CMA
Competition & Markets Authority

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From: Andrea Gomes da Silva

30 October 2019

Dear Jonathan,

CMA Response: Clarification of our position on potential Energy Licence Modification Appeals

1. Many thanks for your open letter. This response is intended to clarify our understanding of the issues raised in your letter and should be read alongside our rules and guidance for energy appeals.[1]

2. Whilst your letter focuses on these important issues in the context of the energy sector, we would note that some of the issues may apply to other regulated utility sectors where price control appeals or references may be made to the CMA.

Materiality

3. The starting point for "materiality" in energy appeals is the reference to "trivial" in the legislation: the CMA may refuse permission to appeal where the appeal is brought for reasons that are trivial or vexatious.[2] However, the concept of a material error goes beyond this. The CMA and its predecessor body, the Competition Commission (CC), have established in previous cases that they should only intervene where an error is material (as opposed to insignificant), and that materiality is a broader concept than size alone.[3]

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[1] CMA Rules for Energy Licence Modification Appeals (CMA 70) and CMA Guide for Energy Licence Modification Appeals (CMA71).
[2] See for example, section 11C(4)(d)(i) of the Electricity Act 1989.
[3] *SONI Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.39, *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.22, *British Gas Trading v GEMA* [2015] para 3.58, *Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] para 3.58, *British Gas Trading v GEMA* [2015] para 3.60, *Carphone Warehouse v Ofcom* [2010] paras 1.27 and 1.62, *CityFibre Infrastructure Holdings plc v Office of Communications and TalkTalk Telecom Group plc v Office of Communications* [2017] para 2.27 and *British Telecommunications plc v Office of Communications and TalkTalk Telecom Group plc v Office of Communications* [2016] para 2.34.

4. The CC and the CMA have provided guidance as to the characteristics of appeals which are not likely to be material, but materiality is assessed on a case by case basis.[4] In the past, the CC made reference to "0.1%" as a size of error which was clearly not material and this has been referred to in subsequent cases.[5] It is clear both from the relevant decision and also from the context that this is not intended to be a "bright line" test and is to be considered in each case alongside other factors.[6] In some cases, wider considerations may mean that the threshold for materiality may be lower, in other cases it may be higher.

5. In *BT* and *CityFibre* the CMA referred to the case of *Carphone Warehouse (LLU)*, where the CC discussed that broader issues should be considered, i.e. some issues may be low value but have broader implications, possibly as a precedent for other regulatory decisions or as significant in the longer term beyond the price control period.[7] Also, some issues may be low value but, if they are a clear and unambiguous factual errors, then they should be corrected. In other cases, what appears to be a large error may only arise due to the presentation of an aggregation of smaller and potentially immaterial errors. In addition, where the appeal relates to an exercise of regulatory discretion, the appeal body should not intervene where the regulator's decision is within the range of what might be considered reasonable responses for the regulator to make.[8]

6. It is important to recognise the possibility that issues that appear large in value may not be "material" when considered in the broader framework of the price control, in particular where there are interlinkages. It may be that the CMA could conclude at the permission stage that such appeals have no reasonable prospect of success, where there is evidence demonstrating that the relevant decision subject to appeal is within the regulator's margin of appreciation.

7. For example, an appeal which sought to overturn one decision which forms part of a series of interlinked decisions might be rejected at the permission stage as the CMA might conclude that the decision under appeal is not a material decision in itself.

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[4] *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.25, *Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] para 3.58 and *British Gas Trading v GEMA* [2015] para 3.60.

[5] *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.24 and *Carphone Warehouse v. Ofcom* [2010] para 1.62.

[6] *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] paras 3.24-3.25, *Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] para 3.58, *British Gas Trading v GEMA* [2015] para 3.60 and *British Telecommunications Plc v Office of Communications* and *British Sky Broadcasting Limited and TalkTalk Telecom Group Plc v Office of Communications* [2013] para 1.60.

[7] *BT v Ofcom and TalkTalk v Office of Communications [2016]* para 2.35, *CityFibre Infrastructure Holdings plc v Office of Communications* [2017] para 2.28 and *Carphone Warehouse Group plc v Office of Communications (LLU) [2010]* paras 1.59 onward.

[8] *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.20.

8. Many decisions taken by regulators involve judgment and an estimation of what might happen in an uncertain context, and the CMA is not expected to impose its own judgment in place of that of the sector regulator provided that the regulator's response is reasonable.[9] In that sense, there may be examples where it is not a material error to choose one from a range of options for the price control, even where that decision might in itself have a material effect on the appellant.[10]

9. This would reflect precedent that, under the energy appeal regimes, the CMA is not intended to be a 'second-tier' regulator making a re-review of detailed assumptions within a price control.[11] The CMA's appeal framework in the energy sector seeks to correct wrong regulatory decisions, not to undertake a fresh review using its own regulatory judgment where more than one approach may be applied.[12] This is different to the approach for re-determinations, applicable in other sectors such as the water sector, though even here the CMA would always exercise some restraint on issues of regulatory judgment.

10. We agree that, in some circumstances, the materiality of an alleged error may not be capable of full assessment until after permission to appeal has been granted. We also agree that section 11E(4) of the Electricity Act 1989 and the equivalent provisions of the Gas Act 1986 would permit the CMA to decide not to allow an appeal where, after permission has been granted, it becomes apparent that the result of an error is immaterial.

11. Other factors relevant to materiality include whether the cost of addressing the error would be disproportionate to the value of the error; whether the error is likely to have an effect on future price controls; and whether the error relates to a matter of economic or regulatory principle[13].

[9] *British Gas Trading Limited v GEMA* [2015] para 3.43, *E.ON UK plc v GEMA* [2007] para 5.11 and *SONI Limited v Northern Ireland Authority for Utility Regulation* [2017] paras 3.29 and 3.36.

[10] *E.ON UK plc v GEMA* [2007] para 5.12, *Hutchison 3G UK Limited v Office of Communications* and *British Telecommunications plc v Office of Communications* [2009] para 1.33 and *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.19.

[11] *TalkTalk WBA* [2012] paras 73 and 74 and *British Telecommunications Plc v Office of Communications* and *British Sky Broadcasting Limited and TalkTalk Telecom Group Plc v Office of Communications* [2013] para 1.35.

[12] *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation* [2017] para 3.21 and *British Gas Trading v GEMA* [2015] para 3.37.

[13] British Gas Trading Limited v The Gas and Electricity Markets Authority [2015] para 3.61, Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v The Gas and Electricity Markets Authority [2015] para 3.58 and British Telecommunications plc v Office of Communications [2016] para 2.35.

Case Management

12. In terms of pre-appeal conduct, we agree that active engagement is beneficial for all parties, whilst recognising that it cannot bind any ultimate decision on whether to appeal. The CMA itself needs to prepare resourcing for any appeals lodged. Also, the timetable for appeals that the CMA adheres to, does not allow for delays receiving defence papers from the appropriate regulators. Hence, we wish to encourage this pre-appeal conduct as good practice. Where it appears that appellants have acted in a way which, without good reason, makes case management more difficult, for example appellants who fail to engage with the appropriate regulators and notify us and update us about their potential intentions to appeal, this could be reflected in our assessment of their conduct when allocating costs at the end of the appeal, even when such appeals are successful. Ideally, we would prefer such pre-notification to include the potential scope of any appeal, rather than be limited to notification of the potential existence of an appeal.

13. In terms of joint/multiple hearings for remedies arising from successful appeals, this is already established practice. The concurrent RIIO-ED1 appeals by Northern PowerGrid and British Gas appeals in 2015 included a combined remedies hearing. Whilst this is a precedent that we may follow in future cases, there are practicalities to consider here, including possible confidentiality issues and any timing discrepancies should appeals not conclude at the same time. Such remedy hearings are useful to clarify that the CMA's proposed remedies are workable and can also be used to discuss the merits or otherwise of the CMA itself implementing the remedies, rather than remittal back to the regulator. CMA remedies are often implemented once the last year of a previous price control period is complete and reported upon, and for some issues a true-up is needed to further adjust customer bills. This complexity further emphasises the need for joint working to ensure there is common ground that the remedies are implemented accurately.

Interlinkages

14. We confirm that, as stated in our guidance and in accordance with previous appeal determinations, the CMA will take interlinkages into account.[14] However, to the extent that such interlinkages form part of the response to an appeal, in stating that an error on one part of the price control is linked to another part of the price control, we encourage regulators to explain these interlinkages, and the reasons for them, in their decision documentation.[15]

[14] *Carphone Warehouse v Ofcom* [2010] para 2.231, *Firmus Energy v Northern Ireland Authority for Utility Regulation* [2017] para 4.225, *British Gas Trading v. GEMA* [2015] para 3.50 and Nor*thern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] para 3.49.

[15] *British Gas Trading v GEMA* [2015] para 3.52 and Nor*thern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] para 3.51.

15. Where there are such interlinkages described clearly by the regulator, we would encourage appellants to explain why the component under challenge is wrong having regard to the interlinked aspects of the decision. The credibility of submissions to the CMA, whether it be from appellants or respondents, is enhanced if they are clear on all of the relevant information and supporting material, rather than extracting and relying on specific snippets of relevant material that may not provide the full context. Our role may be to assess the reliance we should place on different sources of information, and this task cannot be progressed fairly or efficiently without the full knowledge of relevant information. This does not require overly lengthy submissions to made to the CMA, as relevant interlinkages should be explained succinctly. Where we conclude that parties have deliberately not referred to the complete base of relevant information in their submissions, then the costs allocation at the end of such inquiries will be able to take this into consideration.

16. We note that there have been previous submissions that a regulatory decision should be considered "in the round". "In the round" can be appropriate when describing interlinkages behind regulatory assessments, assumptions and decisions the effect of which also needs to be considered as a whole, such as the level of the cost of capital.[16] It is correct that an appellant cannot "cherry pick" just one specific unfavourable component of a regulatory assessment, assumption and decision where that is not in practice a separable decision, and can only be considered alongside other linked decisions.[17] Equally, the overall price control set by a regulator is the combination of a number of individual decisions, and we do not accept that it can be beyond the CMA's powers to review these individual decisions, on the basis that they need to be considered "in the round" with decisions that are otherwise unconnected parts of the regulatory settlement.

Yours sincerely

Andrea Gomes da Silva

Executive Director, Markets and Mergers

[16] *SONI v Northern Ireland Authority for Utility Regulation* [2017] paras 7.5 and 7.124, *Bristol Water* plc [2015] para 6.320, *British Gas Trading v GEMA* [2015] paras 3.57-3.64, *Northern Ireland Electricity Limited* price determination [2014] para 13.155 and Nor*thern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority* [2015] paras 4.82 and 6.57.

[17] *BT v Ofcom* [2012] para 1.377.