



An appeal under section 173 of the Energy Act 2004

**E.ON UK Plc**

**Appellant**

**and**

**GEMA**

**Respondent**

**and**

**British Gas Trading Limited**

**Intervener**

Decision and Order on costs

**01 August 2007**

**CC02/07**

1. On Tuesday 10 July 2007 the Competition Commission (**the CC**) handed down its decision in the appeal by E.ON UK Plc (**E.ON**) and British Gas Trading Limited (**BGT**) from the decision of the Gas and Electricity Markets Authority (**GEMA**) dated 5 April 2007 in relation to proposed changes to arrangements for the offtake of gas from the National Transmission System (**the Decision**). At that hearing the CC heard argument on costs. Because this is the first code modification appeal on which costs have to be determined, and because the issues are not entirely straightforward, the CC chose to reserve its decision. We hope that it will assist parties to future appeals if we briefly give our reasons for the costs order that we now make.

### **The two issues**

2. Two discrete issues have to be decided. First, who should pay the CC's costs of the appeal, it being mandatory that an order for the CC's costs be made. Secondly, what if any order should be made for parties' costs.

### **The CC's costs**

3. The relevant provisions of the Energy Act 2004 are found in Schedule 22. Paragraph 13(1) of Schedule 22 provides that a group that determines an appeal must make an order requiring the payment to the CC of the costs incurred by the CC in connection with the appeal. Paragraph 13(2) provides that where the appeal is allowed the order must require those costs to be paid by GEMA. Paragraph 13(3) provides that where the appeal is dismissed, the order must require those costs to be paid by the appellant. Interveners are excluded from the obligation imposed by paragraph 13(3).
4. The issue that arises in this appeal is that of the order the CC should make where the CC has allowed the appeal in part. E.ON argued that GEMA should pay all of the CC's costs because the CC had allowed the appeal.
5. GEMA submitted that the mandatory provision in paragraph 13(2) of Schedule 22 does not apply where an appeal is allowed in part, and observed that the express terms of the CC's Order on the appeal are that the appeal has been allowed only in part. While GEMA did not dispute that E.ON had succeeded in part, because the decision to implement modification proposal 116V has been quashed, and because the decision not to implement modification proposal 116A has also been quashed, GEMA's submission was that E.ON had not succeeded on all of its appeal. GEMA pointed out that the CC's decision not to implement 116A was quashed only so that GEMA could have the widest possible number of modifications open to it when it came to reconsider the Decision. GEMA therefore said that E.ON had not really achieved what it wanted in relation to 116A, which was a direction for the implementation of that modification proposal. GEMA submitted that it had been put to more time and expense by grounds of appeal that were dismissed than by those that had succeeded, and submitted that this consideration, which it said is relevant to liability for inter-partes costs, should also be reflected in the liability for the CC's costs.
6. We wish to make three observations on the obligation to pay the CC's costs in this appeal. First, it has not been suggested by either E.ON or GEMA that the CC can never make a split order in relation to its own costs. Although the point has not been fully argued, we think that it is right that a split order could in certain circumstances be made. However, we do not think that where an appeal has succeeded in part a split order *must* be made, and we do not think that GEMA argued that a split order *must* be made—only that in this case a split order should be made on grounds of fairness.

7. Secondly, under paragraph 13 the obligation to pay the CC's costs is determined by the outcome of the appeal—whether the appeal is allowed or dismissed. In our view, the outcome of the present appeal is that the appeal has been substantially allowed. We think that this is so whether the outcome is looked at formally, concentrating on the Order of the CC on the appeal, or in terms of the substantive outcome of the appeal. Looked at from either point of view GEMA will have to take the Decision again.
8. The identification of the outcome of the appeal is related to an issue discussed in some detail in our decision on the appeal, which is whether the Decision consisted of one decision or more than one decision. Because of agreement between E.ON and GEMA that there are two decisions under appeal, we have couched our Order on the appeal in terms which address the position should there be a separate decision in respect of proposal 116A. However, for reasons given in our decision on the appeal, we find the argument that there are two decisions artificial. The substance of this appeal has been whether the decision to implement proposal 116V was wrong. We have found that it was, and so have quashed the Decision. In our view, that is the essential outcome of this appeal.
9. Thirdly, while we have quashed GEMA's decision not to implement proposal 116A, we accept GEMA's submission that E.ON has not succeeded on its case in respect of proposal 116A. However, although the CC may make a split order in respect of its own costs, an order for the CC's costs should seek to reflect the substance of the appeal, and the time and effort expended by the CC in connection with the substance of the appeal. Taking this into account, the amount of time and costs expended by the CC in relation to modification proposal 116V far exceeds the time and costs spent on modification proposal 116A. We do not consider that E.ON's failure to secure an order for the implementation of proposal 116A means that E.ON should bear part of the CC's costs.
10. We have decided that GEMA should pay the CC's costs.

### **The parties' costs**

11. The statutory provisions relevant to parties' costs are also found in paragraph 13 of Schedule 22. Paragraph 13(5) provides that the group that determines an appeal may make such order as it thinks fit for requiring a party to an appeal to make payments to another in respect of costs incurred by that other party in connection with the appeal. By paragraph 2(5) of Schedule 22 the CC's direction that BGT should be allowed to intervene in the appeal means that BGT, like E.ON and GEMA, is a party to the appeal.
12. By contrast with the provisions relating to the CC's costs, which are mandatory, the CC has a power but not a duty to make an order for parties' costs. Under the Energy Act, there is no express link between the outcome of the appeal and liability for parties' costs. However, the Energy Code Modification Rules ('the Rules') define the way in which the CC will exercise its power, stating that the CC will normally order an unsuccessful party to pay the costs of the successful party, but may make a different order. Rule 22.2 sets out a non-exclusive list of the matters to which the CC will have regard in deciding what order to make.
13. Relying substantially on rule 22, E.ON and BGT asked for their costs from GEMA. GEMA asked that no order for parties' costs be made. GEMA said that this was the proper order both having regard to the extent to which E.ON had succeeded on its appeal and having regard to particular considerations in proceedings involving regulators (explained further below).

14. In relation to BGT, GEMA relied on authority including *Bolton MDC v Secretary of State for the Environment [1995] 1 WLR 1176* which, GEMA said, established a presumption that interveners should not obtain their costs unless either there was a separate matter on which the intervener was entitled to be heard or the intervener had an interest requiring separate representation. GEMA said that separate representation was not required on the appeal because BGT, having no separate interest, simply made the same points as E.ON. GEMA also submitted that there is a lesser case for payment of an intervener's costs on an appeal than at first instance. BGT submitted that the true significance of *Bolton MDC v Secretary of State for the Environment* lay in the proposition that there are no absolute rules in relation to costs, and that in *Bolton MDC v Secretary of State for the Environment* a second set of costs were awarded. BGT also argued that the appeal was effectively a first instance matter because issues had otherwise yet to crystallize. This last point is one that we address specifically in the Guide to Appeals in Energy Code Modification Cases at paragraph 2.3. In paragraph 2.3 the CC recognizes that while the code modification jurisdiction is properly characterized as an appellate jurisdiction, the appeal is nonetheless the first occasion on which a dispute has crystallized and that this will be taken into account by the CC in the exercise of its powers under the Energy Act. There is an element of hybridity in the jurisdiction.
15. GEMA submitted that the discretion accorded the CC in paragraph 13 and preserved in rule 22 should be exercised having regard to, and consistently with, decisions of the Competition Appeal Tribunal and of the Court of Appeal as to whether regulators should be required to pay costs. In a very helpful note GEMA told us that it would be unhelpful and anomalous if the CC's approach were to be significantly different from that developed and refined in the Tribunal and in the Court of Appeal in recent years. GEMA took us to *BT plc v OFCOM [2005] CAT 20* and *Baxendale-Walker v Law Society [2007] All ER (D) 254*, both of which support GEMA's argument about the approach taken to regulators' costs in other jurisdictions. In the course of its submissions, GEMA observed that the Rules were published very shortly after the Tribunal's decision and some time before the judgment of the Court of Appeal in *Baxendale-Walker v Law Society*.
16. GEMA pointed out that in *BT v OFCOM* the Director General had to resolve a dispute concerning interconnection and in doing so had 'to strike a fair balance' between a number of interests. GEMA submitted that in the present case GEMA had effectively to adjudicate between competing modifications.
17. E.ON submitted that GEMA's argument about the approach adopted in other jurisdictions was no more than an attempt to circumvent rule 22. E.ON argued that in the authorities relied on by GEMA the regulators in question were not subject to a rule equivalent to rule 22. E.ON also doubted whether GEMA's role in relation to code modifications is comparable to that of The Law Society in instituting disciplinary proceedings.
18. We should be very slow to differ from the approach of the Court of Appeal or of the Tribunal in equivalent circumstances. However, we doubt the closeness of the comparison that can be made between GEMA in the code modification procedure and either the Director General of Telecommunications in *BT v OFCOM* or The Law Society in *Baxendale-Walker v Law Society*. GEMA has told us that there are limits to the extent to which its role in code modifications can be said to be adjudicatory. In its Reply GEMA told us that E.ON's characterization of GEMA as a 'quasi-judicial' body was mistaken and that GEMA's role was not adjudicatory. Rather, we were told, GEMA must not sit on its hands waiting for industry to promote reform where GEMA considers that action is necessary. GEMA said that it might be regarded as the 'effective progenitor' of modification 116V.

19. In *Baxendale-Walker v Law Society*, The Law Society brought disciplinary proceedings in the Solicitors Disciplinary Tribunal. The Law Society's function was therefore essentially prosecutorial and it is not surprising that in such circumstance no order for costs was made against The Law Society. We do not see that these authorities really assist GEMA in the present case, though we can see that *BT v OFCOM* may be of more help to GEMA where a code modification appeal arises in respect of a modification of which GEMA is not the progenitor.
20. Further, the Energy Act makes clear and careful provision in relation to costs. It is notable that the only specific provision relating to GEMA in paragraph 13 is a provision that requires it to pay costs when an appeal is allowed. The provisions of paragraph 13 sit uneasily with a general proposition that GEMA should not be liable for parties' costs.
21. We agree with E.ON that the starting point in relation to parties' costs in code modification appeals is paragraph 13 of Schedule 22 and rule 22: costs will normally follow the event. However, that is only the starting point. We think that the award of costs should reflect *the extent to which* the appeal has succeeded. This is specifically envisaged by rule 22.2.2, which provides that the CC will have regard to whether an appeal has succeeded in whole or in part.
22. We also think that the award of costs should follow rule 22.2.1.1 and should promote the overriding objective of the Rules, which is to dispose of appeals fairly and efficiently within the time periods prescribed in the Energy Act. The short timescale within which code modification appeals are to be determined makes it particularly important that parties should be selective in identifying and pursuing their grounds of appeal. If they are not, and the appellant fails in significant parts of its case, that should be reflected in the CC's order for parties' costs. In future cases the CC will consider whether orders for costs should be made on an issue-by-issue basis.
23. In this case we do not think that a pure issue-by-issue approach is possible. This is because of the complex interrelationship between the different strands of modification proposal 116V relied on in the Decision, and because of the complex nature of E.ON's Statement of Case and of its point form statement of its grounds of appeal. However, during the appeal we have divided the issues in point into five. These are the user commitment model, the reform of interruptibility, the reform of flexibility capacity, the cost benefit analysis, and procedural flaws in the process by which the Decision came to be taken.
24. Applying rule 22.2.2 to these five issues, E.ON's appeal has succeeded only in part. It has succeeded in relation to certain of the arguments it made in relation to flexibility reform and the cost benefit analysis. We did not accept all of E.ON's grounds of appeal in relation to these issues, but clearly the grounds of appeal in relation to which it did succeed are important. E.ON has substantially failed, in our view, in relation to its procedural case, the user commitment model and the question of interruptibility. Although we accepted that the Decision was lacking in transparency, that finding was principally a consequence of our substantive findings in relation to flexibility and the cost benefit analysis, rather than the main arguments made by E.ON on its procedural case.
25. In our view, the appropriate order having regard to these considerations is that GEMA should pay 50 per cent of E.ON's costs of the appeal. That order fairly takes account of the fact that the appeal has substantially been allowed rather than dismissed, but that E.ON has also failed in relation to certain important issues which did involve the expenditure of time and cost.

26. Paragraph 13 of Schedule 22 and rule 22 are also the starting point for our assessment of the intervener's costs. However, while they provide us with a clear locus for the imposition of a costs order in favour of BGT we do not think that the considerations that apply to an appellant apply equally to an intervener. It is significant that an intervener can only rely on grounds of appeal that are already before the CC in the appeal. In our view, it would be unfair and unjust if GEMA were to have to pay twice for what was in effect the repetition of a criticism of its Decision by a party which had chosen not to appeal against the decision, however well founded that criticism might be. Consequently the 'added value' that an intervener has brought to an appeal must be reviewed with particular care before an award of costs is made in its favour.
27. It may well be that, in a given case, the CC will decide to make no order for the payment of an intervener's costs, even if the arguments it relies on prevail. At the same time, we observe that the participation of an intervener from a different sector of the industry than the appellant may provide the CC with a useful perspective on the issues in an appeal, notwithstanding the strict limits on the scope of the intervention allowed. It may also be the case that given the very short timescales for the determination of appeals, the overriding objective is better facilitated by one appeal with an intervention than by two appeals.
28. While BGT supported the totality of E.ON's appeal, it concentrated its efforts on the reform of flexibility capacity and on the accuracy of GEMA's cost benefit analysis. Some of BGT's arguments, in particular those relating to the risk of artificial scarcity of flexibility capacity and some of its estimates of the costs of reform, have played no part in our conclusion that the Decision was wrong. There was also a considerable degree of duplication between the arguments of E.ON and BGT on flexibility issues. Nevertheless, some of BGT's criticisms of the Decision in relation to the likelihood of a scarcity of flexibility capacity had a different emphasis from some of E.ON's arguments and gave a valuable focus to some of the flexibility issues on which our decision is based. Having regard to the value which BGT added to E.ON's appeal, we think that GEMA should pay 25 per cent of BGT's costs.
29. In submissions GEMA told us that we should disallow one-third of the costs claimed by E.ON and BGT on the basis that such would be the rate of disallowance had their costs been taxed by a taxing master. That may or may not have been the outcome of a detailed assessment of costs. However, we do not think that we can disallow costs on that somewhat arbitrary basis without a detailed assessment. Given the tight timescales of a code modification appeal, and given the complexity and technicality of the issues in this appeal, we think that the rates at which costs have been incurred by the parties are reasonable. The rate at which costs have been incurred does differ between the parties. However, we do not think that the differences exceed what may reasonably be the product of different approaches to litigation and costs risk.
30. The CC's order must stipulate a rate of interest in default of payment. We think that a commercial rate of interest is appropriate in this case. It should be one percentage point above the Bank of England's base rate from time to time in force. Time for payment is now determined by statutory instrument (SI 2006/1519). In our order for costs, references to costs incurred by any party in the appeal are references to the costs stated in the final statement of costs submitted to the CC for the hearing on 10 July 2007 less any amounts in those final statements in respect of value added tax recoverable as input tax.

### **Order of the Competition Commission**

- 1. That GEMA pays E.ON 50 per cent of its costs incurred in the appeal.**
- 2. That GEMA pays BGT 25 per cent of its costs incurred in the appeal.**
- 3. That GEMA pays the Competition Commission's costs of the appeal.**
- 4. That in default of payment by the due date interest shall be payable on costs at one percentage point above the Bank of England's base rate from time to time in force.**