

WALES & WEST UTILITIES 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, Wales & West Utilities Limited (WWU) 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 WWU 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 WWU's Notice of Appeal, to the submissions in response made by GEMA on 17 March 2021, and to a further letter dated 26 March 2021 from WWU's solicitors containing further submissions in response to a request from the CMA.

Decision on permission

5. On 3 March 2021 WWU'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 WWU licence. I am therefore satisfied that WWU 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. WWU seeks permission to appeal the Decision on the following grounds:
 - (a) Head A: Cost of debt. WWU submitted that GEMA based its determination on a flawed indexation methodology, which was irrational as a matter of law and lacked any valid policy justification, and consequently failed to determine an adequate cost of debt allowance for WWU.
 - (b) Head B: Cost of equity. WWU submitted that the cost of equity determined by GEMA is significantly lower in this price control when compared with the GD1 price control, and that the difference is largely due to methodological changes which are undermined by a series of fundamental errors (including in relation to the risk-free rate, total market return, the beta, the point estimate and the expected outperformance adjustment).
 - (c) Head C: Repex. WWU submitted that GEMA failed to take account of, or place appropriate weight on, the increased costs faced by WWU in the GD2 period for undertaking its repex work, and has therefore failed to provide sufficient allowances for WWU to undertake its repex work.
 - (d) Head D: Licence modification process. WWU submitted that GEMA has adopted a regulatory approach under which key aspects of the RIIO-GD2 price control framework are set out in a number of subsidiary documents which have not yet been fully disclosed to WWU and can be unilaterally changed by Ofgem by direction. WWU submits that this approach creates regulatory uncertainty leading to regulatory risk and revenue uncertainty.
 - (e) Head E: Ongoing efficiency. WWU submitted that the method used by GEMA to set the ongoing efficiency challenge contains a number of errors which mean that its analysis is incorrect both in principle and in application, including taking account of irrelevant factors, ignoring relevant factors, building in inconsistencies and contradicting both empirical evidence and the purpose of Ofgem's underlying totex approach.

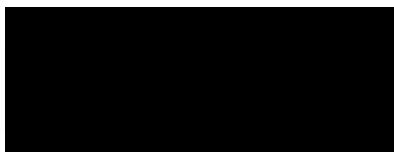
- (f) Head F: Tax clawback. WWU submitted that until October 2020, it had excluded derivatives from interest for the purposes of calculating tax clawback, pursuant to a letter it received from GEMA in 2015, an approach which was reaffirmed to it by GEMA in October 2019. WWU submits that in October 2020 GEMA reversed this approach and now requires derivatives to be included in interest for tax clawback calculations. WWU submitted that this will have a material adverse effect on WWU's revenues, and that it is a newly adopted position which is inconsistent and irrational, in breach of legitimate expectation, in breach of requirements to consult, and lacking in policy justification of any kind.
9. In responding to Head A, GEMA submitted that WWU's argument that GEMA has a statutory obligation to allow WWU to recover its actual cost of debt has been previously considered and rejected by the Competition Commission in *Bristol Water plc*, and by the CMA in the provisional findings of *Anglian Water Services Ltd*, *Bristol Water plc*, *Northumbrian Water Ltd* and *Yorkshire Water Services Ltd*. GEMA therefore submits that Head A has no reasonable prospect of success.
10. I have reviewed the submissions made by GEMA as regards Head A and consider that the previous decisions of the CMA do not bind the group appointed to consider this appeal and do not in themselves demonstrate that WWU's Head A would have no reasonable prospect for success, given the specifics of this appeal.
11. In responding to Head F, GEMA submitted that it has not, as part of the Decision, made any modification to the Gas Transportation Licence Conditions concerning the treatment of interest payments on derivatives for the purposes of the tax clawback. GEMA submitted that it issued the tax clawback rules in 2009 and that the mechanism was incorporated into Part B of Licence Special Condition 3C (Specified Financial Adjustments) from 1 April 2013. GEMA accepts that it gave incorrect advice (as to the interpretation of the policy) in 2015 but stated that the clawback mechanism itself remains unchanged since its inception in 2009.
12. In response to GEMA's submission, the CMA wrote to WWU on 23 March 2021 and asked it to identify which provision or element of the licence modifications this ground of appeal was directed against.
13. WWU submitted that the tax clawback policy was incorporated within the revised Price Control Financial Handbook (that will be effective from 1 April 2021).

14. That document is expressed on its first page to be part of a special condition of the licence. The 2021 Handbook, including the paragraphs dealing with the tax clawback, has been substantively re-written when compared with the 2013 Handbook (also expressed to be part of a special condition of the licence). The re-wording therefore stands as a modification of a condition of the licence.
15. At permission stage, I am required to consider whether a ground of appeal is trivial, vexatious, or has no reasonable prospect of success. A detailed comparison of complex documents to determine the application and/or effects of a particular policy, before and after a change in wording, goes beyond that exercise. I express no view here on the correctness of GEMA's submission that the effects of the tax clawback policy are unchanged, nevertheless I am satisfied that there is a modification of a condition of a licence to direct an appeal against.
16. I do not consider this ground to be trivial or vexatious and cannot conclude that it has no reasonable prospect of success.
17. I am satisfied that each of WWU'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

18. 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).
19. 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.

20. Pursuant to section 23B and paragraph 1 of Schedule 4A to the Gas Act 1986 I have decided to grant permission to WWU to bring the appeal on all grounds set out in its Notice of Appeal.
21. Pursuant to paragraph 1(11)(c) of Schedule 4A to the Gas Act 1986 this grant of permission is conditional upon the following:
- (a) Head B (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), Southern Gas Networks plc and Scotland Gas Networks plc (joint application) (Ground 1), Scottish Hydro Electric Transmission plc (Ground 1) and SP Transmission plc (Ground 1).
 - (b) Head E (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), Southern Gas Networks plc and Scotland Gas Networks plc (joint application) (Ground 3) and SP Transmission plc (Ground 3).
 - (c) Head D (Licence modification process) of this appeal shall be considered with the licence modification process grounds pleaded by Scottish Hydro Electric Transmission plc (Ground 3) and SP Transmission plc (Ground 4).
22. Heads A, C and F will be considered as a separate appeal to those grounds that are joined with others.
23. 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