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Agenda

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What are the merits of appeals on the merits?

Consulting on the future of regulatory and competition appeals, the UK government is proposing substantial reforms, including a move away from appeals on the merits towards a judicial review standard. Oxera's response to the consultation, summarised here, sets out why such a move may be unappealing

In June 2013, the UK Department for Business, Innovation & Skills (BIS) launched a consultation on the future of regulatory and competition appeals in the UK, which generated considerable interest and diverse commentary. The response by the Competition Appeal Tribunal (CAT), a specialised body dealing with most of these appeals, endorses some of the proposed reforms—in particular, in relation to streamlining processes—but criticises the proposed reform of the standard of review, from appeals on the merits to judicial review. The variety of the comments received reflects the central role that an appeals process plays in holding regulatory and competition authorities to account on their judgments.

Appeals: a vital part of the regulatory framework

The route of appeal against regulatory and competition decisions is vital as part of a system of checks and balances on decisions by regulators and competition authorities. This involves reviewing decisions for any errors, but also assessing the reasonableness of judgments that have been made (discussed further below). Table 1 below shows that seven appeals against a regulator or competition authority in the UK were upheld between 2008 and 2012 (i.e. the original decision was overturned), while 28 appeals were rejected (i.e. the decision was not overturned).

Table 1 Outcome of appeals by regulator, 2008–12

	Number of appeals	Not overturned (%)	Mixed/ ongoing (%)	Overturned (%)
Competition Commission	12	50	42	8
Civil Aviation Authority	2	50	0	50
Ofcom	21	67	24	10
Ofgem	4	25	25	50
Office of Fair Trading	7	29	57	14
Ofwat	5	60	40	0
Utility Regulator (Northern Ireland)	2	50	50	0

Note: Ofcom, the UK communications regulator. Ofgem, the energy regulator for Great Britain. Ofwat, the economic regulator of the water industry in England and Wales. This table includes the 2013 CAT ruling in BMI Healthcare Limited v Competition Commission, where the Competition Commission lost an appeal about access to the data room. This was not included in the original BIS consultation.

Source: Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, Table D5.

Where errors or questionable judgments occur, it is important to be able to address them. Not doing so could harm not only the wronged parties, but also the credibility of the system. If a company receives an unduly stringent regulatory settlement, without the ability to overturn it and obtain a fairer settlement, it might find itself in financial difficulties. Such an outcome is likely to be more detrimental to consumers than the less stringent but more appropriate regulatory settlement that the regulator might have reached in the first place.

Additionally, regulators, like the companies they oversee, respond to incentives. Having a robust and effective appeals mechanism that is sufficiently well used acts as a strong incentive for regulators to get things right first time. Regulators are aware that being taken to appeal and losing can be financially costly and damaging to their credibility. The threat of appeal in itself acts as an incentive on authorities to ensure that their analysis and findings are robust.[1]

The BIS consultation highlighted the range of appeal routes available to different industries. The harmonisation of these routes is likely to be beneficial in principle, in order to ensure that the most relevant expertise is available to deal with each level of appeal. Sectors will have the same access to entities that can assess on-the-merits appeals. Additionally, harmonisation will support a consistent and fair approach across sectors, with no one sector having a weaker or stronger appeals regime. A further benefit will come from the greater clarity and understanding of the process that will be gained by parties not typically involved in the intricacies of the appeal process.

One recent example of movement towards harmonisation has been in the airports sector. Previously, the airport price control reviews of the Civil Aviation Authority (CAA) were automatically referred to the Competition Commission—a process that was out of line with other regulated sectors.[2] Critics had suggested that this process was unhelpful, since it duplicated a substantial administrative burden and added time and cost to the process.[3] In a way, the Competition Commission was effectively replacing the CAA as the economic regulator of airports. Moreover, they argued that the CAA, as an industry specialist, ought to be better placed to conduct the regulatory review than the more generalist Competition Commission. There is therefore a trade-off between ensuring that the CAA is accountable to passengers and avoiding costs from unnecessary automatic appeals.

The then Chairman of the Better Regulation Commission,[4] Rick Haythornwaite, had previously given evidence to the UK Parliament's Select Committee on Transport. In this, he described the automatic referral as an 'odd situation', and noted that one of its disadvantages was that it effectively removed a route of appeal from the regulated community.[5] The Civil Aviation Act 2012 has now removed the automatic referral, helping to bring consistency with other sectors and allowing any appeals to focus on specific issues, rather than involving a review of the entire price control.

The discussion so far has focused on the role of appeals in correcting errors. However, while it is important, this is not the only aspect of the appeals process. Competition authority decisions typically involve a degree of judgement, and a clear-cut answer is not always available. As the CAT has put it:[6]

> competition law is not an area of law in which there is much scope for absolute concepts or sharp edges

The same holds for many regulatory determinations. Appeals are therefore not always about correcting errors or mistakes.

Indeed, this lies at the heart of the debate behind appeals on the merits: a critical viewpoint is that the process just replaces the judgement of one authority with that of another. However, it might be said that the first authority plays the role of prosecutor and adjudicator simultaneously, and that a second, fully independent, body is therefore required. This argument comes close to a call for a proper prosecutorial system like those in a number of other jurisdictions, a proposal that the BIS rejected following a 2011 consultation.[7]

Appeal on the merits or judicial review

The BIS consultation proposes to move away from appeals on the merits towards a judicial review standard. These alternative approaches have significant differences, in terms of process, but also in the question that is posed to the court:

- the **timeline** for a judicial review is generally significantly shorter than an appeal to the Competition Commission, although there have been regulatory appeals with a constraint on the appellant body to complete a review within a particular timeframe, generally where the appellant is a sectoral regulator;
- the **question** examined during a judicial review is different—it focuses on whether the regulator acted appropriately within its powers, and does not seek to repeat the regulator's role in applying judgement in assessing the evidence;
- the **remedies** will be different—under a successful judicial review, the regulator will be required to repeat its process, whereas, following a successful appeal to the Competition Commission or the CAT, the regulator will generally be provided with specific proposals for an alternative response (which it will usually be expected to accept, or face further challenge).

These differences are fundamental and illustrate that the aims and outcomes of the two processes will be different. The merits appeal can be seen as a review of whether the conclusions made by the regulator are appropriate, and therefore a review of its judgement. The judicial review is intended to provide a constraint on the regulator's process, to ensure that it complies with all relevant legislation and best practice. At present, both options are open to the regulated companies.

The risk in moving to a judicial review-only process would therefore be that an important check and balance in the system is weakened, which could lead to poorer decision-making (given the incentive issues highlighted above). In contrast, the potential advantages of a move to a judicial review-only system are mainly that it could help to avoid costly and time-consuming appeals on the merits where the appeal's benefits are outweighed by its costs.

The evidence from the BIS consultation regarding the nature of existing appeals indicates that this issue is currently largely limited to sectors (specifically under the Communications Act 2003) where the appeals process has arguably been 'gold-plated' (i.e. where an appeal leads to a full re-hearing). By contrast, if there is a concern in other sectors where this is not the case, such as energy, it is more likely to be because there has been very limited use of the current system.

Furthermore, there is little analysis in the BIS consultation document on appeals under competition law. Several competition cases in the last decade saw a substantive review of the merits in the CAT, and this has created some substantive case law, the importance of which is likely to exceed the costs of preparing and reviewing the evidence.

BIS, itself, acknowledges the potential systemic cost of removing appeals on the merits, although it has not quantified this:[8]

> The main ongoing cost of this option is to firms who would want a more detailed appeal in order to challenge regulatory decisions which they disagree

with. We are clear that the new appeals standard should still allow for decisions to be appealed and for the factual and legal basis of the regulators' decisions to be scrutinised effectively. However, there may be a risk that reducing the level of scrutiny that regulatory decisions are subject to may increase the likelihood of an incorrect regulatory decision not being overturned by an appeal body. We have not attempted to monetise this cost, but intend to use the consultation to test views on the extent to which there is a material risk, and to consider the potential costs for different types of regulatory and competition decisions.

Is there an alternative solution?

An interesting question is whether an intermediate option, in between a full on-the-merits review and judicial review, might provide a suitable balance between these concerns. Such an option could be an on-the merits appeal on the basis of broadly self-contained aspects of a regulatory decision. This could be broader than the current Communications Act 2003 appeals (which can focus on very narrow issues), but would be narrower than referring a whole price control to the Competition Commission (which essentially involves repeating the whole price control process).

For example, a regulator may take an approach to incentives, or to the longer-term framework for rewarding investments, as part of a particular price control decision, and this may have longer-term consequences for investors. Arguably, this aspect of a decision should be appealable on the merits, given its importance to investors and the long-term future of the business, without undermining other aspects of the decision on operating costs and capital investment for a single period, for example.

In practical terms, this intermediate option could be achieved by making it clear that narrowly focused appeals like those from the Communications Act should generally be extended to include associated issues. This would allow a whole issue, such as the cost of capital, to be considered in the round, rather than focusing on, say, only one coefficient within the cost of capital calculation.[9] In addition to ensuring that any decision is taken on issues in the round, this would give greater clarity to appellant bodies about the fact that they would be expected to resolve issues within their wider context.

While this might increase the number of appeals in some sectors, it is reasonable to expect that it might result in a reduction in the number of Communications Act appeals, and therefore that the impact on the costs outlined in the BIS consultation would be limited.

The costs of the current system

The consultation highlights the costs of the current system. In particular:[10]

> Appeals can also impose significant costs on firms, regulators and appeal bodies. The impact assessment accompanying this consultation estimates that the current appeal system costs £21.8m per annum (£16.9m incurred by businesses, £3.4m by regulators and £1.5m by the courts and tribunal services)

While £21.8m may seem a large absolute cost, it needs to be considered in the context of the value of the issues at stake in these appeals, and the extent of the regulated services provided by the firms that are (or could) make these appeals.

It is difficult to estimate the size of the issues at stake across the range of appeals considered by the consultation. However, it could be argued that the £16.9m incurred by businesses will be justified in terms of the issues at stake, since they are commercially oriented entities. Furthermore, in at least some of the appeals, material errors have been made by regulators. Expending resource on correcting these is not really the key issue, since even relatively minor errors can cost consumers or businesses many millions of pounds.

More generally, in terms of the size of the regulated services, the £21.8m cost per year is equal to less than 0.1% of the investment budget of the regulated sectors.[11] In this context, £21.8m seems a relatively small price to pay for the benefits associated with ensuring robust regulatory decisions.

The £3.4m incurred by the regulators and £1.5m incurred by courts and tribunals should be seen in the context of the budgets of these organisations.

- Regulators—the total budget of Ofcom, the ORR, Ofwat, Ofgem and the CAA is around £350m.[12] The £3.4m equals less than 1% of the total. Arguably, the total budgets of these regulators include functions other than those directly related to economic regulation. However, even if only one-third of the total budgets of the regulators relates to economic regulation, the £3.4m equates to around 3% of the relevant budget. (The ORR's accounts indicate that it had an approximate 60/40% split between its safety and economic regulation functions in 2011/12 and 2012/13.)

- Courts and tribunals—the budget of the CAT is around £4m per annum.[13] It is more difficult to identify an appropriate benchmark budget for the wider courts and tribunals service, since these encompass a wide range of litigation cases that are different from regulatory and competition appeals. Nevertheless, any cost savings from a move away from appeals on the merits—BIS estimates these at around £5m, of which £350,000 are savings to the CAT budget[14] —would seem small both in absolute terms and when compared with the issues at stake in these appeals, and the importance of ensuring the robustness of regulatory and competition decisions.

Concluding thoughts

Overall, determining the appropriate form of appeals regime is complex, and different parties will take different views. However, there are a number of points that are sensible in principle, as follows.

As the consultation makes clear, 'appeals form a vital part of the regulatory decision-making framework'.[15] Making judicial processes more efficient, and harmonising the approaches in different appeals bodies and across different sectors, are both sensible objectives.

However, there are questions about the proposed move from appeals on the merits to judicial reviews. There is the concern that an important check and balance in the system is being weakened, which could lead to poorer decision-making. Appeals on the merits allow for more thorough testing of the evidence and reasoning of the decision, including the economic aspects of the case. The consultation contains limited analysis of whether appeals on the merits are currently problematic, especially as regards competition law appeals (there is somewhat more discussion on regulatory appeals).

At the same time, it is unclear whether the costs of appeals are currently as high as suggested in the consultation, and this weakens one of the reasons for the proposed reform. The data indicates that there are fewer than ten appeal cases every year, and that they are generally completed within a year. They represent a tiny fraction of all commercial litigation in the UK, and their costs are less than 0.1% of regulators' budgets and regulated firms' investments each year.

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[1] There is at least one potential unintended consequence of the threat of appeal: regulators may attempt to make their decisions appeal-proof by simplifying them, which runs the risk of making them less accurate. While this may happen, simpler decisions themselves have some advantages in terms of providing better precedent, since they can be more easily drawn upon in other contexts.
[2] As described in Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, para. 4.84.
[3] See, for example, House of Commons (2006), 'Select Committee on Transport—Thirteenth Report', October.
[4] The Better Regulation Commission, which operated until January 2008, worked with policymakers to reduce unnecessary regulatory and administrative burdens.
[5] House of Commons (2006), 'Select Committee on Transport—Minutes of Evidence, 25 January 2006', Q482.
[6] Cases 1035/1/1/04 and 1041/2/1/04, Racecourse Association and British Horseracing Board v OFT [2005] CAT, para. 167.
[7] See Oxera (2011), 'Merging the merger authorities', Agenda, July. While BIS has rejected the move to a prosecutorial system, in the current consultation it recognises that authorities have multiple roles: 'Economic regulators and competition authorities have considerable power because they combine the roles of investigator, prosecutor and adjudicator. To balance this, it is essential that an effective appeals mechanism is available for firms and consumers that are materially affected by a regulatory decision.' Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, p. 8.
[8] Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, p. 17.
[9] For example, BT's appeal to the CAT (referred to the Competition Commission) of the Ofcom 2011 wholesale broadband access decision focused on how gearing was applied within the cost of capital calculation. See Competition Commission (2012), British Telecommunications Plc (and others) v Office of Communications, Determination, Case 1180/3/3/11, 9 February.
[10] Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, para. 3.12.
[11] Calculated using an approximate investment budget per year of around £20bn. The £20bn is estimated using the £200bn value provided in Department for Business, Innovation & Skills (2011), 'Principles for Economic Regulation', April, p. 1; this £200bn includes some unregulated sectors and covers five years, so Oxera has conservatively assumed that 50% relates to the regulated sectors. (The BIS document notes that the 'majority' relates to the regulated sectors.)
[12] The budgets are £348m for 2011/12 and £360m for 2012/13. See Ofcom (2013), 'Ofcom's tariff tables 2012/13', available at http://www.ofcom.org.uk/about/annual-reports-and-plans/tariff-tables/tariff-tables-2012-13/; Ofwat (2013), 'Annual report and accounts 2012–13', available at http://www.ofwat.gov.uk/aboutofwat/reports/annualreports/rpt_ar2012-13.pdf; Ofgem (2013), '2012–13 Annual report and accounts', available at https://www.ofgem.gov.uk/ofgem-publications/74220/ofgem-arr-201213final.pdf; Civil Aviation Authority (2012), 'Annual Report and Accounts', 19 June, available at http://www.caa.co.uk/docs/1743/CAA_AR2012.pdf; and Office of Rail Regulation (2013), 'Annual Report and Accounts 2012–13', June, available at http://www.official-documents.gov.uk/document/hc1314/hc00/0004/0004.pdf.
[13] Competition Appeal Tribunal and Competition Service Accounts 2011–12, p. 87.
[14] Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, p. 5.
[15] Department for Business, Innovation & Skills (2013), 'Streamlining regulatory and competition appeals: Consultation on options for reform', 19 June, para. 1.9.