle flows directly from Article 81 of the Treaty and from developing European case law).

- Fifth, it provides for a coherent way of addressing environmental effects, health and safety, etc. in RIAs, which is consistent with statutory duties. Consider, for example, a measure that is desirable on energy market grounds, but that has some direct, negative environmental consequences. Ofgem might simply note these points and then balance them off in its judgement. *That, however, would be to ignore unintended consequences.* Other things equal, a measure might have a negative *direct* effects on the environment, but its *indirect effects might improve the trade-offs for environmental policy decisions.* Indeed, this is the basis for one of the intellectual arguments for the primacy of competition, which primacy is embodied in Article 81 of the European Treaty: competition tends to improve the trade-offs amongst alternative ends, allowing other public policy objectives to be reached at lower cost. The indispensability/ necessity test addresses this directly: if the restriction of competition is not necessary then, whatever its immediate justification in terms of, say, direct environmental benefits, *there will most likely be a better, less costly way of meeting the environmental objectives*.

In any event, even if the Authority and Ofgem decide against such a structured approach to decision making, it remains that case that the competition section is better placed before 'costs and benefits' and that it should assess the impact on competition of (and hence any restrictions of competition likely to be caused by) each and every of the various options that have been identified.

As indicated above, this is not the way in which RIAs are currently laid out, and the actual analyses of the impacts on competition are, for the most part, insufficiently detailed and reasoned.

Environment

It is clear that an increasing proportion of Ofgem's work involves environmental issues, and this is reflected by the fact that such issues are the motivating factor for increased regulation in three of the eight policy developments covered by the sample RIAs. Considerable challenges will be posed to the organisation in this area, not least because, at least to date, general environmental regulation has been subject to intense criticism on grounds of egregious inefficiency (i.e. objectives have been

pursued by means that are much more costly than are necessary to achieve those objectives). The RIA process is therefore potentially of particular importance in helping ensure that a similar outcome does not occur in the energy sector, and, more specifically, that where imposed environmental objectives exist, they are achieved in ways that do not unnecessarily impair the attainment of other Ofgem objectives such as the protection of consumer interests, the promotion of competition et al.

The sample RIAs

There is considerable variation in practice in the ways in which environmental impacts are evaluated. As in relation to costs and benefits, the level of detail and of quantification differs, but, speaking broadly, the pattern of variation is appropriate. That is, where environmental impacts are more significant they attract greater attention, and where they can be expected to be negligible, the matter is disposed of quite quickly.

Of more concern is the way in which environmental impacts are considered in relation to the other sections of the RIAs. The differing approaches are:

- Separate and specific assessment, following the RIA boiler-plate (3 cases)
- Inclusion in costs and benefits (2 cases)
- Omission (2 cases)
- Inclusion in summary (1 case, but special considerations apply)

It is likely that omission simply means that no significant impacts were anticipated but, if so, it would be better to state this explicitly, to provide reassurance that the relevant matters have not simply been overlooked.

The divergence in practice as between separate analysis and integration into the costs and benefits section raises more general and important questions about the structure of reporting, which are also relevant in relation to the treatment of impacts on security of supply. These will therefore be considered in the final section of this

review. At this point, it can be simply said that there would be benefits in greater standardisation in the approach, not only to assist readers but also to help promote greater consistency in analysis across the different parts of Ofgem.

Security of supply

Evaluation of the impacts on security of supply raises similar issues to those discussed in relation to environmental impacts, with the added complication that, in this case, it is not at all clear whether security of supply should be considered as anything other than an impact on consumers (existing and in the future). There is potential double counting of impacts here, and, although evaluation of impacts on security of supply is effectively required by the way in which statutory duties are written, some care is needed in order to prevent inappropriate weighting (which could, of course, potentially lead to poor regulatory decisions).

The sample RIAs

The coverage of security of supply issues is one of the most satisfactory aspects of the RIAs considered as a set.

In the only case where an assessment is absent, there are special factors that make such an assessment superfluous. In the remaining seven documents, the relevant impacts are assessed in varying degrees of detail, but the variation appears to reflect, in a roughly proportionate way, the significance of the relevant issues. Thus, where no material impacts have been identified, this is simply stated; and where the issues are less clear cut there is more extensive analysis.

The only question that arises is that already identified in the discussion of environmental impacts: should security of supply issues be addressed under a separate heading, or should they be assessed in a way that is more closely linked to other impacts, which currently are generally handled under the costs and benefits heading? (See the final section of this review for further discussion.)

Impacts on small businesses

Cabinet office guidelines nowadays indicate that RIAs should pay explicit attention to impacts on small businesses, but none of the documents appears to deal with the matter. Quite apart from any considerations of general public policy, there are particular economic reasons why it would be desirable to remedy this oversight.

Academic work on regulation has shown how, in a range of differing contexts, regulation can be influenced and used to protect the positions of incumbents against new entrants and against the expansion of smaller firms in the market. The effect is particularly associated with the 'political' influence that larger enterprises can have over the conduct of regulation (e.g. by having greater access to regulators and politicians, by being more frequently relied upon by regulators to provide relevant information, by being more active – because of greater resources – in the rule-making processes surrounding market governance, etc.). Some responsibility therefore falls on Ofgem to ensure that the interests of smaller enterprises are not forgotten.

There are two potential approaches:

- Include a separate section summarising potential impacts (in the eight documents considered, the dominant entry would likely be "There are no material effects").

- Include the relevant matters within the analysis of competition (where there might be concern about barriers to entry or expansion) and the analysis of distributional effects (distinguishing impacts on small and large businesses serving the relevant energy market).

The latter is generally to be preferred, since it maintains a clearer distinction between considerations of efficiency/competition and of equity/social engineering. However, given the Cabinet Office stance, it might be advisable to make special reference to the relevance of small business impacts (under the headings of competition and distributional effects) in any guidelines on how to conduct RIAs that might be developed for internal purposes. Otherwise, the danger remains that this particular group, whose 'voice' may not be clearly heard, will tend to be neglected.

Distributional effects

It is generally not in the interests of good regulation for regulators to become over-concerned with, or over-attentive, to distributional impacts as decision criteria, since it is abundantly clear from the research evidence that 'political' disputes over the distribution of resources are a very major, adverse influence on policy making (as Ofgem knows all too well, for example from its experience in trying to introduce more efficient arrangements for the pricing/charging of electricity transmission losses).

The administrative costs of attempting to assess all the distributional impacts of proposed changes also point in favour of a low key approach, although it should be explicitly recognised that there is an obvious tension here with the principle of transparency. Such tension is normally handled, in RIA processes generally, by focusing attention on those impacts that may potentially have very major implications for identifiable groups, particularly when the affected parties can be classified, in some sense or other, as 'vulnerable'.

In this context, it can be noted that the Authority has responsibilities to certain, specific consumer groups, as well as to consumers in general, and, as argued above, might properly be concerned with impacts on small businesses (as suppliers, rather than as consumers of energy). Some reference to distributional effects is therefore appropriate in RIAs.

The sample RIAs

Specific reference to distributional effects is included in only half the documents, two of which indicate simply that no material effects can be expected. The remaining two documents that deal with distributional effects take different approaches. One considers rather general distributional consequence of the favoured regulatory measure, whilst the other focuses on possible effects on lower income consumers.

There would be benefit from specific guidance on how to assess distributional consequences. Should this be, for example, an exercise in transparency, or is the purpose to identify impacts on specific groups (particular customer groups, small businesses) whose interests may be of special concern to the Authority and Ofgem?

Given the purposes of RIAs, and given the existence of other Ofgem documents and processes (where matters can be discussed in ways that satisfy transparency requirements), the balance of advantage appears to me to lie with the latter approach.

Review and compliance

Given that review and compliance are routine, across the board, activities for Ofgem, this section of a RIA document can be expected, usually, to be relatively short, and summary in nature. Only where there are 'special' characteristics of the relevant initiative will it be necessary to do a little more. One such special circumstance arises when the decision involves a trial period, or where 'do nothing' is the favoured option subject to review at a later date.

No substantial issues arise from the sample RIAs in this area although, again for consistency, it might be desirable to include this section as a matter of routine, even if its content is just a one line statement. In the sample, some documents included comments on review and compliance whilst others did not.

Timing, length and style

Both the Cabinet Office and the NAO have stressed the importance of starting RIAs early in the process of policy development. This has the advantage of providing opportunity for the assessment to have greater influence on policy, since in the absence of such influence RIAs can only lead to incremental regulatory costs, with no associated benefits. The necessity of producing an early RIA document, on a relatively standardised template, can also help in the development of consistent analysis within Ofgem, by, among other things, serving as a reminder of the full range of issues that need to be considered when developing new policy. This can offset any emerging tendency for particular parts of the organisation to get "too narrow" in the way in which problems are addressed, and to neglect possible conflicts with policy objectives that have not been prominent on the relevant radar.

Since Ofgem produces substantive consultation documents, and engages with market participants in a range of other ways, the initial RIA documents should be relatively crisp and to-the-point documents: here are the objectives, here are the

general issues, here are the competition issues, here are the policy options, here are our views on possible impacts, etc. They should be documents that are relatively standardised in format: they are not the location for longer, discursive discussions of issues, extended reasoning, detailed analysis, or treatises on costs and benefits. All that will come later. Length will necessarily vary according to factors such as the scale of the initiative and the complexity of the issues, but a range of between about 2,000 and 5,000 words may be in the right ball-park.

An initial RIA will, among other things, identify a set of potentially significant impacts, but it should not be constrained to seek substantive quantification (although some broad-brush quantitative indicators of the scope of the issues being addressed, most likely falling in the 'key issues' section, would be helpful). If numbers are available which would help signify the scope of particular impacts, then they can be included; if information is not available, no major effort to fill the gaps is justified at this early stage.

From the initial document onwards, the RIA can be viewed as a work in progress, leading to a final RIA document. The latter can be expected to contain more quantification and more summary reasoning, but, since there will be considerable overlap with the initial RIA, and since more extensive evidence and reasoning (including on costs and benefits) should have been developed and published during consultation and the normal Ofgem policy development process, the information can be presented in a relatively summarised form. In effect, the final RIA is largely a reporting and (internal) monitoring document, serving an accountability purpose and as a final check on decision-making (e.g. have all the relevant factors been taken into account and been evaluated in ways consistent with statutory duties?).

In contrast to these desiderata, the sample documents are of widely varying length, style and content, and a number of them contain material that goes well beyond what is best included in a final RIA document. This likely reflects the state of play currently reached: RIAs have been introduced as an added requirement, on top of pre-existing consultation and policy development processes – which are often very substantial exercises – so there has been no very clear differentiation

Structure of the RIAs

The point has been made earlier that the competition assessment should come before the evaluation of impacts, and the evaluation of the costs and benefits associated with those impacts. The remaining substantial question is how the analysis of impacts, and their costs and benefits, should be structured.

As indicated, the initial RIA document can not realistically address costs and benefits in any very major way: it comes too early for that, and preoccupation with quantification at the initial stage could cause delay that, on Cabinet Office and NAO arguments, would be damaging. Cost and benefit evaluations are therefore better conducted during the course of policy development, and summarised at the final stage. The issue at the initial stage therefore reduces to the question of how the assessment of potential impacts is to be organised.

I believe there is merit in setting out all the (initially) identified, potential impacts of each of relevant options in one place – in a section that might, in initial RIAs (but not in final) RIAs, be re-labelled Possible Impacts – following an order linked as closely as possible to Ofgem's hierarchy of statutory duties (i.e. starting with consumers). This ordering should be relatively standard for all measures, whatever their specific, intended purposes.

The reason for this is that it can help limit the emergence of compartmentalised thinking of the form "This is a measure driven by environmental / supply security considerations, so we can focus on the environmental impacts only, or at least can treat the other issues as of lesser importance." Such a tendency would be manifestly inappropriate given Ofgem's general objectives, and would be liable to lead to inconsistent decision-making (in violation of one of the five principles of good regulation). In practical terms, the adjacent and sequential ordering of possible impacts serves as a constant reminder that effects on consumers have similar importance and priority when evaluating a measure aimed chiefly at environmental / supply security problems as when evaluating a measure more directly concerned with consumer protection.

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