

**BEFORE THE COMPETITION AND MARKETS AUTHORITY**

**IN THE MATTER OF AN APPEAL**

**UNDER ARTICLE 14B OF THE ELECTRICITY (NORTHERN IRELAND) ORDER 1992**

**B E T W E E N : -**

**SONI LIMITED**

**Appellant**

**and**

**THE NORTHERN IRELAND AUTHORITY FOR UTILITY REGULATION**

**Respondent**

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**RESPONDENT'S REPRESENTATIONS & OBSERVATIONS  
ON APPELLANT'S APPLICATION FOR PERMISSION TO APPEAL**

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Reference: 2634114/JAC/RKR/KXL3**

## Introduction

1. These are the representations and observations of the Northern Ireland Authority for Utility Regulation (the **Respondent** or the **UR**) pursuant to paragraph 3(2) of Schedule 5A to the Electricity (Northern Ireland) Order 1992 (the **Electricity Order**). They relate to the application by SONI Limited (the **Appellant** or **SONI**) for permission to appeal certain aspects of UR's decision to modify the price control conditions of SONI's electricity transmission system operator licence (the **Decision**).
2. For the purposes of this document, the UR focuses solely on the permission-stage test to be applied by the CMA under the Electricity Order, taking into account the limited time available to the CMA to make a permission decision and (as a result) the limited procedure that is followed for that purpose.
3. These representations and observations are made without prejudice to the fuller and more detailed submissions that will be made by the UR, under paragraph 3(4) of Schedule 5A to the Electricity Order, should permission be granted on one or more grounds. In particular, where no representations or observations are made at this stage about any individual ground, alleged 'error' under an individual ground, or line of argument introduced by the Appellant, that is entirely without prejudice to the UR's intention to contest the appeal in respect of that matter.

## Applicable Test

4. The CMA is empowered to refuse permission to appeal on the grounds that:
  - a. the appeal is brought for reasons that are trivial or vexatious; and/or
  - b. the appeal has no reasonable prospect of success.<sup>1</sup>
5. An appeal will have no reasonable prospect of success where there is no reasonable prospect of the CMA finding that the Decision was "*wrong*" in the sense used in Article 14D(4) of the Electricity Order.

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<sup>1</sup> Electricity Order, Article 14B(4)(d).

6. SONI contends that the CMA must allow an appeal where it finds that the UR has either –
  - a. reached the wrong decision on one or more of the statutory grounds contained in Article 14D(4) of the Electricity Order (the **Statutory Grounds**), or
  - b. followed an inappropriate or unreasonable approach in reaching its decision.<sup>2</sup>
7. The addition of the second limb is both invalid and incorrect. The CMA may only allow an appeal if it finds that a decision is wrong on one or more of the Statutory Grounds. There are no additional grounds for allowing an appeal that can be constructed outside of the Statutory Grounds, whether on the basis of any ‘inappropriateness or unreasonableness’ of the approach followed by the UR or otherwise.
8. SONI's error in this regard stems from a misreading of the Competition Commission's comments in *E.ON*<sup>3</sup>, which were endorsed and applied by the CMA in the RIIO-ED1 appeals against GEMA.<sup>4</sup>
9. In the EDI appeals, in relation to the legislative provisions in section 11E(4) of the Electricity Act 1989, which are for all relevant purposes equivalent to those applicable to this appeal, the CMA observed that –

*‘it is not our role to substitute our judgment for that of GEMA simply on the basis that we would have taken a different view of the matter were we the energy regulator’<sup>5</sup>; and*

*‘[the statutory test] clearly admits of circumstances in which we might reach a different view from GEMA but in which it cannot be said that GEMA’s decision is wrong on one of the statutory grounds. For example, GEMA may*

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<sup>2</sup> Notice of Appeal, para. 11.5.

<sup>3</sup> *E.ON UK plc v. GEMA: energy code modification appeal* (CC02/07, 10 July 2007).

<sup>4</sup> Final determinations dated 29 September 2015 in *British Gas Trading Ltd. v. GEMA* (the **BGT Decision**) and *Northern Powergrid (Northeast) Ltd. & Northern Powergrid (Yorkshire) plc v. GEMA* (the **NPg Decision**).

<sup>5</sup> NPg Decision, para. 3.26.

*have taken a view as to the weight to be attributed to a factor which differs from the view we take, but which we do not consider to be inappropriate in the circumstances*<sup>6</sup>.

10. In the second of these quotations, the CMA was simply explaining the effect of the statutory test. It was not seeking to supplement the Statutory Grounds with additional grounds. Indeed it would not be possible in law to supplement the Statutory Grounds.
11. Therefore there is no different or separate test to be applied in circumstances where the CMA might have reached a different view – the test remains whether the decision was wrong on one of more of the Statutory Grounds.
12. The CMA is respectfully requested to refuse permission to appeal on the basis that the grounds identified by SONI have no reasonable prospect of successfully establishing that the UR was wrong on any of the Statutory Grounds.
13. SONI's appeal is fundamentally based on the position that it simply dislikes and therefore disagrees with the various decisions made by the UR. It has attempted to characterise that disagreement as a series of errors made by the UR. But the issues to which it draws attention are not errors at all. There is no decision in respect of which it can be said that the UR has made any error of fact or law, failed to have regard to a relevant matter, or failed to give appropriate weight to a relevant matter. It is simply the case that SONI disagrees with the level of regard and/or weight given to a particular matter. In doing so SONI fails to recognise that there are a range of matters to which the UR is required to have regard, and that appropriate weight is to be given to all of the relevant matters, when exercising its electricity functions.
14. In none of the instances cited by SONI can it be said that the UR has exercised its judgement outside the bounds within which reasonable disagreement is possible, and in such cases the CMA has been clear that it will not interfere with a decision.<sup>7</sup>

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<sup>6</sup> NPg Decision, para. 3.27.

<sup>7</sup> The CMA adopted the Competition Commission's reliance in *E.ON* on the judgment of the Court of Appeal in *Azzicurazioni Generali SpA v Arab Insurance Group* [2003] 1 WLR 577 that "so far as the appeal raises issues of judgment on unchallenged primary findings and inferences, this court ought not to interfere unless it is satisfied

## Specific Observations

### Ground 1 – Financeability Methodology Ground

15. SONI's difficulty in tying the 'errors' it identifies to the Statutory Grounds is shown most starkly by its reference back in every case to what it refers to as the UR's breach of its 'Financeability Duty' by which SONI means a failure on the part of the UR "to secure the Appellant's financeability, in breach of its obligations under Article 12(2) of the Energy Order".<sup>8</sup>
16. SONI confirms that this apparent failure is the primary foundation of its appeal.<sup>9</sup> It is a recurring refrain throughout the Notice of Appeal<sup>10</sup> and forms the basis for all three grounds of appeal.<sup>11</sup>
17. However, SONI systematically misquotes and misinterprets the UR's duty.
18. The UR's principal objective is set out in Article 12(1) of the Energy (Northern Ireland) Order 2003 (the **Energy Order**). This is to –

*'protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.'*

19. Under Article 12(2)(b) of the Energy Order, the UR must carry out its electricity functions in a manner best calculated to further the principal objective –

*'having regard to [among other things]... the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or this Order.'*

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that the judge's conclusion lay outside the bounds within which reasonable disagreement is possible" (NPG Decision, para. 3.29).

<sup>8</sup> Notice of Appeal, para. 2.10.

<sup>9</sup> Ibid.

<sup>10</sup> See, for example, Notice of Appeal, paras 2.11, 3.13, 3.19, and 4.1.

<sup>11</sup> Notice of Appeal, para. 4.3.

20. Contrary to SONI's repeated assertions, the UR does not have an absolute ('strict test'<sup>12</sup>) duty to ensure that SONI is financeable. In addition, the statutory concept of being able to finance activities does not have the technical debt financing meaning which SONI seeks to project onto it, or (as some other regulators' duties do) encompass provisions relating to a rate of return<sup>13</sup>.
21. These arguments are an attempt to say that the duty means whatever SONI wants it to mean, first misquoting the statute and then seeking to align it to its own case. This is an unsustainable basis on which to bring the appeal.
22. As all of SONI's grounds of appeal are rooted in its characterisation of the UR's Financeability Duty, its error as to the nature of that duty is fatal, not only to its first ground, but to its appeal as a whole.
23. Notwithstanding this fatal error, SONI's central point in relation to its financeability is that the UR's use of RAB\*WACC model is inappropriate given the 'asset-light' nature of SONI's business.<sup>14</sup> However, it does not go so far as to explicitly state that the model is wrong for its business. Indeed its own expert Europe Economics states that the model is used elsewhere for other asset-light businesses.<sup>15</sup> As such this is a clear illustration of an occasion in which SONI has attempted to characterise a disagreement on an issue which admits of a range of reasonable views, as a legal error.
24. Furthermore, prior to 6 February 2015<sup>16</sup>, the UR could only modify the conditions of a licence with the consent of the licence holder. It is notable that SONI consented to its price control being based on the use of the RAB\*WACC model during the previous price control period. The asset-light nature of SONI's business did not change either

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<sup>12</sup> Notice of Appeal, para 10.20.

<sup>13</sup> Notice of Appeal, para 10.23 summarises the meaning that SONI seeks, without any legal basis, to project onto the duty.

<sup>14</sup> Notice of Appeal, paras 18.1 – 18.30.

<sup>15</sup> Notice of Appeal, para 18.24.

<sup>16</sup> Date from which Article 14 of the Electricity Order was amended by the Gas and Electricity Licence Modification and Appeals Regulations (Northern Ireland) 2015.

during the course of or between the price controls and will not change over the course of the 2015 – 2020 price control period.

25. SONI states that the UR has failed to take account of the characteristics of its business by not changing to a different model. There is no evidence that the UR has so failed. Indeed, the consultation and extensive correspondence undertaken by the UR with SONI shows that the UR fully considered whether a different model would be more appropriate given the nature of SONI's business – but concluded that it was not.
26. In such circumstances it is unarguable that the adoption of a model similar to that which has been used before – and to which SONI has previously consented – would in any way breach the UR's duty to have regard to the need to secure that SONI can finance the activities which are the subject of obligations under the legislation.

#### **Ground 2 – Revenue Uncertainty Ground**

27. SONI argues that in failing to provide an upfront allowance for unknown or uncertain costs, the UR has created *'unprecedented levels of uncertainty for the Appellant, directly affecting its financeability'*.
28. However, the uncertainty that SONI seeks to establish does not in fact exist. SONI will be able, through the  $D_t$  mechanism, to recover all of its efficiently incurred costs which are necessary to incur in order to carry out its activities and fulfil its obligations.
29. It is appropriate and good regulatory practice for the UR to include such a mechanism for the purpose of ensuring that those costs that are uncertain, unknown or unforeseeable at the outset of the price control period are recoverable but are subject to the same regulatory scrutiny as certain, known, or foreseeable costs.
30. In terms of the amounts of costs that SONI will be able to recover, it is very clear that once those unknown costs become clear and can be quantified they will, to the extent they are efficiently incurred costs, be recoverable. There is simply no question that where SONI incurs or needs to incur costs – and can demonstrate that these are efficiently incurred – it will not be able to recover such costs.

31. SONI suggests that the process for the  $D_t$  mechanism is unworkable.<sup>17</sup> However, it is not a new or unique process and is in practice the same process which is followed in respect of claims being made under the existing  $D_t$  provisions in SONI's licence. It is also not dissimilar to the mechanisms used in the licence of the transmission network owner (Northern Ireland Electricity Networks - **NIEN**) for regulating unknown or uncertain costs (which mechanism have been endorsed by the CMA (then the Competition Commission) in its determination on NIEN's RP5 price control). The Decision simply refines and clarifies the timings such that the process on the face of the licence reflects what actually already happens in practice.
32. SONI also takes issue with the fact that determinations made by the UR under the  $D_t$  mechanism will not be subject to appeal to the CMA.<sup>18</sup> But it is not 'wrong' for determinations made under the licence not to be appealable to the CMA, nor does this deprive SONI of an appropriate level of legal protection.
33. The statutory provisions explicitly recognise that determinations can be made under the licence<sup>19</sup>. Indeed the statutory framework also provides for licence conditions to provide for their own modification (i.e. be self-modifying)<sup>20</sup>. The UR is not acting contrary to the statutory framework in making determinations under the price control conditions. Had it been the intention of the legislation that any decision taken by the UR under the licence should be capable of appeal to the CMA it would have provided for that. The UR cannot be said to be wrong when it is acting properly in accordance with the applicable legislation.
34. In any event SONI is not deprived of a right to challenge UR decisions. It will be able to challenge decisions made by the UR under the  $D_t$  mechanism by way of an application for judicial review in the way that it always been able to do so.

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<sup>17</sup> Notice of Appeal, paras 22.12 and 28.1 – 28.13.

<sup>18</sup> Notice of Appeal, paras 27.1 – 27.16.

<sup>19</sup> Electricity Order, Article 11(3).

<sup>20</sup> Electricity Order, Article 11(5).



35. Finally, SONI states that inclusion of the  $Q_t$  term has not been properly consulted upon.<sup>21</sup> Again this is incorrect as the introduction of that term was the subject of the required statutory consultation.<sup>22</sup> The effect of the  $Q_t$  term is simply to ‘true-up’ the price control such that it essentially has effect from the intended start date of the price control period (i.e. 1 October 2015). That the new price control would have effect from 1 October 2015 was understood and accepted by both the UR and SONI from the outset and the  $Q_t$  term simply reflects that understanding and acceptance.
36. Without the required truing-up via the  $Q_t$  term, the effective start date of the new price control would not be 1 October 2015 (as intended) as no account would be taken of the difference (including in respect of any under and over recoveries) in the allowed and actual revenues for the relevant period from 1 October 2015. In its application for suspension, SONI acknowledges that ‘truing-up’ can be necessary and is appropriate for a price control to take effect from the date that it should have done had the modifications been made in time.

### **Ground 3 - Inadequate Allowances Ground**

37. SONI asserts that the UR unjustifiably disallowed or neglected to allow certain specific costs that SONI is required to incur to fulfil its functions and licence obligations.
38. The first of these costs relates to the payroll allowances granted to SONI in respect of staff that have transferred to it under arrangements protected by Transfer of Undertakings (Protection of Employment) Regulations 2006. In particular, SONI claims that the UR has breached a legitimate expectation that it would fully fund the payroll costs of such staff on an ongoing basis.<sup>23</sup>
39. The basic test for a substantive legitimate expectation is that there must be a clear and unambiguous representation by the public authority, devoid of any relevant qualification.<sup>24</sup> Nothing that SONI has referred to in its Notice of Appeal in terms of

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<sup>21</sup> Notice of Appeal, para 30.8.

<sup>22</sup> Under Article 14 of the Electricity Order.

<sup>23</sup> Notice of Appeal, paras 36.18 – 36.34.

<sup>24</sup> *R (Bancoult) v Secretary of State for Foreign and Commonwealth Affairs (No 2)* [2008] UKHL 61, at [28].

the assurances it says have been given by the UR comes close to such a representation in relation to the UR's treatment of such payroll costs. Instead the UR simply assured SONI on various occasions that it would consider the issue, and it has done so.

40. SONI states that the UR has granted it an inadequate allowance in respect of pensions. The UR is currently consulting in relation to the funding of SONI's pension deficit – arising both before and after 1 April 2015 – as well as SONI's ongoing pension liabilities in relation to its defined benefit pension scheme.<sup>25</sup> SONI's appeal with respect to pensions is therefore premature as no decision has been made to which it can legitimately attach. Any decision made by the UR following its consultation will give rise to a separate right of challenge.

### **Conclusion**

41. The CMA is therefore respectfully requested to refuse permission to appeal on the basis that it has no reasonable prospect of success – generally, for the reasons given above in relation to the threshold for permission and the standard of review; and in particular, for the additional reasons advanced in respect of each of the three grounds of appeal.

**Gowling WLG (UK) LLP**

for the Respondent

28 April 2017

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<sup>25</sup> UR, *Further consultation on certain matters relating to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland (SONI)*, 11 April 2017.