

**SOUTHERN GAS NETWORKS PLC AND
SCOTLAND GAS NETWORKS PLC
-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, Southern Gas Networks plc and Scotland Gas Networks plc (together, SGN) 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 SGN licences 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 SGN'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 26 March 2021 from SGN's solicitors containing a number of representations and observations on GEMA's response.

Decision on permission

5. On 3 March 2021 SGN'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 SGN licences. I am therefore satisfied that SGN are relevant licence holders 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. SGN seeks permission to appeal the Decision on the following grounds:
 - (a) Ground 1: Cost of equity. SGN submitted that GEMA underestimated key components of the cost of equity including total market return, beta and risk-free rate, failed to 'aim up', and that GEMA's financeability assessment was based on unjustified assumptions.
 - (b) Ground 2: Outperformance wedge. SGN submitted that GEMA's decision to introduce the outperformance wedge *i)* is a disproportionate and untargeted tool that undermines consistency and transparency in the regulatory regime to the detriment of consumers, *ii)* undermines incentives for investment and performance, *iii)* is not supported by adequate evidence or analysis and *iv)* wrongly dismissed concerns over the impact of the outperformance wedge on financeability.
 - (c) Ground 3: Ongoing efficiency challenge. SGN submitted *i)* that the innovation uplift applied by GEMA is unjustified, *ii)* the methodology used to derive the level of the innovation uplift is wholly inadequate and based on a number of false and/or inappropriate assumptions, and *iii)* the implementation of the innovation uplift results in an unjustified overall ongoing efficiency challenge.
 - (d) Ground 4: Efficiency benchmark. SGN submitted that GEMA erred in its approach to setting and applying the efficiency benchmark, which it splits into two sub-grounds: Ground 4A (that GEMA's decision to set the efficiency benchmark at a level higher than the upper quartile is not supported by the evidence) and Ground 4B (that GEMA has wrongly applied its efficiency benchmark to costs that have been removed from the regression model to account for regional differences).
9. In relation to Ground 4, GEMA submitted that SGN has not identified any clear and obvious factual error which should be corrected, and that it is insufficiently material in terms of the impact on the overall level of SGN's

allowances to merit further consideration by the CMA. GEMA submitted 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.

10. I have reviewed the submissions made by GEMA and the letter from SGN's solicitors dated 26 March 2021 in relation to Ground 4, and consider that SGN has raised concerns regarding an important and material part of GEMA's decision that cannot be considered trivial. 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.
11. I am satisfied that each of SGN'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

12. 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).
13. 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.
14. I have decided to grant permission to SGN 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.
15. 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

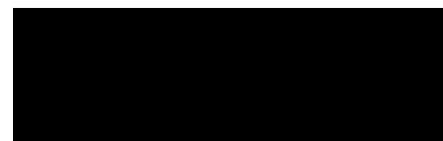
Grid Electricity Transmission plc (Ground 1), National Grid Gas plc (Ground 1), Northern Gas Networks Limited (Ground 1), Scottish Hydro Electric Transmission plc (Ground 1), SP Transmission plc (Ground 1) and Wales & West Utilities Limited (Head B).

(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), Northern Gas Networks Limited (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), Northern Gas Networks Limited (Ground 3), SP Transmission plc (Ground 3) and Wales & West Utilities Limited (Head E).

16. Ground 4 will be considered as a separate appeal to those grounds that are joined with others.

17. 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