

NORTHERN GAS NETWORKS LIMITED

-and-

GAS AND ELECTRICITY MARKETS AUTHORITY

Decision on Permission to Appeal

1. Under cover of a Notice of Appeal received by the Competition and Markets Authority (CMA) on 3 March 2021, Northern Gas Networks Limited (NGN) sought permission to bring an appeal under section 23B of the Gas Act 1986 against the decision by the Gas and Electricity Markets Authority (GEMA), dated 3 February 2021, under section 23 of the Gas Act 1986 to modify the conditions of the NGN licence to give effect to the RIIO-GD2 price control determination (the Decision).

Requirement for permission to appeal

2. Under section 23B(3) of the Gas Act 1986, the CMA's permission is required before such an appeal may be brought.
3. I make this decision on permission to appeal in my capacity as an authorised member of the CMA (see paragraph 1(8) of Schedule 4A to the Gas Act 1986).
4. In making this decision I have had regard to NGN's Notice of Appeal, as well as to the submissions in response made by GEMA on 17 March 2021, and to a further letter of 24 March 2021 from NGN's solicitors containing a number of representations and observations on GEMA's response.

Decision on permission

5. On 3 March 2021 NGN's Notice of Appeal was received by the CMA within the period prescribed by paragraph 1(3) of Schedule 4A to the Gas Act 1986.
6. Section 23B(2)(a) of the Gas Act 1986 provides that an appeal may be brought by a relevant licence holder (within the meaning of section 23(10) of

the Gas Act 1986). The Decision relates to the modification of the conditions of the NGN licence. I am therefore satisfied that NGN is a relevant licence holder affected by the Decision.

7. Under section 23B(4) of the Gas Act 1986, the CMA may refuse permission to bring an appeal only on one of a number of specified grounds. The potentially relevant grounds in the present case are (i) that the appeal is brought for reasons that are trivial or vexatious, or (ii) that the appeal has no reasonable prospect of success.
8. NGN seeks permission to appeal the Decision on the following grounds:
 - (a) Ground 1: Cost of equity. NGN submitted that GEMA's approach to calculating the risk-free rate materially underestimates the risk-free rate; GEMA has made a number of material errors in its methodology for setting the beta in the Decision; GEMA has made a number of errors in its methodology for setting total market return; and GEMA has rejected the principle of 'aiming up' and has therefore failed to account for the uncertainty and asymmetric risks facing gas distribution networks.
 - (b) Ground 2: Outperformance wedge. NGN submitted that GEMA is not entitled to introduce an outperformance wedge as a matter of law, that the decision to introduce it is based on flawed analysis of historical and other data and that GEMA has made a number of errors in its calculation of the outperformance wedge.
 - (c) Ground 3: Ongoing efficiency. NGN submitted that the ongoing efficiency challenge set by GEMA is unreasonably high and inconsistent with regulatory practice. NGN submitted that GEMA's analysis is based on materially flawed methodologies, assumptions and factual errors, and that the innovation uplift applied by GEMA is both unjustifiable in principle and based on a materially flawed calculation methodology.
 - (d) Ground 4A: Business plan incentive Stage 4. NGN submitted that GEMA's methodology for the calculation of the NGN's business plan incentive Stage 4 assessment is flawed and that it is 'too small to adequately incentivise the frontier company'.
 - (e) Ground 4B: Efficient costs benchmark. NGN submitted that the efficient cost benchmark set by GEMA is overly challenging, is inconsistent with regulatory good practice, is not supported by the confidence appropriate for a single econometric model (as GEMA's modelling process was characterised by a number of errors), and adversely impacts NGN as a frontier company (thus limiting incentives to innovate and push the sector forward to the detriment of customers' interests).

9. GEMA submitted that Ground 4A identifies no properly arguable ground of review and/or has no reasonable prospect of success and is no more than a disagreement with GEMA's regulatory judgement.
10. GEMA submitted that Ground 4B is insufficiently material in terms of the impact on the overall level of NGN's allowances to merit further consideration by the CMA. GEMA said that the selection of the efficient costs benchmark amounts to the exercise of regulatory judgement and discretion and it cannot be said to have materially erred by choosing one from a range of reasonable regulatory options.
11. I have reviewed the submissions made by GEMA in relation to Ground 4A and Ground 4B and the letter from NGN's solicitors dated 24 March 2021, and consider that NGN has raised concerns regarding an important and material part of GEMA's decision that cannot be considered trivial. I also consider that there are inter-relationships between these grounds which require further consideration. I therefore do not consider that the CMA can come to a decision on whether this is an error without a substantive review of the evidence.
12. I am satisfied that each of NGN's other grounds of appeal are substantive arguments that are clearly not trivial or vexatious. At permission stage, I am not able to conclude that any of the grounds have no reasonable prospect of success. These issues will be determined as part of the appeal.

Grant of permission and conditions

13. Under paragraph 1(11) of Schedule 4A to the Gas Act 1986, the CMA's grant of permission may be made subject to conditions, which may include:
 - (a) conditions which limit the matters that are to be considered on the appeal in question;
 - (b) conditions for the purpose of expediting the determination of the appeal; and
 - (c) conditions requiring that appeal to be considered together with other appeals (including appeals relating to different matters or decisions and appeals brought by different persons).
14. I have therefore considered whether, in granting permission to appeal, any grant of permission should be subject to particular conditions. The CMA received seven other applications for permission to appeal the Decision, and sought representations from the appellants and the respondent in this regard.

15. I have decided to grant permission to NGN to bring the appeal on all grounds set out in its Notice of Appeal, pursuant to section 23B and paragraph 1 of Schedule 4A to the Gas Act 1986.
16. Pursuant to paragraph 1(11)(c) of Schedule 4A to the Gas Act 1986, this grant of permission is conditional upon the following:
- (a) Ground 1 (Cost of equity) of this appeal shall be considered with the cost of equity grounds pleaded by Cadent Gas Limited (Ground 2), National Grid Electricity Transmission plc (Ground 1), National Grid Gas plc (Ground 1), Southern Gas Networks plc and Scotland Gas Networks plc (joint application) (Ground 1), Scottish Hydro Electric Transmission plc (Ground 1), SP Transmission plc (Ground 1) and Wales & West Utilities Limited (Head B).
 - (b) Ground 2 (Outperformance wedge) of this appeal shall be considered with the outperformance wedge grounds pleaded by Cadent Gas Limited (Ground 3), National Grid Electricity Transmission plc (Ground 2), National Grid Gas plc (Ground 2), Southern Gas Networks plc and Scotland Gas Networks plc (joint application) (Ground 2), Scottish Hydro Electric Transmission plc (Ground 2) and SP Transmission plc (Ground 2).
 - (c) Ground 3 (Ongoing efficiency) of this appeal shall be considered with the ongoing efficiency grounds pleaded by Cadent Gas Limited (Ground 1C), Southern Gas Networks plc and Scotland Gas Networks plc (joint application) (Ground 3), SP Transmission plc (Ground 3) and Wales & West Utilities Limited (Head E).
17. Ground 4 will be considered as a separate appeal to those joined with others.
18. I consider that the above conditions will enable the CMA to dispose of the appeals fairly and efficiently and at proportionate cost.



Kirstin Baker
Authorised Member of the CMA
31 March 2021