

**Cadent Gas Limited, National Grid
Electricity Transmission plc,
National Grid Gas plc, Northern Gas
Networks Limited, Scottish Hydro
Electric Transmission plc, Southern
Gas Networks plc and Scotland Gas
Networks plc, SP Transmission plc,
Wales & West Utilities Limited
vs
the Gas and Electricity Markets
Authority**

**Final determination
Volume 1: Introductory chapters**

Issued: 28 October 2021

© Crown copyright 2021

You may reuse this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence/ or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Website: www.gov.uk/cma

**Members of the Competition and Markets Authority
who conducted this inquiry**

Kirstin Baker (*Chair of the Group*)

Susan Hankey

David Thomas

Chief Executive of the Competition and Markets Authority

Andrea Coscelli

The Competition and Markets Authority has excluded from this version of the final determination information which the inquiry group considers should be excluded having regard to section 23G Gas Act 1986 and section 11H Electricity Act 1989. The omissions are indicated by [✂].

Contents

Page

1. Introduction	3
Structure of our final determination	5
Introductory chapters	5
Joined grounds of appeal	6
Individual grounds of appeal	6
Relief and glossary	6
2. Background to the energy industry	7
Overview of the GB energy sector	7
Upcoming challenges: Net Zero	11
The parties to the appeals	12
GEMA	12
The gas transmission operator	12
The four gas distribution operators	13
The three electricity transmission operators	15
Intervenors to the appeals	17
Background to relevant regulation issues	18
History of energy regulation	18
Structure of RIIO and components of allowed revenue	19
Observations from RIIO-1	20
Changes made for RIIO-2	22
Summary of RIIO-2 financials	23
Other relevant reports	24
UKRN report	24
CMA PR19 Redetermination	25
3. Legal framework	26
The decision under appeal	26
GEMA's objectives, powers and duties	26
The appeals	29
Test on appeal	31
Standard of review	31
The meaning of 'wrong'	35
GEMA's margin of appreciation	41
General principles	43
Errors of primary fact and errors of law	43
Regulatory judgement	44
Nature of the decision under review	47
Interlinkages	47
Precedents	49
Materiality	49
The CMA's powers on determination of the appeals	51
4. The appeals and conduct of the appeals	53
Permission to appeal	53
Extension of period for determination of the appeals	55
Intervenors	55
Submissions	56
GEMA's response to the NoAs	56
Submissions in relation to the CMA PR19 Redetermination	56
Appellants' replies to GEMA's response	56

Teach-ins, site visits and hearings.....	57
Provisional determination of the appeals	58
Reconsultations	58
Other information gathering	58
Transparency.....	59
Final determination	59

1. Introduction

- 1.1 The Office of Gas and Electricity Markets (**Ofgem**) regulates the monopoly companies that run the gas and electricity networks. Ofgem takes decisions on price controls and enforcement, acting in the interests of consumers and helping the industries achieve environmental improvements. Ofgem is a non-ministerial department.¹
- 1.2 Ofgem is governed by the Gas and Electricity Markets Authority (**GEMA**). GEMA was established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain (**GB**).² GEMA's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.³
- 1.3 On 3 February 2021, GEMA published its decision (the **Decision**) for the electricity transmission, gas transmission and gas distribution network companies and the Electricity System Operator, modifying the conditions of their respective licences to give effect to the RIIO-2 price control Final Determinations (**FD**), which were published on 8 December 2020 and revised on 3 February 2021. GEMA's Decision sets the revenue that the companies will be entitled to collect from their customers in respect of their regulated activities over the period 1 April 2021 to 31 March 2026. This price control process is also referred to as **RIIO-2**.⁴
- 1.4 On 3 March 2021 the following gas distribution network operators (**GDNs**) sought permission from the CMA to appeal GEMA's **RIIO-GD2**⁵ price control determination pursuant to section 23B of the Gas Act 1986 (**GA86**):
- (a) Cadent Gas Limited (**Cadent**);⁶
 - (b) Northern Gas Networks Limited (**NGN**);⁷
 - (c) Southern Gas Networks plc and Scotland Gas Networks plc (together, **SGN**) (joint application);⁸ and

¹ [Government webpage about Ofgem](#).

² Energy companies in Northern Ireland are regulated separately by the Northern Ireland Authority for Utility Regulation.

³ GA86, section 4AA(1) and EA89, section 3A(1).

⁴ RIIO stands for Revenues = Incentives + Innovation + Outputs. See Chapter 2 for further information.

⁵ RIIO-GD2 is the Decision as applied to the GDNs.

⁶ [Cadent NoA](#).

⁷ [NGN NoA](#).

⁸ [SGN NoA](#).

- (d) Wales & West Utilities Limited (**WWU**).⁹
- 1.5 On 3 March 2021 the following electricity transmission operators (**TOs**) sought permission from the CMA to appeal GEMA's **RIIO-T2**¹⁰ price control determination pursuant to section 11C of the Electricity Act 1989 (**EA89**):
- (a) National Grid Electricity Transmission plc (**NGET**);¹¹
 - (b) Scottish Hydro Electric Transmission plc (trading as SSEN Transmission) (**SSEN-T**);¹² and
 - (c) SP Transmission plc (**SPT**).¹³
- 1.6 On 3 March 2021 the following gas transmission network operator sought permission from the CMA to appeal GEMA's **RIIO-GT2**¹⁴ price control determination pursuant to section 23B of GA86:
- (a) National Grid Gas plc (**NGG**).¹⁵
- 1.7 On 31 March 2021 the CMA granted permission to appeal to all appellants, on all grounds. This is discussed further in Chapter 4.
- 1.8 On 11 August 2021, we issued our provisional determination of the appeals and the parties and interveners were provided with the opportunity to make submissions in response to it.¹⁶
- 1.9 In reaching our final determination, we also considered the appellants' Notices of Appeal (**NoAs**) and related documents, GEMA's response to the appellants' NoAs (**Response**), the appellants' replies to GEMA's Response (**Replies**), submissions from the appellants and GEMA in relation to the CMA's redetermination (**CMA PR19 Redetermination**)¹⁷ of Ofwat's PR19 price control for the water sector (**PR19**),¹⁸ and responses to various Requests for Information (**RFIs**). We also considered submissions from

⁹ [WWU NoA](#).

¹⁰ RIIO-T2 is the Decision as applied to the TOs.

¹¹ [NGET NoA](#).

¹² [SSEN-T NoA](#).

¹³ [SPT NoA](#).

¹⁴ RIIO-GT2 is the Decision as applied to the gas transmission network operator.

¹⁵ [NGG NoA](#).

¹⁶ The provisional determination was not published. Instead, we published a short summary of the provisional determination for transparency.

¹⁷ CMA, 17 March 2021, [Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final Report](#). We note that at times this has also been referred to as 'PR19 Redetermination', 'PR19 Final Determination', 'PR19 FD', 'CMA's PR19 Determination', 'PR19 water appeals', 'PR19 decision', 'CMA's findings in PR19', and 'CMA's PR19 Redetermination Final Report'.

¹⁸ These submissions have been published on our [case page](#).

interveners¹⁹ and interested third parties,²⁰ and held hearings with the appellants, GEMA, the interveners and Ofwat.

- 1.10 After considering the parties' and interveners' submissions on the provisional determination, we sought further information from certain parties by way of RFIs. The CMA also held one further hearing and several roundtable meetings with relevant parties and interveners in relation to certain topics, where the CMA considered that this would be useful. We also reconsulted on certain aspects of two grounds of appeal.
- 1.11 This document contains the CMA's final determination of the appeals. A non-sensitive version of this final determination will be published on the CMA case page as soon as practicable after it is issued.
- 1.12 Under the statutory framework for the appeals process, the CMA must reach its final determination by 30 October 2021.²¹

Structure of our final determination

Introductory chapters

- 1.13 In this section, we set out the background to the appeals before considering each ground of appeal in detail in later sections.
- 1.14 In Chapter 1 we provide an introduction to the appeals.
- 1.15 In Chapter 2 we briefly summarise the role of the electricity transmission, gas transmission and gas distribution network companies and the structure of the industry in GB and provide an overview of the parties to the appeals. We also provide background information on the relevant regulation issues, including GEMA's price control process.
- 1.16 Chapter 3 sets out the legal framework for the appeal, including the applicable standard of review.
- 1.17 Chapter 4 sets out the appeals and the conduct of the appeals, including the NoAs, the permission process and the joining of common grounds of appeal and the process followed to this final determination.

¹⁹ British Gas Trading Limited and Citizens Advice.

²⁰ Electricity North West Limited and Ofwat.

²¹ EA89, section 11G and GA86, section 23F, having extended the statutory deadline by a month (see paragraph 4.10).

Joined grounds of appeal

1.18 Chapters 5 to 8 address each of the joined grounds of appeal in turn, summarising the relevant main submissions and supporting evidence put forward by the parties, interveners and third parties to each ground before turning to our assessment and final determination:

- (a) Chapter 5: Joined Ground A – Cost of equity
- (b) Chapter 6: Joined Ground B – Outperformance wedge
- (c) Chapter 7: Joined Ground C – Ongoing efficiency
- (d) Chapter 8: Joined Ground D – Licence modification process

Individual grounds of appeal

1.19 Chapters 9 to 16 address each of the individual grounds of appeal in turn, summarising the relevant main submissions and supporting evidence put forward by the parties, interveners and third parties to each ground before turning to our assessment and final determination:

- (a) Chapter 9: Cadent Ground 1A – Local Transmission System (**LTS**) rechargeable diversions
- (b) Chapter 10: Cadent Ground 1B – London regional factors
- (c) Chapter 11: NGN Ground 4 – Business Plan Incentive (**BPI**) stage 4
- (d) Chapter 12: SGN Ground 4 – Efficiency benchmark
- (e) Chapter 13: SSEN-T Ground 4 – Transmission Network Use of System charges (**TNUoS**)
- (f) Chapter 14: WWU Head A – Cost of debt
- (g) Chapter 15: WWU Head C – Repex
- (h) Chapter 16: WWU Head F – Tax clawback

Relief and glossary

1.20 For those grounds where we have found for the appellants, we have set out the appropriate relief in the relevant chapter. In Chapter 17 we set out the approach to implementing that relief.

1.21 Lastly, we provide a glossary of the terms used in the final determination.

2. Background to the energy industry

- 2.1 Regulation of energy in the UK is split, with GEMA being responsible for regulation of energy in GB while energy in Northern Ireland is overseen by the Utility Regulator.²² This appeal is against a decision by GEMA, and so we have focused on GB throughout this report.
- 2.2 In this chapter we set out the background to the GB energy sector and provide additional context around parties involved and challenges that they face. Additional detail on the industry and specific activities undertaken will be included in specific grounds of appeal where relevant.
- 2.3 This rest of this chapter sets out:
- (a) An overview of the GB energy sector;
 - (b) Recent developments and upcoming challenges;
 - (c) The parties to the appeal; and
 - (d) Background on relevant regulatory issues.

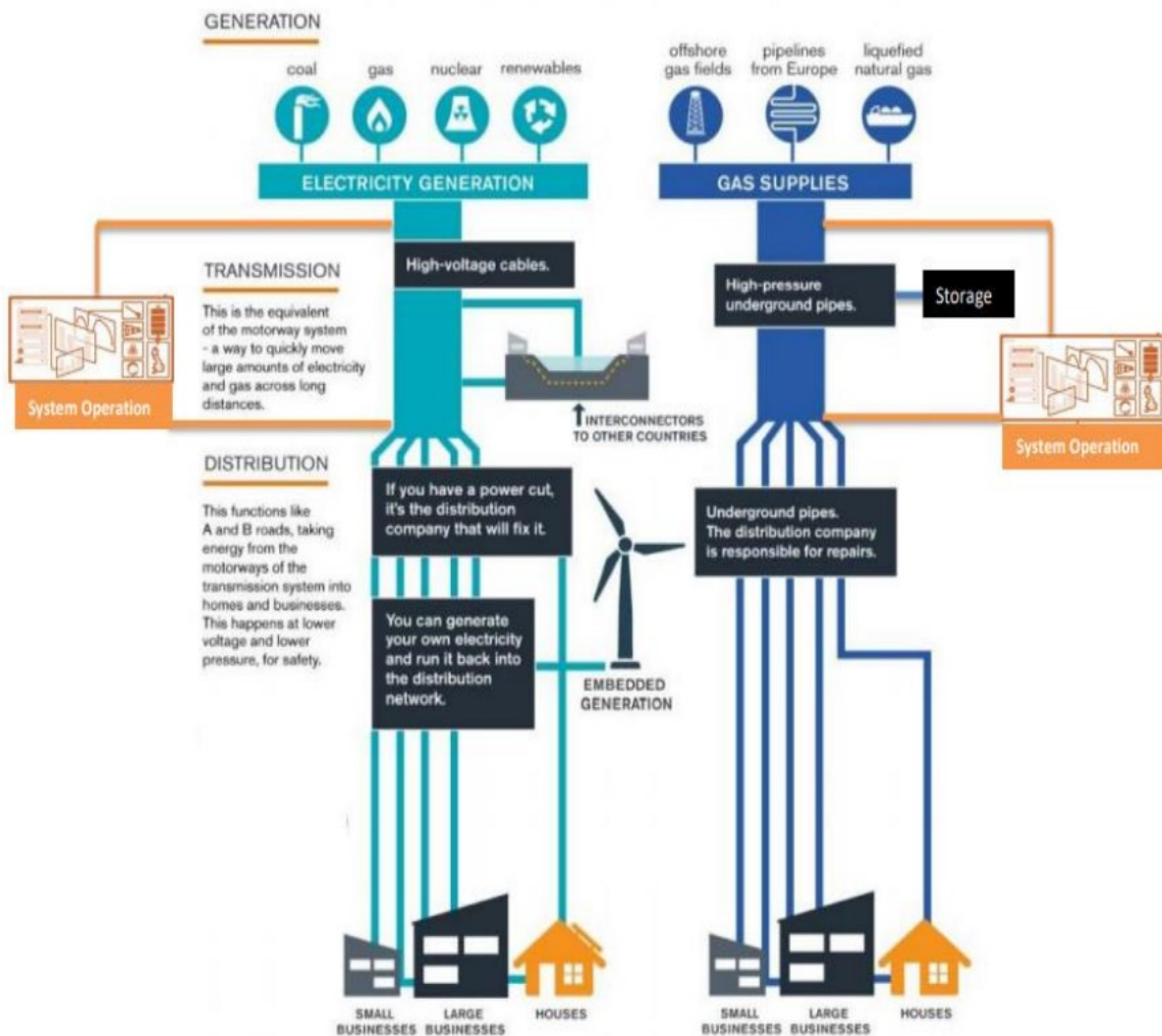
Overview of the GB energy sector

- 2.4 The GB energy sector consists of two distinct products: electricity and gas. While private companies had been involved in these industries historically, both the electricity and gas sectors were nationalised shortly after World War 2. In the late 1980s, the government chose to privatise these sectors,²³ granting licences to private companies to operate different parts of the supply chain. An illustrative summary of the modern supply chains for each of electricity and gas is shown in Figure 2-1:

²² [Great Britain and Northern Ireland Regulatory Authorities Reports 2020](#).

²³ Gas through the GA86 and electricity through the EA89.

Figure 2-1: Illustration of energy supply chains



Source: Teach-in session 3 – GEMA, slide 46.

- 2.5 The transmission and distribution elements of the electricity and gas supply chains are, together, generally referred to as 'energy networks'. These networks are natural monopolies and therefore there is no competition to drive better service, greater efficiency or more investment. Instead, the energy networks are subject to oversight from a sectoral regulator, GEMA, which operates through Ofgem.
- 2.6 GEMA sets price controls to protect the interests of consumers (both existing and future), which includes determining the amount of revenue that each company is allowed to recover. The private companies that hold relevant licences (network operators) undertake the necessary activities to meet their obligations to deliver the relevant service safely and collect the revenue that GEMA has allowed. This revenue is collected from downstream participants, and ultimately paid for by consumers of gas and electricity through their

energy bills, with network charges making up around 25% of the average dual-fuel bill.²⁴

2.7 For this appeal, the relevant parts of the energy network are as follows:

- (a) **Gas transmission network:** Owns and operates the high-pressure underground pipes used to move large volumes of gas long distances from entry points (production and importation) to directly connected large users (eg power stations and industry) and to the local distribution zones.
- (b) **Gas distribution networks (GDNs):** Own and operate underground gas pipes that take gas, at a lower pressure, from the transmission network to homes and businesses.
- (c) **Electricity transmission networks:** Own and operate the high-voltage electrical cables (usually strung between pylons but in some places underground) and transformers used to transmit electricity from large centrally located generators to demand centres.

2.8 We note that GEMA has not updated its price control yet for the 14 electricity distribution operators (for which the next price control is due to begin on 1 April 2023) and so these companies are not part of this appeal.

2.9 The number of companies involved in the operation of these energy networks differs, as does the geographic region that is covered by each. Table 2-1 sets out a summary of the companies, with Figure 2-2 and Figure 2-3 showing the operating regions of each. We note that some companies operate across multiple geographic regions. As the sole gas transmission operator, NGG's operating area spans all of GB.

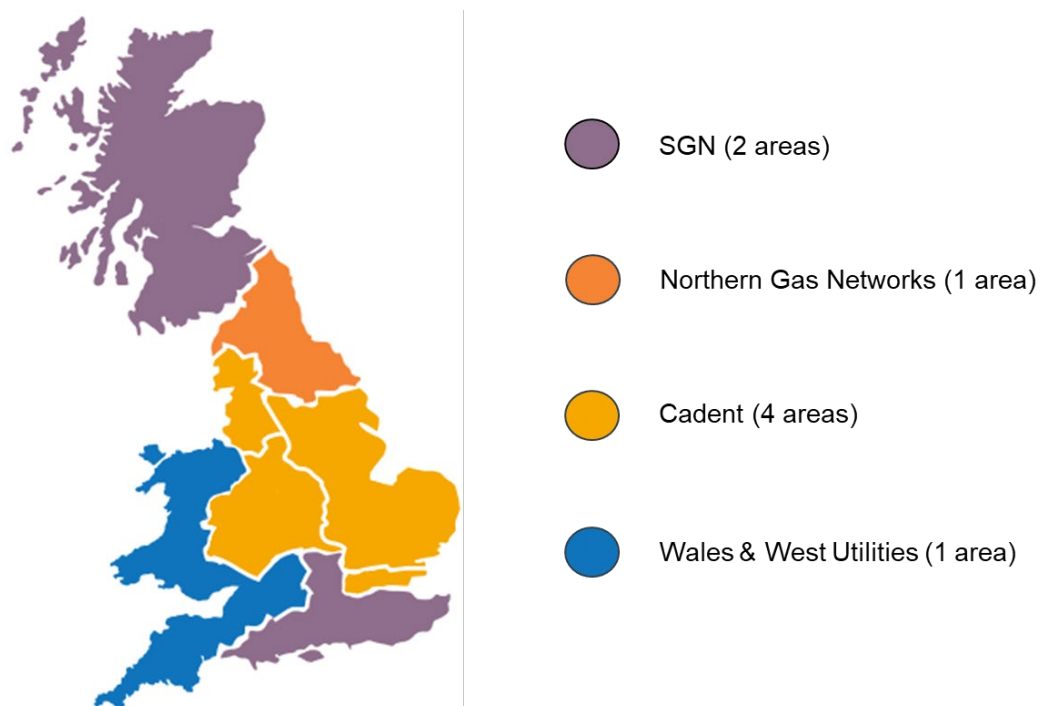
Table 2-1: List of companies and operating regions:

	<i>Number of companies</i>	<i>Names of companies</i>	<i>Common abbreviation</i>
Gas transmission	1	National Grid Gas	NGG
Gas distribution	4	Cadent	Cadent
		Northern Gas Networks	NGN
		Southern Gas Network & Scottish Gas Network	SGN
		Wales & West Utilities	WWU
Electricity transmission	3	National Grid Electricity Transmission	NET
		SSEN Transmission	SSEN-T
		SP Transmission	SPT

Note: the names used here represent trading names rather than legal names.

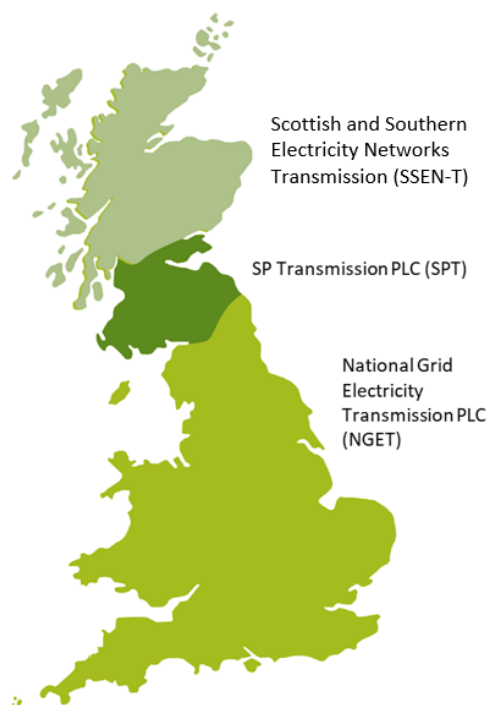
²⁴ Kaul 1 (GEMA), paragraph 13.

Figure 2-2: Geographic areas covered by each gas distribution network



Source: Teach-in session 1 – gas distribution and transmission, slide 11.

Figure 2-3: Geographic areas covered by each electricity transmission operator



Source: Teach-in session 2 – electricity transmission, slide 11.

Note: Original image referred to Scottish and Southern Electricity Networks Transmission as Scottish Hydro Electric Transmission PLC.

2.10 We discuss these various parties in more detail in paragraphs 2.15 to 2.56 below.

Upcoming challenges: Net Zero

- 2.11 In the Climate Change Act 2008, the UK committed to reduce its greenhouse gas emissions to 20% of 1990 levels by 2050.²⁵ In 2019, the UK Government amended this Act by introducing a new target, requiring at least 100% reduction of greenhouse gas emissions by 2050, compared to the 1990 levels.²⁶ This is referred to as **Net Zero**. The Scottish Government has imposed a more stretching target of achieving this by 2045.²⁷
- 2.12 While substantial progress has been made in decarbonising the energy sector over the past 30 years, it remains one of the largest contributors to greenhouse gases.²⁸ GEMA has stated that one of the key objectives for its latest price control is to prepare network companies to deliver Net Zero, and that investment will be needed to:²⁹
- (a) Decarbonise power, heat and transport;
 - (b) Manage increasing decentralisation of power as more people produce their own energy locally; and
 - (c) Manage opportunities and threats emerging from increasing digitalisation of the energy system.
- 2.13 The network operators have particularly highlighted the challenges that this change will place on their current operations:
- (a) **Electricity:** The electricity transmission networks will need to invest more to (i) handle the changing electricity generation mix, (ii) manage increasing volumes of renewable generation in remote parts of the country and (iii) deal with increased levels of demand due to the electrification of heat and transport.³⁰
 - (b) **Gas:** In order to meet the requirements of Net Zero, existing uses of natural gas will need to be supplemented/replaced by 2050. Currently, there is substantial uncertainty around how this will be achieved, particularly for heating where it is a major energy source. The uncertainty around the future of gas in the UK has implications for the existing gas sector and its asset base. Future scenarios range from further upgrading the network (eg if there were widespread adoption of low-carbon fuels

²⁵ [Ofgem, state of the energy market report, 2017](#), p.13.

²⁶ Teach-in session 2 – electricity transmission, slide 23.

²⁷ Teach-in session 1 – gas distribution and transmission, slide 36.

²⁸ Teach-in session 2 – electricity transmission, slide 24.

²⁹ Teach-in session 3 – GEMA, slide 18.

³⁰ Teach-in session 2 – electricity transmission, slide 35.

such as hydrogen, which could use similar assets to natural gas) to decommissioning all existing gas assets (eg if transitioning over to full electrification).³¹

- 2.14 GEMA recognises the level of uncertainty that arises for the energy sector from Net Zero and particularly that neither it nor the network companies can anticipate the development of new technologies and policies in the coming years. It stated that over £10 billion of additional Net Zero investment could be unlocked during the price control (in addition to the £30 billion base investment allowances), to help make new ideas a reality and adjust to any changes across policy, technology and the markets.³²

The parties to the appeals

- 2.15 Here we set out summary details of the parties to the appeals, specifically:

- (a) GEMA;
- (b) The gas transmission operator;
- (c) The four gas distribution operators;
- (d) The three electricity transmission operators; and
- (e) Interveners to the appeals.

GEMA

- 2.16 GEMA is the sectoral regulator for the GB energy sector, and acts as Ofgem's senior board, with GEMA's members appointed by the Secretary of State at the Department for Business, Energy and Industrial Strategy. GEMA operates through Ofgem, a non-ministerial government department and an independent National Regulatory Authority, which supports GEMA's work.³³
- 2.17 See paragraphs 3.4 to 3.14 for additional details on GEMA's objectives, powers, and duties.

The gas transmission operator

- 2.18 NGG is the gas transmission operator within GB.

³¹ Teach-in session 1 – gas distribution and transmission, slides 36, 39, and 40.

³² [GEMA RIIO-2 Final Determination Overview](#), page 5.

³³ [Ofgem website](#).

NGG

- 2.19 NGG is a public limited company with its registered office in London. NGG holds a gas transporter licence treated as granted under section 7 of the Gas Act 1986.³⁴
- 2.20 NGG is a wholly owned subsidiary of National Grid plc (**National Grid**), which has a primary listing on the London Stock Exchange and a secondary listing on the New York Stock Exchange. National Grid has a wide array of shareholders.³⁵
- 2.21 NGG plans, constructs, owns and operates the high-pressure National Transmission System to transmit gas in GB.³⁶ This includes over 7,600km of high-pressure pipes, 24 compressor stations, and over 500 above-ground installations.³⁷
- 2.22 National Grid stated in March 2021 an intent to sell a majority stake in NGG, with a plan to launch this sale process in the second half of 2021.³⁸ At the time of publication this transaction had not been completed.

The four gas distribution operators

- 2.23 There are four gas distribution operators within GB: Cadent, NGN, SGN and WWU.

Cadent

- 2.24 Cadent Gas Limited is a private limited company (owned by a consortium of investors) with its registered office in Coventry, England.^{39,40} Cadent holds a gas transporter licence under section 7(2) of GA86.⁴¹
- 2.25 Cadent owns, manages, and operates four of the eight regional gas distribution networks in Great Britain, specifically: (i) North London, (ii) East of England, (iii) North West, and (iv) West Midlands.⁴² In doing so, it transports gas to 11 million homes, schools, hospitals, offices, and businesses through 131,000 miles of pipes.⁴³

³⁴ NGG NoA, paragraphs 1.1 and 1.2.

³⁵ NGG NoA, paragraphs 1.1 and 1.2; [National Grid plc 2020-21 annual report](#), page 242.

³⁶ NGG NoA, paragraphs 1.1.

³⁷ Teach-in session 1 – gas distribution and transmission, slide 9.

³⁸ [National Grid Investor Update, March 2021](#).

³⁹ [Companies House](#).

⁴⁰ [Cadent NoA](#), paragraph 2.3.

⁴¹ [Cadent NoA](#), paragraph 2.1.

⁴² *Moon 1 (Cadent)*, paragraph 10.

⁴³ [Cadent NoA](#), paragraphs 2.1 and 2.3.

2.26 Until October 2016, the four GDNs now owned by Cadent were part of NGG. At the end of September 2016, they were split from NGG into a new limited company, with a majority share in this new company being sold to a consortium of investors in March 2017. The company was then renamed Cadent in May 2017. NGG then sold its remaining stake in Cadent in June 2019.⁴⁴

NGN

2.27 Northern Gas Networks Limited is a private limited company with its registered office in Leeds, England.⁴⁵ NGN holds a gas transporter licence under section 7(2) of GA86.⁴⁶

2.28 NGN is owned by a consortium of three partners: CK Infrastructure, Power Assets Holdings (which is also partly owned by CK Infrastructure), and SAS Trustee Corporation.⁴⁷

2.29 NGN's operating region covers the north of England, including Yorkshire, the North East and Northern Cumbria.⁴⁸ NGN distributes gas to around 6.8 million customers through 37,000km of pipes.⁴⁹

2.30 NGN was formed in 2005 when it was split out from National Grid.⁵⁰

SGN

2.31 Southern Gas Networks plc is a public limited company with its registered office in Surrey, England.⁵¹ Scotland Gas Networks plc is a public limited company with its registered office in Edinburgh, Scotland.⁵² Each of these companies holds a gas transporter licence under section 7(2) of GA86.⁵³ Both companies are wholly owned subsidiaries of Scotia Gas Networks Limited, and together are known as SGN.⁵⁴

2.32 SGN is owned by three shareholders: OTPP (the Ontario Teachers' Pension Plan board), OMERS Infrastructure (a Canadian-based pension plan for

⁴⁴ *Moon 1 (Cadent)*, paragraph 15.

⁴⁵ [Companies House](#).

⁴⁶ [Ofgem website, list of all gas licensees including suppliers](#).

⁴⁷ [NGN website](#) (accessed July 2021); [CK infrastructure website](#) (accessed July 2021).

⁴⁸ [NGN NoA](#), paragraph 1.

⁴⁹ *Horsley 1 (NGN)*, paragraph 40(i).

⁵⁰ [NGN website](#) (accessed July 2021); Teach-in session 1 – gas distribution and transmission, slide 4.

⁵¹ [Companies House](#).

⁵² [Companies House](#).

⁵³ [SGN NoA](#), paragraphs 1 and 2.

⁵⁴ [SGN 2020 Annual Report](#), page 35; SGN Natural Gas is licensed to conveyance gas within the West distribution licensed area in Northern Ireland, but is not directly relevant to this appeal, see <https://www.uregni.gov.uk/gas-licences>.

Ontario's municipal employees), and a consortium comprising OTPP and Brookfield Super-Core Infrastructure Partners.⁵⁵

2.33 SGN has two operating regions in GB.⁵⁶

- (a) South-east and central south of England: serving 4.1 million customers through 49,000km of pipes, in densely populated urban areas in London and the south east; and
- (b) Scotland: 1.8 million customers in Scotland representing approximately 75% of Scottish households and businesses, including main cities and across the sparsely populated rural area, though 25,000km of pipes.

2.34 SGN was formed in 2005 when it was split out from National Grid.⁵⁷

WWU

2.35 Wales & West Utilities Limited is a private limited company with its registered office in Newport, Wales.⁵⁸ WWU holds a gas transporter licence under section 7(2) of GA86.⁵⁹

2.36 WWU is owned by a consortium of CK Hutchison (30%), CK Infrastructure (30%), Power Assets Holdings (30%; as mentioned above this is in turn part owned by CK Infrastructure), and the Li Ka Shing Foundation (10%).⁶⁰

2.37 WWU's gas distribution network covers the areas of Wales and the South West of England. It serves around 2.5 million homes and businesses (representing a population of around 7.5 million people) using around 35,000km of gas pipe-lines.⁶¹

2.38 WWU was formed in 2005 when it was split out from National Grid.⁶²

The three electricity transmission operators

2.39 There are three electricity transmission operators within GB: NGET, SSEN-T, and SPT.

⁵⁵ SSE sold its stake in SGN to this consortium on 2 August 2021, during the appeal (see [announcement on SSE website, retrieved October 2021](#))

⁵⁶ SGN NoA, paragraphs 11 and 12.

⁵⁷ Teach-in session 1 – gas distribution and transmission, slide 4.

⁵⁸ Companies House.

⁵⁹ WWU NoA, paragraph 1.2.

⁶⁰ WWU 2020 annual accounts, retrieved from [Companies House](#), page 73.

⁶¹ WWU NoA, paragraph 1.6.

⁶² WWU NoA, paragraph 1.3; Teach-in session 1 – gas distribution and transmission, slide 4.

NGET

- 2.40 NGET is a public limited company with its registered office in London, England.⁶³ NGET holds a licence treated as granted under section 6(1)(b) of the EA89.⁶⁴
- 2.41 NGET is a wholly owned subsidiary of National Grid, the details of which are described in paragraph 2.20 above.
- 2.42 NGET is the licensed electricity transmission owner which plans, develops, maintains and owns the onshore electricity transmission system in England and Wales.⁶⁵ It currently connects around 62GW of electricity generation using over 7,200km of overhead lines and 2,200km of underground cable.⁶⁶
- 2.43 On 14 June 2021, National Grid announced that it had completed the acquisition of PPL WPD Investments Limited (together with its subsidiary undertakings), the holding company of Western Power Distribution (**WPD**), the UK's largest electricity distribution business.

SSEN-T

- 2.44 Scottish Hydro Electric Transmission plc, trading as Scottish and Southern Electricity Networks Transmission, is a public limited company with its registered office in Perth, Scotland.⁶⁷ SSEN-T holds an electricity transmission licence under section 6(1)(b) of EA89.⁶⁸
- 2.45 SSEN-T is a wholly owned subsidiary of SSE plc which is listed on the London Stock Exchange.⁶⁹ SSE plc has a wide array of shareholders, and is active in other parts of the UK energy supply chain, including electricity generation and distribution.⁷⁰
- 2.46 SSEN-T owns and maintains the electricity transmission network in the north of Scotland.⁷¹ It currently connects around 8GW of electricity generation using over 4,500km of overhead lines and nearly 200km of underground cable.⁷²

⁶³ [Companies House](#).

⁶⁴ [NGET NoA](#), paragraphs 1.1 and 1.2.

⁶⁵ [NGET NoA](#), paragraph 1.1.

⁶⁶ Teach-in session 2 – electricity transmission, slide 37.

⁶⁷ [Companies House](#).

⁶⁸ [SSEN-T NoA](#), paragraph 1.2.

⁶⁹ [Companies House](#).

⁷⁰ [SSE website](#) (retrieved July 2021).

⁷¹ [SSEN-T NoA](#), paragraph 1.1.

⁷² Teach-in session 2 – electricity transmission, slide 37.

- 2.47 SSEN-T was formed in 1998 when the former Scotland Hydro-Electric Board and Southern Electricity Board (both of which were privatised in the early 1990s) merged to create SSE plc.⁷³
- 2.48 SSEN-T is sometimes referred to by parties as SHE-T (Scotland Hydro-Electric Transmission). In this report the two names are used interchangeably.

SPT

- 2.49 SP Transmission PLC is a public limited company with its registered office in Glasgow, Scotland.⁷⁴ SPT holds an electricity transmission licence under section 6(1)(b) of EA89.⁷⁵
- 2.50 SPT is a wholly owned subsidiary of Scottish Power, which in turn is owned by Spanish utility firm Iberdrola.⁷⁶ Iberdrola is listed on stock exchanges in Madrid, Barcelona, Bilbao, and Valencia, and has a wide array of shareholders.⁷⁷
- 2.51 SPT operates the electricity transmission network in central and southern Scotland. It currently connects around 6GW of electricity generation using over 3,700km of overhead lines and 600km of underground cable.⁷⁸
- 2.52 Scottish Power has wider operations within the UK energy supply chain, including electricity generation, distribution, and retailing.⁷⁹
- 2.53 SPT was formed in 1990 as part of Scottish Power's creation from the South of Scotland Electricity Board. Scottish Power (and hence SPT) was subsequently acquired by Iberdrola in 2007.⁸⁰

Interveners to the appeals

- 2.54 We permitted two parties to intervene formally in these appeals:⁸¹

- (a) British Gas Trading (**BGT**); and
- (b) Citizens Advice.

⁷³ [SSE website](#) (retrieved July 2021).

⁷⁴ [Companies House](#).

⁷⁵ [SPT NoA](#), paragraph 1.

⁷⁶ We note that this is not direct ownership, but ultimate control.

⁷⁷ [Iberdrola website](#) (retrieved July 2021).

⁷⁸ Teach-in session 2 – electricity transmission, slide 37.

⁷⁹ [Scottish Power website](#) (retrieved July 2021).

⁸⁰ [Scottish Power website](#) (retrieved July 2021).

⁸¹ See [Decision on BGT application to intervene](#) and [Decision on Citizens Advice application to intervene](#).

BGT

- 2.55 BGT is one of the largest energy suppliers in the UK and is part of the Centrica plc group (**Centrica**), which has significant interests in generator assets.⁸² As a supplier of electricity and gas, BGT pays charges for transmission and distribution of both electricity and gas.⁸³

Citizens Advice

- 2.56 Citizens Advice is a charity that provides free advice on issues such as debt, consumer rights, and witness support.⁸⁴ It also acts as the statutory consumer advocate for energy.⁸⁵

Background to relevant regulation issues

- 2.57 In this section, as described to us by GEMA, we set out a brief history of energy regulation in GB and a summary of how this has evolved to the setting of the current price control which is subject to this appeal.

History of energy regulation

- 2.58 At the point of privatisation, a new form of price control regulation was developed and implemented in the UK. This was known as RPI-X and was designed to incentivise improvements in efficiency, particularly as the networks were seen as being inefficient with high operating costs and spare capacity.⁸⁶
- 2.59 Under RPI-X the regulator limits average network charges from rising at the rate of inflation (measured by the retail price index, or **RPI**) less an efficiency factor (called 'X'). Since price limits are set before expenditure has been incurred by companies, RPI-X is a form of ex-ante regulation. Once price caps are set, companies face incentives to reduce expenditure as much as possible to maximise their profits. In doing so, they reveal the potential for efficiency gains to the regulator. The regulator periodically resets the caps, and 'squeezes out the remaining efficiency potential' by increasing the X factor and reducing prices.⁸⁷

⁸² [BGT intervention notice](#), paragraph 1.1.

⁸³ *Edwards 1 (BGT)*, paragraph 13.

⁸⁴ [Citizens Advice website](#) (retrieved July 2021).

⁸⁵ [Citizens Advice intervention notice](#), paragraph 25.

⁸⁶ *Kaul 1 (GEMA)*, paragraph 15.

⁸⁷ *Kaul 1 (GEMA)*, paragraph 16.

- 2.60 While RPI-X was generally considered to have worked well initially, some potential issues arose, particularly around the incentives to reduce customer service (in order to reduce costs), limited levels of innovation, and a bias towards capital expenditure in order for companies to expand their asset bases.⁸⁸
- 2.61 In 2008, GEMA decided to review its approach to setting price controls, in particular to try and address some of the issues it saw arising from RPI-X. This resulted in the creation of the 'RIIO' framework (where RIIO stands for: Revenues = Incentives + Innovation + Outputs). This aims to build on the previous RPI-X regime, but places more emphasis on incentives to drive the outputs and innovation needed to deliver a sustainable energy system in a way that provides value for money to existing and future consumers. GEMA's first RIIO price control (**RIIO-1**) ran from 1 April 2013 to 31 March 2021 for the gas transmission and distribution networks as well as the electricity transmission networks.⁸⁹
- 2.62 The latest iteration of GEMA's updated regulatory framework (RIIO-2) is the price control that is subject to this appeal. When needing to differentiate between the controls for different sectors these are often referred to as RIIO-GT2 (for the gas transmission network), RIIO-GD2 (for the gas distribution networks), and RIIO-ET2 (for the electricity transmission networks).

Structure of RIIO and components of allowed revenue

- 2.63 The RIIO model is an incentive-based model under which GEMA sets both the amount that regulated companies can earn over the price control period and what the companies must deliver in return for those revenues. Although it is referred to as a price control, GEMA actually controls the total revenues each company can recover rather than specific prices. GEMA explained the total allowed revenue as comprising:⁹⁰
- (a) the baseline revenue;
 - (b) mechanisms that adjust this revenue during the price control period relative to company performance, eg rewards and penalties to specific incentives; and
 - (c) other adjustments to baseline revenue, eg due to uncertainty mechanisms that increase or reduce allowances within the price control period.

⁸⁸ Kaul 1 (GEMA), paragraph 17.

⁸⁹ Teach-in session 3 – GEMA, slide 4.

⁹⁰ Teach-in session 3 – GEMA, slide 7.

- 2.64 Baseline revenue is the revenue that a company needs to cover the efficient operating and financing costs of delivering outputs and long-term value for money, including allowances for maintenance of, and investment in, capital assets and taxation. GEMA assesses the efficiency of these costs.
- 2.65 GEMA describes baseline revenue as comprising four different categories:⁹¹
- (a) An allowance for expenditures that is set at the time of the price control review. These expenditures are called total expenditure (**totex**), an element of which is included in the in-period revenues.⁹²
 - (b) The depreciation of the existing regulatory asset value (**RAV**).⁹³
 - (c) An allowance intended to reflect the cost of capital for the company.
 - (d) Tax.
- 2.66 RIIO adopts a totex approach to ensure companies make balanced decisions between different types of solution. Totex includes capital expenditure (**capex**), operating expenditure (**opex**), and replacement expenditure (**repex**).⁹⁴ Totex is remunerated by a combination of 'fast money' and 'slow money':⁹⁵
- (a) Fast money may be thought of as akin to operating costs or expenditure and is provided in-year (contributing to the baseline revenue described above).
 - (b) Slow money remunerates costs that are added to the RAV, which is subsequently depreciated. The expenditure funded by slow money may be thought of as akin to capital expenditure.

Observations from RIIO-1

- 2.67 As part of its planning for RIIO-2, GEMA consulted on what had worked well in RIIO-1, and what needed to change. It also commissioned an evaluation from economic consulting firm Cambridge Economic Policy Associates Ltd (**CEPA**), and considered independent reports from other relevant bodies such as the National Audit Office (**NAO**).⁹⁶ Since the planning of RIIO-2 started in

⁹¹ Teach-in session 3 – GEMA, slide 6.

⁹² This component will also include some pass-through costs which are not within the control of the company.

⁹³ The RAV is the value ascribed by GEMA to the capital employed in the licensee's regulated business (ie the regulated asset base).

⁹⁴ Repex is only relevant for the GDNs; Teach-in session 3 – GEMA, slide 26.

⁹⁵ [GEMA FD Core Document \(revised\)](#), pages 182 and 194.

⁹⁶ *Kaul 1 (GEMA)*, paragraphs 24–36.

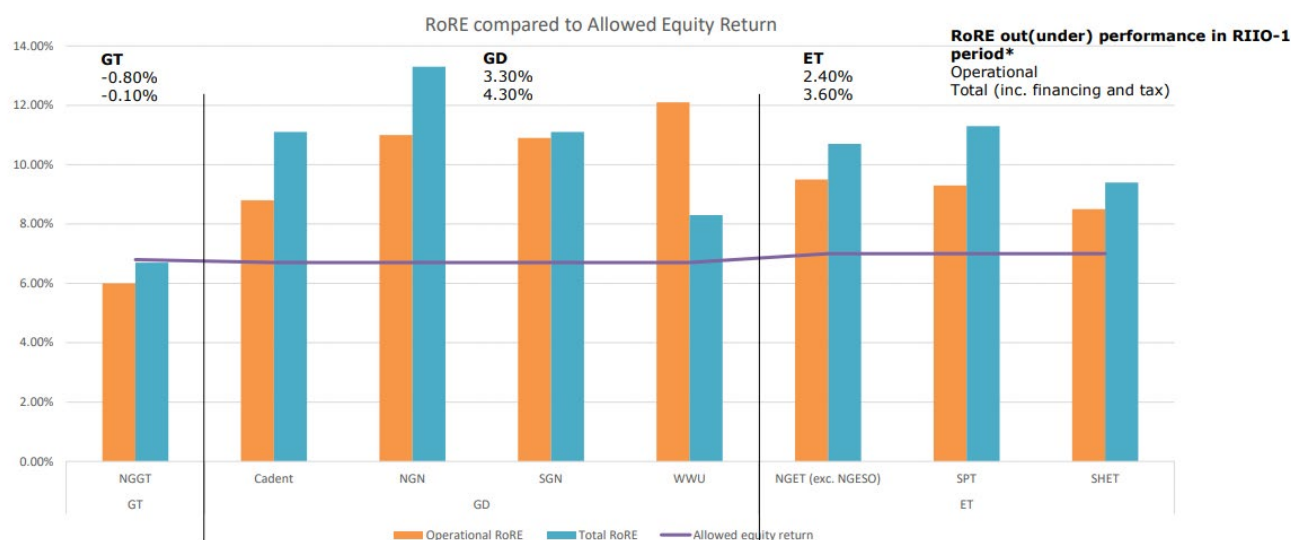
2017, these reports and observations were generally produced before the RIIO-1 period had finished.⁹⁷

2.68 These reviews generally found that most networks were providing a high-quality service to consumers and outperformed their quality of service targets.⁹⁸

2.69 However, there was some concern and criticism around the level of allowances provided to the companies, and the subsequent impact on customer bills. In particular, CEPA said that it had ‘identified issues around the way the RIIO-1 price controls were implemented, and the risk-reward balance of those price controls, that have also made material contributions to the level of added returns for network companies’,⁹⁹ while the NAO said ‘consumers have paid more than they should have under RIIO-1’.¹⁰⁰

2.70 GEMA said that it largely agreed with these concerns and took them into account when developing its RIIO-2 framework,¹⁰¹ while itself identifying the level of financial outperformance displayed by most of the companies during RIIO-1 as shown in Figure 2-4.¹⁰²

Figure 2-4: Return on Regulatory Equity (RoRE) out(under) performance in RIIO-1 period



Source: Teach-in session 3 – GEMA, slide 12.

Note: There are different ways in which RoRE may be calculated. The approach used for the purposes of Ofgem’s annual published Regulatory Financial Performance Reporting follows the method set out in its RFPR guidance.

⁹⁷ Teach-in session 3 – GEMA, slide 20.

⁹⁸ Eg Teach-in session 3 – GEMA, slide 10.

⁹⁹ [CEPA Review of RIIO Framework and RIIO-1 Performance](#).

¹⁰⁰ [NAO report on electricity networks](#); and [NAO press release for its report on electricity networks](#).

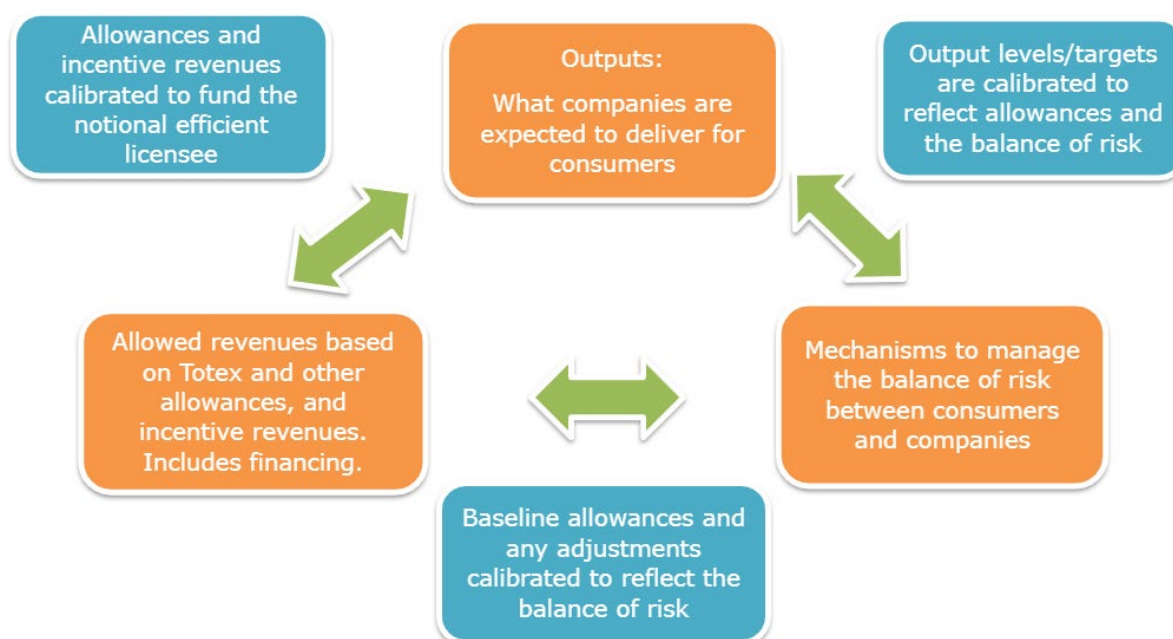
¹⁰¹ *Kaul 1 (GEMA)*, paragraphs 23–56.

¹⁰² We note that the level and reasons behind any observed financial outperformance is a point of contention in these appeals and is discussed in more detail in the relevant chapters.

Changes made for RIIO-2

2.71 GEMA described three ‘pillars’ to the RIIO-2 package, as shown in Figure 2-5:

Figure 2-5: RIIO-2 pillars



Source: Teach-in session 3 – GEMA, slide 40.

2.72 In order to better balance these requirements, GEMA made a number of changes from RIIO-1, in particular:¹⁰³

- (a) **Length of the price control:** Reduced from 8 years in RIIO-1 to 5 years for RIIO-2;
- (b) **Price control deliverables (PCDs):** Baseline funding linked to delivery of outputs, so consumers are refunded if the work is not needed or not carried out;
- (c) **Output delivery incentives (ODIs):** Calibrated to reward companies for going beyond business as usual (BAU), and focused on areas which are under the company’s control;
- (d) **Baseline funding vs uncertainty mechanisms:** Increased proportion of costs expected to be funded through uncertainty mechanisms to allow for more flexibility as both needs and costs become clearer over time;
- (e) **Increased efficiency challenge:** Ongoing efficiency challenge set at 1.2% pa (vs 0.8% pa in RIIO-1), and catch-up efficiency set to rise to 85th

¹⁰³ Teach-in session 3 – GEMA, slides 13 and 14.

percentile in later years of the price control (vs 75th percentile throughout RIIO-1);

- (f) **Confidence-dependent totex cost sharing factors:** Lower totex cost sharing factors (incentive rates) compared to RIIO-1 to more closely align with GEMA's level of confidence in its cost benchmarks;
- (g) **Indexation:** Use of indexation for elements of input prices and financial metrics;
- (h) **Cost of equity and allowed returns:** Reduced cost of equity allowance vs RIIO-1 (from around 7.8% to 4.55%), and introduction of an 'outperformance wedge' of 25 Basis Points (bps);¹⁰⁴ and
- (i) **Return adjustment mechanisms:** Implementation of a symmetrical return adjustment mechanism if return on equity is significantly above or below the expected value.

Summary of RIIO-2 financials

2.73 Key financial information for the gas transmission network, gas distribution networks and the electricity transmission operators in RIIO-2 can be found in Table 2-2, Table 2-3 and Table 2-4.

Table 2-2: Gas transmission network's key financials in RIIO-2

	<i>Baseline totex</i>	<i>Baseline revenue</i>	<i>Opening RAV (after transfers)</i> ^{£m}
NGG	2,010	731*	5,960

* Figure as stated for NGGT TO (ie excluding NGGT SO)

Source: [GEMA FD NGGT Annex](#), Table 7; [GEMA FD Finance Annex](#), Table 19; [GEMA FD GT Licence Model](#), tab 'Return&RAV', cell AP22

Table 2-3: Gas distribution networks' key financials in RIIO-2

	<i>Baseline totex</i>	<i>Baseline revenue</i>	<i>Opening RAV (after transfers)</i> ^{£m}
East of England	1,523	538	3,259
London	1,243	390	2,456
North West	1,083	368	2,301
West Midlands	858	287	1,749
<i>Cadent total</i>	<i>4,708</i>	<i>1,583</i>	<i>9,766</i>
NGN	1,186	380	2,233
Scotland	907	288	1,756
Southern	1,772	599	3,949
<i>SGN total</i>	<i>2,680</i>	<i>887</i>	<i>5,705</i>
WWU	1,157	380	2,230
GD sector total	9,730	3,230	19,935

Source: [GEMA FD GD Annex](#), Table 1; [Cadent Annex](#), Table 1; [SGN Annex](#), Table 1; [GEMA FD Finance Annex](#), Table 19; [GEMA FD GD Licence Model](#), tab 'Return&RAV', cell AP22

¹⁰⁴ Set at 1 hundredth of 1%.

Table 2-4: Electricity transmission operators' key financials in RIIO-2

	<i>Baseline totex</i>	<i>Baseline revenue</i>	<i>Opening RAV (after transfers)</i> £m
NGET	5,377	1,629	14,229
SSEN-T	2,158	482	3,555
SPT	1,226	331	2,509
ET sector total	8,761	2,442	20,293

Source: [GEMA FD ET Annex](#), Table 1; [GEMA FD Finance Annex](#), Table 19; [GEMA FD ET Licence Model](#), tab 'Return&RAV', cell AP22

Other relevant reports

2.74 During these appeals, the parties referred to two reports in particular in their submissions: the **UKRN Report** and the CMA PR19 Redetermination.

UKRN report

- 2.75 In March 2018, a subgroup¹⁰⁵ of the UK Regulators Network members commissioned a report on how to set cost of capital for regulated companies.¹⁰⁶
- 2.76 This report aimed to take a 'fresh look' at the role of the cost of capital in the regulation of UK utilities, building on previous work, and in particular the measurement of the components of the weighted average cost of capital (**WACC**) – primarily focusing on the measurement of the cost of equity.¹⁰⁷
- 2.77 Amongst its conclusions, the UKRN Report made ten key recommendations around estimating the WACC using the capital asset pricing model and provided observations around wider considerations such as the level of bid premia. The report also included an additional discussion about the way that calculated estimates are used by regulators, particularly when setting the allowed return for regulated companies.¹⁰⁸
- 2.78 The report states that it was authored by individuals from a range of relevant disciplines and perspectives, and while all four authors were able to agree on much of the content of the report, this was not true in all cases. Where there was disagreement, the report included the separate views of each of the relevant individuals or groups of authors.¹⁰⁹

¹⁰⁵ This subgroup consisted of the CAA, Ofcom, Ofgem, and the Utility Regulator.

¹⁰⁶ Wright, Burns, Mason and Pickford (2018), [Estimating the cost of capital for implementation of price controls by UK Regulators](#).

¹⁰⁷ UKRN Report, page 4.

¹⁰⁸ UKRN Report, pp 7–16.

¹⁰⁹ UKRN Report, for example pp 9–10, 12–14, and 15–16.

CMA PR19 Redetermination

- 2.79 On 17 December 2019, Ofwat published its final determination of the PR19 price controls applying to all the water and wastewater service suppliers in England and Wales for the period 2020 to 2025.¹¹⁰
- 2.80 Four companies rejected Ofwat's final determination and requested that their price controls be referred to the CMA for redetermination. Ofwat did this on 19 March 2020.¹¹¹
- 2.81 Between 19 March 2020 and 17 March 2021 the CMA undertook its redetermination process. The legal framework for this redetermination was that the CMA was not bound simply to accept or reject the position adopted by Ofwat or the disputing companies; rather it evaluated the evidence and adopted what it considered to be the best approach to the issues it was deciding on (taking account of the same statutory duties as Ofwat).¹¹²
- 2.82 The CMA published its provisional determination on 29 September 2020 (**CMA PR19 Provisional Findings**).¹¹³ This was therefore available to GEMA at the point of making its final determination on 8 December 2020.¹¹⁴
- 2.83 The CMA published a small number of supplementary working papers in early January 2021, and the final CMA PR19 Redetermination on 9 April 2021.¹¹⁵ These publications therefore took place after GEMA had made its final determination. The timings also meant that the appellants did not have the CMA's final determination when drafting their NoAs that were submitted on 3 March 2021.
- 2.84 We therefore invited supplementary submissions to clarify and update the case presented in the NoAs to take into account any additional evidence introduced in the CMA's final determination. The appellants made their submissions on 23 April 2021,¹¹⁶ and GEMA responded to these on 17 May 2021.¹¹⁷

¹¹⁰ [CMA PR19 Redetermination \(summary document\)](#), paragraph 13.

¹¹¹ [CMA PR19 Redetermination \(summary document\)](#), paragraphs 1 and 14.

¹¹² [CMA PR19 Redetermination \(summary document\)](#), paragraph 19.

¹¹³ [CMA PR19 Provisional Findings](#). We note that at times this has sometimes been referred to as 'PR19 PFs', 'Provisional PR19 Redetermination', 'CMA PR19 Redetermination Provisional Findings', and 'CMA's provisional findings in the PR19 redetermination'.

¹¹⁴ [Ofgem website](#).

¹¹⁵ [CMA PR19 Redetermination case page](#).

¹¹⁶ [Cadent PR19 submission](#); [NGET and NGG joint PR19 submission](#); [NGN PR19 submission](#); [SGN PR19 submission](#); [SSEN-T PR19 submission](#); [SPT PR19 submission](#); [WWU PR19 submission](#).

¹¹⁷ [GEMA PR19 Response on Finance](#); [GEMA PR19 Response on Totex](#).

3. Legal framework

The decision under appeal

- 3.1 One of GEMA's specific functions under the EA89 and the GA86 is to license persons engaged in various activities in the electricity and the gas supply chain, including the generation, transmission and distribution of electricity for the purpose of giving or enabling a supply to any premises (as well as the supply of electricity to premises itself) and the conveyance of gas through pipes.¹¹⁸
- 3.2 GEMA's periodic price controls are given effect by way of modifications to licences. By virtue of section 11A of EA89 and section 23 of GA86, subject to the prescribed notice having been provided,¹¹⁹ GEMA may make modifications of:
- (a) the conditions of a particular licence;
 - (b) the standard conditions of licences of any types mentioned in section 6(1) of EA89 (including transmission licences) or as mentioned in sections 7, 7ZA, or 7A(1) or (2) of GA86.
- 3.3 The price controls which are at issue in the present appeals were introduced by way of modification to the affected electricity transmitters', gas transmitters' and gas distributors' licences under section 11A of EA89 and section 23 of GA86. The decision to modify the licences was published on 3 February 2021¹²⁰ and gave effect to the 'RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator' (the **Decision**). Prior to issuing the FD in December 2020,¹²¹ GEMA consulted on its Draft Determination (**DD**) in July 2020.

GEMA's objectives, powers and duties

- 3.4 In carrying out its functions in relation to the supply of electricity and gas, GEMA is subject to a statutory 'principal objective', which is to protect the interests of existing and future consumers:

¹¹⁸ EA89, section 6 and GA86, section 7.

¹¹⁹ EA89, section 11A(2) and GA86, section 23(2).

¹²⁰ [Decision on the proposed modifications to the RIIO-2 Transmission, Gas Distribution and Electricity System Operator licences | Ofgem.](#)

¹²¹ [RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator | Ofgem.](#) Some documents part of the FD were revised in February 2021.

- (a) under EA89, in relation to electricity conveyed by distribution systems or transmission systems;¹²² and
 - (b) under GA86, in relation to gas conveyed through pipes.¹²³
- 3.5 In this context, EA89¹²⁴ and GA86¹²⁵ explain that the ‘interest of existing and future consumers’ means their interests taken as a whole, including:
- (a) their interests in the reduction of electricity - and gas - supply emissions of targeted greenhouse gases;
 - (b) their interests in the security of the supply of electricity and gas to them, and
 - (c) their interests in the fulfilment by GEMA, of the ‘designated regulatory objectives’.¹²⁶
- 3.6 Sections 3A of EA89 and 4AA of GA86 go on to set out a series of specific duties with which GEMA must comply in relation to its principal objective, as well as a series of considerations to which it must (or, in some cases, may) have regard in performing those duties.
- 3.7 First, GEMA is required to carry out its functions under EA89 and GA86 in a manner which it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors (in the case of EA89), or the shipping, transportation or supply of gas conveyed through pipes (in the case of GA86).¹²⁷
- 3.8 Second, before deciding to carry out its functions in a particular manner with a view to promoting competition, GEMA must consider:
- (a) to what extent the interest of consumers would be protected by the manner of carrying out those functions; and

¹²² EA89, section 3A(1).

¹²³ GA86, section 4AA(1).

¹²⁴ Section 3A(1A).

¹²⁵ Section 4AA(1A).

¹²⁶ The ‘designated regulatory objectives’ means (i) under EA89 the objectives set out in Article 36(c) to (h) of the Electricity Directive 2009/72/EC but read with modifications as stated in the Electricity and Gas etc. (Amendment etc.) (EU Exit) Regulations 2019 and (ii) under GA86 the objectives set out in Article 40(c) to (h) of the Gas Directive 2009/73/EC but read with modifications as stated in the Electricity and Gas etc. (Amendment etc.) (EU Exit) Regulations 2019.

¹²⁷ EA89, section 3A(1B) and GA86, section 4AA(1B).

- (b) whether there is any other manner (whether or not it would promote competition) in which GEMA could carry out those functions which would better protect those interests.¹²⁸
- 3.9 Third, when performing the duties described in paragraphs 3.7 and 3.8 above, GEMA must have regard to:
- (a) the need to secure that all reasonable demands for electricity or gas are met;
 - (b) the need to secure that licence holders are able to finance their activities; and
 - (c) the need to contribute to the achievement of sustainable development.¹²⁹
- 3.10 Fourth, in performing its duties set out in paragraphs 3.7, 3.8 and 3.9 above, GEMA shall have regard to the interests of a number of specified categories of individuals (eg those who are disabled).¹³⁰
- 3.11 Fifth, and subject to the requirements set out in paragraphs 3.7 and 3.9 above,¹³¹ GEMA must carry out its functions in relation to the supply of electricity and gas in the manner which it considers is best calculated:
- (a) to promote efficiency and economy on the part of persons authorised by licences or exemptions (i) under EA89, to distribute, supply or participate in the transmission of electricity, to participate in the operation of electricity interconnectors, to provide a smart meter communication service and the efficient use of electricity conveyed by distribution systems or transmission systems and, (ii) under GA86, to carry on any activity, and the efficient use of gas conveyed through pipes;
 - (b) to protect the public from dangers arising from (i) under EA89, the generation, transmission, distribution or supply of electricity or the provision of a smart meter communication service and, (ii) under GA86, the conveyance of gas through pipes or from the use of gas conveyed through pipes or the provision of a smart meter communication service; and

¹²⁸ EA89, section 3A(1C) and GA86, section 4AA(1C).

¹²⁹ EA89, section 3A(2)(b) and GA86, section 4AA(2).

¹³⁰ EA89, section 3A(3) and GA86, section 4AA(3).

¹³¹ GEMA is also required to have regard to section 132(2) of the Energy Act 2013 which requires GEMA to carry out its functions under Part I of EA89 in a way which it considers is best calculated to promote the delivery of policy outcomes. By virtue of section 131 of the Energy Act 2013, the Secretary of State may designate a statement as the strategy and policy statement. This statement sets out the particular outcomes to be achieved as a result of the implementation of that policy (amongst other things).

- (c) to secure a diverse and viable long-term energy supply.
- 3.12 In carrying out those functions, GEMA must have regard to the effect on the environment of activities connected with, under EA89, the generation, transmission, distribution or supply of electricity or the provision of a smart meter communication service and, under GA86, the conveyance of gas through pipes or the provision of a smart meter communication service.¹³²
- 3.13 Sixth, in carrying out its functions in relation to the supply of electricity and gas, GEMA must have regard to:
- (a) the principles under which regulatory activities should be transparent, accountable, proportionate and targeted only at cases in which action is needed;¹³³
 - (b) any other principles appearing to it to represent the best regulatory practice;¹³⁴ any guidance issued by the Secretary of State on social and environmental factors;¹³⁵ and
 - (c) any advice given by the Health and Safety Executive or the Office for Nuclear Regulation or Secretary of State about any electricity or gas safety issue.¹³⁶
- 3.14 Seventh, where the following is affected by the carrying out of its function, GEMA may have regard to the interest of consumers in relation to these services:
- (a) gas conveyed through pipes (in the case of EA89) or electricity conveyed by distribution systems (in the case of GA86);
 - (b) communication services and electronic communications apparatus; or
 - (c) water services or sewerage services.¹³⁷

The appeals

- 3.15 GEMA's decisions to modify electricity licences and gas licences are subject to a specific appellate regime. The appeals are brought pursuant to sections 11C of EA89 and 23B of GA86, which provide that an appeal lies to the CMA

¹³² EA89, section 3A(5) and GA86, section 4AA(5).

¹³³ EA89, section 3A(5A)(a) and GA86, section 4AA(5A)(a).

¹³⁴ EA89, section 3A(5A)(b) and GA86, section 4AA(5A)(b).

¹³⁵ EA89, section 3B and GA86, section 4AB.

¹³⁶ EA89, section 3C(3) and (4) and GA86, section 4A(2).

¹³⁷ EA89, section 3A(4) and GA86, section 4AA(4).

against a decision by GEMA to proceed with the modification of a condition of a licence.

- 3.16 Only certain persons are entitled to appeal GEMA's decision to the CMA.¹³⁸ These include (i) persons who hold a licence under section 6(1) of EA89 and section 7, 7ZA, or 7A(1) or (2) of GA86, where the decision at issue involves a modification to the terms of that licence (referred to in EA89 and GA86 as a 'relevant licence holder') as well as (ii) any other person who holds a licence of any type under section 6(1) of EA89 and section 7, 7ZA, 7A(1) or (2) or 7AB of GA86 and whose interests are materially affected by the decision.
- 3.17 Potential appellants require permission from the CMA to bring an appeal.¹³⁹ On 3 March 2021, nine parties sought permission to appeal, claiming standing as 'relevant licence holders':
- (a) Cadent;
 - (b) NGET;
 - (c) NGG;
 - (d) NGN;
 - (e) SGN;¹⁴⁰
 - (f) SSEN-T;
 - (g) SPT; and
 - (h) WWU.
- 3.18 The CMA granted permission to appeal to all parties on 31 March 2021, subject to the condition that four common grounds of appeal would be joined across appellants which pleaded the ground.¹⁴¹ As requested by NGET and NGG, their appeals were joined by the CMA.
- 3.19 Section 11G(1) of EA89 and section 23F(1) of GA86 provide that the CMA must determine an appeal against a price control decision within the period of six months beginning with the permission date. However, on 21 April 2021, following representations by the parties, we decided to extend the time period

¹³⁸ EA89, section 11C and GA86, section 23B.

¹³⁹ By virtue of section 11C(3) of EA89 and section 23B(3) of GA86, no appeal may be brought without the CMA's permission.

¹⁴⁰ Southern Gas Networks PLC and Scotland Gas Networks PLC submitted a joint application.

¹⁴¹ The four common grounds of appeal are cost of equity, outperformance wedge, ongoing efficiency, and licence modification process.

for determination of the appeals to seven months pursuant to section 11G(4)(a) of EA89 and section 23F(4)(a) of GA86, as applicable. Accordingly, the statutory deadline for our final determination on the appeals is 30 October 2021.

Test on appeal

Standard of review

3.20 Under section 11E(4) of EA89 and section 23D(4) of GA86, having granted permission, the CMA may allow an appeal only where it is satisfied that the decision appealed was wrong on one or more of the following specified grounds, that:

- (a) GEMA failed properly to have regard to the matters to which GEMA must have regard in carrying out its principal objective under section 3A of EA89 or section 4AA of GA86, and its duties under sections 3A or section 3B and 3C of EA89 or sections 4AA, 4AB and 4A of GA86.
- (b) GEMA failed to give the appropriate weight to any of those matters.
- (c) The decision was based, wholly or partly, on an error of fact.
- (d) The modifications fail to achieve, in whole or in part, the effect stated by GEMA in the decision (as required by section 11A(7)(b) of EA89 and section 23(7)(b) of GA86).
- (e) The decision was wrong in law.

3.21 Section 11E(2) of EA89 and section 23D(2) of GA86 provide that in determining appeals under sections 11C of EA89 and 23B of GA86 (following the grant of permission), the CMA must have regard, to the same extent as is required of GEMA, to the matters to which GEMA must have regard:

- (a) in the carrying out of its principal objective under section 3A of EA89 or 4AA of GA86 (see paragraph 3.4 above);
- (b) in the performance of its duties under section 3A of EA89 or 4AA of GA86 (see paragraph 3.6 above); and
- (c) in the performance of its duties under section 3B and 3C of EA89 or 4AB and 4A of GA86 (set out at paragraphs 3.13(b) and 3.13(c) above).

- 3.22 Section 11E(3) of EA89 and section 23D(3) of GA86 provide that in determining the appeal, the CMA may have regard to matters to which GEMA was not able to have regard to in relation to the decision. However, the CMA must not, in determining the appeal, have regard to any matters to which GEMA would not have been entitled to have regard in reaching its decision had it had the opportunity of doing so.
- 3.23 This is the second time that an appeal has been brought under section 11C of EA89. In the appeals of the RIIO-1 price control decision¹⁴² (**ED1 Determinations**) the CMA published its conclusions on the standard of review in its two decisions of 29 September 2015. Neither decision was challenged by any party in the ED1 Determinations, and the applicable legislation remains unchanged. We have therefore applied the standard of review employed in the ED1 Determinations in the current appeals.
- 3.24 Furthermore, in considering the submissions we have received on the statutory framework in the course of these appeals, we have also drawn on the approach taken in other regulatory appeals involving substantially the same statutory framework, where relevant. Notably, as in the ED1 Determinations, we have had regard to cases under the Energy Act 2004 (**EA04**) on the basis that the grounds for allowing an appeal under EA04 are very similar to the grounds for allowing an appeal under EA89 and GA86. As such, these provide helpful guidance as to the level of scrutiny which an appellate body with particular expertise such as the CMA should adopt in reviewing GEMA's decisions in the present case.¹⁴³ We have also taken guidance from the approaches taken in more recent appeals brought under the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992, given that the statutory grounds for allowing an appeal are essentially the same as the grounds for allowing an appeal under EA89 and GA86. Although we are not bound by these decisions, which concern a different statutory appeal mechanism under a different legislative scheme, we consider that they are instructive for the approach which the CMA should take in the present appeals.
- 3.25 Similarly, we have also drawn guidance from appeals brought under other regimes such as the Communications Act 2003 (**CA03**). Whilst we acknowledge that there is no direct analogy with the present appeals given some differences in the statutory provisions, we consider the approach adopted in these cases by the Competition Appeal Tribunal (the **CAT**) to be

¹⁴² CMA, 2015, *Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v GEMA, Final determination*, (**Northern Powergrid**) and CMA, 2015, *British Gas Trading v GEMA, Final determination* (**British Gas**) (together, **ED1 Determinations**).

¹⁴³ *Northern Powergrid*, at paragraph 3.24 and *British Gas*, at paragraph 3.25.

broadly analogous to the approach taken by the CMA in the ED1 Determinations and that they therefore also provide some guidance as to the level of scrutiny which an appellate body with particular expertise such as the CMA should adopt in reviewing GEMA's decision in the present case.¹⁴⁴

- 3.26 Both ED1 Determinations concluded that the CMA's role was not limited to reviewing the decision on traditional judicial review grounds and that the CMA is not only able, but required by EA89, to consider the merits of the decision under appeal, albeit by reference to the specific grounds of appeal laid down in the statute.¹⁴⁵ In this context, the appeals took note of the fact that, when this appeal mechanism was inserted into the provisions of EA89, the preceding consultation document¹⁴⁶ referred to the grounds of appeal that would be available to appellants, stating:

It is the Government's intention that the proposed grounds for appeal for licence modification decisions also enable the appeal body to take account of the merits of the case in a similar manner [to energy code modification appeals]. The Government considers the Competition Commission's approach in relation to code modifications to be helpful in this regard.¹⁴⁷

- 3.27 In the ED1 Determinations, the CMA found that a useful analogy could be drawn between the appeal on the basis of EA89 and the approach taken by the CAT in the context of appeals against Ofcom price controls in the telecommunications sector. In *BT v Ofcom*,¹⁴⁸ the CAT stated that:

[b]y section 192(6) of the 2003 Act and rule 8(4)(b) of the 2003 Tribunal Rules, the notice of appeal must set out specifically where it is contended OFCOM went wrong, identifying errors of fact, errors of law and/or the wrong exercise of discretion. The evidence adduced will, obviously, go to support these contentions. What is intended is the very reverse of a de novo

¹⁴⁴ Previously, CA03 required consideration of appeals on the merits by reference to whether the decision under appeal was wrong. It was amended in July 2017 by the Digital Economy Act which introduced a new standard of review. The CAT is now required to 'apply the same principles as would apply in a judicial review case but also to ensure that the merits of the case are duly taken into account' (see *TalkTalk and Vodafone v. Ofcom* [2020] CAT 8, at paragraph 120; see also paragraph 139, where the CAT considered that it 'should continue, as before, to scrutinise the Decision for procedural unfairness, illegality and unreasonableness, but, in addition, we should form our own assessment of whether the Decision was wrong'). For the purposes of the present appeals, we have drawn guidance from cases brought both before and after the CA03 was amended where we consider that they raise points about the standard of review that are relevant to the regime under EA89 and GA86.

¹⁴⁵ *Northern Powergrid*, at paragraph 3.23 and *British Gas*, at paragraph 3.24.

¹⁴⁶ Department of Energy and Climate Change, "Implementation of the EU Third Internal Energy Package: Government Response" (January 2010), at paragraph 2.24, available here [Responses to the main consultation \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/214422/Responses_to_the_main_consultation.pdf).

¹⁴⁷ *Northern Powergrid*, at paragraph 3.22 and *British Gas*, at paragraph 3.23.

¹⁴⁸ *BT v. Ofcom* [2010] CAT 17, at paragraph 76.

hearing. OFCOM's decision is reviewed through the prism of the specific errors that are alleged by the appellant. Where no errors are pleaded, the decision to that extent will not be the subject of specific review. What is intended is an appeal on specific points.

3.28 We agree with and adopt the CMA's position outlined in the ED1 Determinations, where the CMA decided that an appeal under EA89 does not involve a rehearing where it is open to it to decide matters afresh untrammelled by GEMA's decision.¹⁴⁹ Furthermore, we also agree with the ED1 Determinations that consideration of the merits of the decision under appeal must be within the confines of the specific grounds of appeal laid down in the statute.¹⁵⁰

3.29 We note that the CAT confirmed this approach in two recent cases brought under CA03:

(a) In *Virgin Media Limited v Ofcom* (**Virgin Media**),¹⁵¹ the CAT stated that

... the focus is Ofcom's decision and whether Ofcom got their decision materially wrong. It is that decision that is being challenged. The question is not what decision the appellate body might itself have reached if it had started afresh.

(b) In *TalkTalk Telecom and Vodafone Limited v Ofcom*,¹⁵² the CAT cited *Hutchison 3G UK and BT v. Ofcom*¹⁵³ when discussing the new standard of review for cases brought under CA03:

[Ofcom's] Decision is the centre point of the challenge and must be the target of any challenge; there is no blank canvas upon which the parties can paint a new picture which fails to heed the reasoning in the decision under challenge.

3.30 In the present case, whilst there was common ground between the appellants and GEMA as to the fact that the CMA's role is not limited to reviewing the Decision on traditional judicial review grounds, there was some disagreement on the extent of the merits review:

(a) WWU argued that 'the CMA ... is to assume Ofgem's role, re-consider the case as if it were the primary decision-maker, and reach its own expert

¹⁴⁹ *Northern Powergrid*, at paragraphs 3.35 and *British Gas*, at paragraph 3.36.

¹⁵⁰ *Northern Powergrid*, at paragraph 3.36 and *British Gas*, at paragraph 3.37.

¹⁵¹ *Virgin Media Limited v Ofcom* [2020] CAT 5, at paragraph 57.

¹⁵² *TalkTalk Telecom and Vodafone Limited v Ofcom* [2020] CAT 8, at paragraph 130.

¹⁵³ *Hutchison 3G UK v Ofcom* [2017] EWHC 3376 (Admin), at paragraph 40.

judgment as to what constitutes “proper” regard or “appropriate weight” in respect of any matter’.¹⁵⁴

- (b) GEMA took issue with this position, describing the standard of review as being ‘more intense than the approach taken by the courts in an application for judicial review, but fall[ing] short of a full rehearing or appeal on the merits. The CMA will take into account the merits of GEMA’s decision, but the question for the CMA will be whether GEMA’s decision was wrong on one of the statutory grounds and not whether the CMA would have made the same decision as GEMA, had it been in the regulator’s position’.¹⁵⁵

- 3.31 In line with the CMA’s position outlined in the ED1 Determinations, we reject WWU’s submission that we should ‘re-consider the case as if [we] were the primary decision-maker’ and agree with GEMA’s submission that the standard of review falls short of a full rehearing. We are required to consider the merits of the Decision but only through the prism of the specific errors alleged by the appellants. The appeals do not entitle the CMA to proceed with a re-run of the original investigation or have a de novo re-hearing of all the evidence. The key question is whether GEMA made a decision that was wrong (on one of the prescribed statutory grounds). Only to that extent must the merits of the Decision be taken into account and we have done so in the present appeals.
- 3.32 Our final determination in this appeal reflects the application of a standard of review that is in line with the approach set out above. We consider that this approach is consistent with the approach taken by the CMA in the ED1 Determinations and the more recent decisions in appeals against decisions by the Northern Ireland Authority for Utility Regulation,¹⁵⁶ as well as the CC in Energy Code appeals,¹⁵⁷ and by the courts in relation to appeals under CA03.¹⁵⁸ It also reflects the government’s intention in implementing the relevant appeal provisions.

The meaning of ‘wrong’

- 3.33 As explained under paragraph 3.20 above, the CMA must decide whether the Decision was wrong.

¹⁵⁴ WWU NoA, paragraph 3.6.

¹⁵⁵ GEMA Response A, paragraph 41.

¹⁵⁶ *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation*, Final determination, 26 June 2017 (**Firmus**) and *SONI Limited v Northern Ireland Authority for Utility Regulation*, Final determination, 10 November 2017 (**SONI**).

¹⁵⁷ *E.ON UK plc v GEMA: energy code modification appeal*, 10 July 2007.

¹⁵⁸ *BT v. Ofcom* [2010] CAT 17, *Virgin Media Limited v Ofcom* [2020] CAT 5, and *TalkTalk Telecom and Vodafone Limited v Ofcom* [2020] CAT 8.

- 3.34 On the point of deciding errors of fact, in 2003 the Court of Appeal in *Assicurazioni Generali Spa v Arab Insurance Group*¹⁵⁹ issued a Practice Note where the Court held that:

where the correctness of a finding of primary fact or of inference is in issue, it cannot be a matter of simple discretion how an appellate court approaches the matter. Once the appellant has shown a real prospect (justifying permission to appeal) that a finding or inference is wrong, the role of an appellate court is to determine whether or not this is so, giving full weight of course to the advantages enjoyed by any judge of first instance who has heard oral evidence. In the present case, therefore, I consider that (a) it is for us if necessary to make up our own mind about the correctness or otherwise of any findings of primary fact or inference from primary fact that the judge made or drew and which the claimants challenge, while (b) reminding ourselves 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 that the judge's conclusion lay outside the bounds within which reasonable disagreement is possible. In relation to (a) we must, as stated, bear in mind the important and well recognised reluctance of this court to interfere with a trial judge on any finding of primary fact based on the credibility or reliability of oral evidence.

- 3.35 Both ED1 Determinations were based on the reasoning in *Assicurazioni* and also referred to the CC's approach in the energy code modification appeal of *E.ON UK plc v GEMA (E.ON)*,¹⁶⁰ which we discuss below. While the CMA recognised that it was not bound by the decision in *E.ON* (which concerned a different statutory appeal mechanism under a different legislative scheme), it considered that the *E.ON* decision accurately characterised the approach which the CMA should take in the RIIO-1 appeals.
- 3.36 In the decision of *SONI Limited v Northern Ireland Authority for Utility Regulation (SONI)*,¹⁶¹ having referred to *Assicurazioni*,¹⁶² the CMA concluded that:

¹⁵⁹ [2002] EWCA Civ 1642, [2003] 1 WLR 577 citing Todd's case [2002] 2 Lloyd's Rep 293 at p 319–320, [129].

¹⁶⁰ An appeal under EA04, section 173, 10 July 2007.

¹⁶¹ *SONI* 10 November 2017, at paragraph 3.36.

¹⁶² See paragraph 3.34 above.

when applying the five statutory tests¹⁶³... we consider that there is an important difference between the CMA making up our own mind about the correctness or otherwise of any findings of primary fact, or inference from primary fact, made in the Price Control Decision, which is permissible, and the CMA substituting our judgment for that of the regulator simply on the basis that we would have taken a different view of the matter, had we been the regulator, which is not permissible.

3.37 In the present appeals, the parties made submissions on what ‘wrong’ means, variously arguing that the Decision may be wrong if:

- (a) there are better alternatives;
- (b) there are flaws in GEMA’s assessment of the evidence;
- (c) there are flaws in GEMA’s reasoning; and/or
- (d) there were procedural deficiencies in the process that led to the adoption of the Decision.

3.38 We consider each of these issues below.

Alternative approaches

3.39 In the present appeals, GEMA submitted that:

The CMA’s starting point is the error the regulator is alleged to have made; it will not pre-empt the regulator’s decision by considering whether it should have started from a different place... ¹⁶⁴

3.40 Consistent with the ED1 Determinations, we note and adopt the finding made in *E.ON*¹⁶⁵ and various other more recent cases¹⁶⁶ that our starting point should not be to determine whether there is an alternative approach and then decide whether it is better. We should only determine whether there is an error in the approach chosen by GEMA, as alleged by the appellants.

¹⁶³ In section 14D of the Electricity (Northern Ireland) Order 1992, which are substantially the same as those in section 11E of EA89.

¹⁶⁴ [GEMA Response A](#), paragraph 32.

¹⁶⁵ *E.ON*, at paragraph 5.11, cited in [Northern Powergrid](#), at paragraph 3.26 and [British Gas](#), at paragraph 3.27, and at paragraph 5.12, cited in [Northern Powergrid](#), at paragraph 3.27 and [British Gas](#) at paragraph 3.28.

¹⁶⁶ See eg, [SONI](#), at paragraph 3.29, and *Firmus*, at paragraph 3.19.

3.41 In *SONI* (an appeal under The Electricity (Northern Ireland) Order 1992) the CMA also adopted this position, stating that:

In particular, we consider that it is not appropriate for the CMA to start by considering an alternative approach and to say that if that approach is considered superior, then there is an error. The first question for the CMA is whether there has been an error in the regulator's approach, not whether an alternative approach might be better. The question of what alternative approach should be adopted is primarily relevant once an error has been identified.¹⁶⁷

3.42 In their response to the provisional determination, NGET/NGG submitted that the CMA should have considered the appellants' alternative approaches **alongside** the GEMA's approach and evaluated the relative merit of the different approaches to determine whether GEMA's approach was wrong.¹⁶⁸ Similarly, Cadent submitted in its reply to GEMA's Response that: '[w]here an alternative approach would have been clearly better, GEMA's decision is wrong.'¹⁶⁹

3.43 As noted at paragraph 3.40 above, our starting point will be to consider the adequacy of GEMA's chosen approach rather than considering which approach we ourselves might have chosen had we been in GEMA's position. However, we agree that, in considering whether GEMA's chosen approach discloses an error, we will consider its inherent merits including by comparing its merits with those of any reasonable alternatives advanced by the appellants. If, out of the alternatives available, we conclude that some alternatives clearly had greater merit than the solution chosen by GEMA, then we are more likely to be persuaded that GEMA has erred. On the other hand, where the alternative options each have competing pros and cons, and none is clearly superior, it will be more difficult to persuade us that GEMA has erred.¹⁷⁰

¹⁶⁷ Paragraph 3.29.

¹⁶⁸ NGET/NGG Response to PD, paragraph 3.9.

¹⁶⁹ [Cadent Reply](#), paragraph 19.

¹⁷⁰ This approach is in line with that of the CC in Case 1149/3/3/09 *The Carphone Warehouse Group v Ofcom (Local Loop Unbundling)* Final Determination of 31 August 2010 (a reference under section 193 of the Communications Act 2003). The CC stated at paragraph 1.34 that: 'In a case where there are a number of alternative solutions to a regulatory problem with little to choose between them, we do not think it would be right for us to determine that Ofcom erred simply because it took a course other than the one that we would have taken. On the other hand, if, out of the alternative options, some clearly had more merit than others, it may more easily be said that Ofcom erred if it chose an inferior solution. Which category a particular choice falls within can necessarily only be decided on a case-by-case basis.'

GEMA's assessment of the evidence

- 3.44 In the present appeals, NGN submitted 'that a number of GEMA's decisions are extreme and not supported by a reasonable consideration of the evidence' and that GEMA is required to '[take] into account all relevant evidence, [give] it appropriate weight and [adopt] a decision which is consistent with such weighing of evidence.'¹⁷¹
- 3.45 SSEN-T submitted that the CMA should find an error if 'GEMA has not taken account of relevant evidence or data, and placed weight on unreliable data'.¹⁷²
- 3.46 In *Northern Powergrid*, the CMA overturned GEMA's decision to impose a cost adjustment relating to Smart Grid Benefits (**SGB**) on the basis that:
- [N]either the evidence nor the reasons put forward by GEMA ... support GEMA's decision to make a specific ... adjustment. In the absence of evidential support for the judgement, GEMA's discretion cannot ... be treated as sufficient to justify the adjustment ... that it made.¹⁷³
- 3.47 We thus agree with the appellants that we may find an error if the Decision is based on unreliable data or fails to take account of the relevant evidence.

GEMA's reasoning

- 3.48 In the present appeals, SGN argued that 'GEMA acts unlawfully where its decision is unreasonable...' and that 'A decision can be unreasonable ... where there is a demonstrable flaw in the reasoning'.¹⁷⁴
- 3.49 GEMA argued in relation to cost of equity, aiming up and sufficiency of return that 'it is not enough for an appellant to identify some error or absence of reasoning, since an appeal can only succeed if the decision itself cannot stand.'¹⁷⁵
- 3.50 In *Firmus Energy (Distribution) Limited v Northern Ireland Authority for Utility Regulation (Firmus)*,¹⁷⁶ the CMA found that:

¹⁷¹ NGN Reply, paragraph 9.

¹⁷² SSEN-T Reply, paragraph 2.4.

¹⁷³ *Northern Powergrid*, paragraph 4.140.

¹⁷⁴ SGN NoA, paragraph 101.

¹⁷⁵ GEMA Response A, paragraph 94.

¹⁷⁶ *Firmus*, 26 June 2017, at paragraph 3.20 citing *Everything Everywhere v Competition Commission* [2013] EWCA Civ 154 at paragraph 22.

If the CMA concludes that the decision can be supported on a basis other than that on which the regulator relied, then the appellant will not have shown that the decision was wrong and will fail.

- 3.51 In line with *Firmus*, we agree with GEMA that the fact that its reasoning underpinning its Decision is wrong does not mean that the Decision itself will necessarily be wrong if it can be supported on a basis other than that on which GEMA relied.

Procedural deficiencies

- 3.52 In the present appeals, several appellants invited us to take into account procedural deficiencies in GEMA's decision-making process when determining whether its Decision was wrong. In particular:

- (a) NGET and NGG¹⁷⁷ submitted that 'in assessing errors of law, the CMA will consider whether GEMA has made any procedural errors ... For example, whether GEMA has conducted the consultation prior to the decision with an open mind and taken account of representations by interested parties.'
- (b) NGN¹⁷⁸ argued that 'the well-established error of law based on procedural unfairness will arise if: the decision-maker has not properly observed the relevant statutory procedures, such as a failure to consult or to give reasons...'
- (c) SGN¹⁷⁹ contended that 'the phrase 'wrong in law' includes the public law concept of procedural unfairness/breach of natural justice ... [and] that this requires GEMA, when making price control decisions, to conduct consultations prior to such decisions with an open mind, allow interested parties to make representations, and to provide clear reasons for its decision.'
- (d) SSSEN-T¹⁸⁰ argued that '...a failure of process that is sufficient to undermine the substance of GEMA's decision ... will render that decision wrong in law.'

- 3.53 In *Firmus*,¹⁸¹ the CMA found that:

¹⁷⁷ NGET NoA and NGG NoA, paragraph 2.10.

¹⁷⁸ NGN NoA, paragraph 120.

¹⁷⁹ SGN NoA, paragraph 106.

¹⁸⁰ SSSEN-T NoA, paragraph 2.62.

¹⁸¹ *Firmus*, at paragraph 3.20(e).

If the CMA is satisfied that the regulator's decision was correct, then the fact that the regulator's consultation process was deficient ought not to matter, unless that process was so deficient that the CMA cannot be assured that the regulator did indeed get it right.

- 3.54 Consistent with *Firmus*, our analysis should only take into account procedural deficiencies (including a flawed consultation process) if they are so serious that we cannot be assured that the Decision was not wrong.

GEMA's margin of appreciation

- 3.55 The margin of appreciation afforded to GEMA in matters of regulatory judgement is important to bear in mind in reaching a finding as to whether a decision is 'wrong', as recognised by the CMA and courts in previous regulatory appeals.
- 3.56 In the present appeals, we were invited by GEMA to find that:
- (a) 'where the alleged error lies in the judgement GEMA has made about an unchallenged primary fact or inference, provided GEMA has not made an error of law, the CMA should not substitute its own judgement simply because it would have taken a different view had it been in the position of the regulator. In other words, there is a field of possible judgements in which GEMA may exercise its regulatory discretion lawfully, and reasonable people may disagree about the judgement which is ultimately made.'
 - (b) 'As to uncertainty, where a regulator is making decisions that address present and future uncertainties, the regulator enjoys a greater margin of appreciation.'
 - (c) 'Many decisions taken by regulators involve judgement and an estimation of what might happen in an uncertain context, and the CMA is not expected to impose its own judgement in place of that of the sector regulator provided that the regulator's response is reasonable.'¹⁸²
- 3.57 Most of the appellants took issue with the way GEMA described its regulatory discretion in its submission. They submitted that GEMA had overstated the extent of its margin of appreciation.

¹⁸² [GEMA Response A](#), paragraphs 36, 43 and 49.

3.58 Cadent argued that:

GEMA repeatedly falls into the error of overstating the limits of its discretion by asserting that its approach meets the baseline standard of rationality ... This is not the standard of review applicable in the present case, which goes further and is concerned directly with the merits of GEMA's decision. Where an alternative approach would have been clearly better, GEMA's decision is wrong. It is not necessary for Cadent to show that GEMA acted outside the bounds of reasonableness; that is the test for judicial review (Wednesbury unreasonableness). A merits review will quite rightly hold GEMA's decisions to a higher standard.

3.59 Further, Cadent contended that it was not correct for GEMA to say that '[T]he question before the CMA ... is whether GEMA's decision "lay outside the bounds within which reasonable disagreement is possible"' and that '... the standard of review in relation to matters of judgement is not limited to Wednesbury unreasonableness'.¹⁸³

3.60 NGET/NGG said that GEMA had 'taken the point on regulatory discretion and judgement too far' and that 'there is no principle that an appeal must fail if it relates to a judgement on which "reasonable people may disagree"'.¹⁸⁴

3.61 Similarly, SGN maintained that 'GEMA seeks to distort and subvert the relevant legal framework by replacing the applicable statutory test, which entails considering whether GEMA's decision is wrong on one of the grounds set out in section 23D(4) GA86, with an alternative test, which entails considering whether the Decision fell outside reasonable bounds...a decision may be "wrong" even if it is not "unreasonable"'.¹⁸⁵

3.62 Quoting the CMA's decision in *Northern Powergrid*, NGN submitted that 'there has to be ... a limit to the discretion of regulators to make adjustments' and ultimately '[t]he exercise of regulatory discretion remains bounded and subject to legal principles.' NGN also argued that 'GEMA's margin of discretion does not allow GEMA to take decisions based on extremely selective, inconsistent and/or inadequate evidence and assumptions'.¹⁸⁶

¹⁸³ [Cadent Reply](#), paragraphs 19 and 21.

¹⁸⁴ [NGET and NGG joint Reply](#), paragraphs 5.5, 5.8 and 5.9.

¹⁸⁵ [SGN Reply](#), paragraphs 8–9.

¹⁸⁶ [NGN Reply](#), paragraph 6.

- 3.63 SSEN-T argued that ‘GEMA’s attempt to hide behind discretion betrays a lack of confidence in the substance of its decisions and must be rejected.’¹⁸⁷
- 3.64 SPT submitted that ‘Whilst of course it is true that GEMA is to be allowed some margin of appreciation as an “expert regulator”, this does not give GEMA carte blanche. It must not be allowed to denude the CMA of its own expert regulatory function.’¹⁸⁸

General principles

- 3.65 The CMA’s starting point when considering an appeal is as set out in *SONI*,¹⁸⁹ where the CMA considered that:

... the test is not whether the decision under appeal was ‘unreasonable’. The test is whether the CMA is satisfied the regulator’s decision was wrong on one or more of the statutory grounds and that the error was material.

- 3.66 In *Virgin Media*, which was a case brought under CA03, the CAT held that ‘[p]roper respect must be accorded to Ofcom’s role as a specialist regulator, and the expertise of Ofcom’s staff.’¹⁹⁰
- 3.67 We consider that these dicta in *SONI* and *Virgin Media* are equally apposite for the margin of appreciation afforded to GEMA in the present context.
- 3.68 In essence, while we agree that GEMA should be afforded a margin of appreciation as an expert regulator, we also agree with the appellants that its margin of appreciation is not unbounded. As explained below, we consider that the approach we should take is different depending on whether the appellants are alleging an error of primary fact (or inferences from such primary facts) or an error of law, or whether they are alleging that GEMA’s weighting of factors or other exercise of judgement is wrong.

Errors of primary fact and errors of law

- 3.69 In *E.ON*, in relation to an appeal under EA04, the CC found in relation to errors of fact that:

GEMA, as the specialist regulator may well have an advantage over the CC in finding the relevant primary facts. ... GEMA ... has

¹⁸⁷ [SSEN-T Reply](#), paragraph 2.4.

¹⁸⁸ [SPT Reply](#), paragraph 9.

¹⁸⁹ [SONI](#), at paragraph 3.35.

¹⁹⁰ *Virgin Media Limited v Ofcom* [2020] CAT 5, at paragraph 57.

an advantage of experience, and will often have the benefit of having conducted a consultation with the industry ... For these reasons, the CC will be slow to impugn GEMA's findings of fact. Nevertheless, the CC has a clear jurisdiction in respect of factual errors, and we will exercise that jurisdiction where we conclude that GEMA has based its decision on a plain error of fact.¹⁹¹

- 3.70 As regards errors of law, in its recent decision in the SSE code modifications appeal,¹⁹² the CMA agreed with the parties that 'in the context of challenges relying on an alleged error of law, ... there [is] no role for 'regulatory judgement' or discretion on the question of what is the correct construction of legislation' and also that 'on that question, the concept of reasonable judgement, as embodied in the Wednesbury test, has no part to play.'
- 3.71 In the present appeals, GEMA itself recognised that 'where an error of law is alleged, the CMA must make its own decision as to what was the correct conclusion, without showing deference to GEMA's reasoning or regulatory discretion.'¹⁹³
- 3.72 Thus, if we find that the Decision is based on a plain error of fact or is wrong in law, there is no room for a margin of appreciation.

Regulatory judgement

- 3.73 In *E.ON*, the CC considered the appellate body's function. The CC noted that the appellate body will exercise a degree of restraint when considering matters of regulatory judgement:

As a specialist appellate body charged with considering whether a decision of GEMA is wrong, the function of the CC is to provide accountability in relation to the substance of code modification decisions. However, leaving to one side errors of law, 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.¹⁹⁴

- 3.74 The CC further took the view that the statutory test under section 175 of EA04:

¹⁹¹ *E.ON*, at paragraph 5.16.

¹⁹² *SSE Generation Limited v GEMA and National Grid Electricity System Operator Limited and Centrica plc/British Gas Trading Limited*, Decision, 30 March 2021, at paragraph 5.17.

¹⁹³ *GEMA Response A*, paragraph 59.

¹⁹⁴ *E.ON*, at paragraph 5.11, cited in *Northern Powergrid*, at paragraph 3.26 and *British Gas*, at paragraph 3.27.

...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 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.¹⁹⁵

- 3.75 In *BT v Ofcom*¹⁹⁶ the Court of Appeal considered the CAT's approach to its jurisdiction to review Ofcom's exercise of judgement. While that appeal concerned a different statutory scheme, the court confirmed the general principle underlying the approach, saying:

Whether or not it is helpful to encapsulate the appropriate approach in the proposition that Ofcom enjoys a margin of appreciation on issues which entail the exercise of its judgment, the fact is that the Tribunal should apply appropriate restraint and should not interfere with Ofcom's exercise of a judgment unless satisfied that it was wrong.

- 3.76 In line with *E.ON* and *BT v Ofcom*, we find that where the exercise of regulatory judgement is involved, GEMA will have a margin of appreciation. GEMA's margin of appreciation will be at its greatest where all that is impugned is an overall value judgement based upon competing considerations in the context of a public policy decision.¹⁹⁷ We will apply appropriate restraint and, in principle, not question issues of judgement on unchallenged primary findings and inferences determined by GEMA unless we are satisfied that GEMA's decision is wrong.
- 3.77 Similarly, where GEMA has exercised regulatory judgement in selecting amongst various alternative solutions to a regulatory problem, we will not substitute GEMA's assessment or weighting of the evidence or reasoning with our own unless we are satisfied that GEMA's approach was wrong – for example, because there was a clearly superior alternative approach (see discussion at paragraph 3.42 above). In their responses to the CMA's provisional determination, a number of the appellants argued that the CMA had shown undue deference to GEMA's expertise in economic matters, which they contended was unwarranted. SSEN-T noted that the CMA considered issues relevant to the Capital Asset Pricing Model (**CAPM**) and cost of equity

¹⁹⁵ *E.ON*, at paragraph 5.12, cited in *Northern Powergrid*, at paragraph 3.27 and *British Gas*, at paragraph 3.28.

¹⁹⁶ *BT v Ofcom* [2014] EWCA Civ 133, at paragraph 87; see also *Firmus*, at paragraph 3.20.

¹⁹⁷ See the dicta of the Court of Appeal to this effect in *T-Mobile v Ofcom* [2008] EWCA Civ 1373 at paragraph 31.

across a range of regulated sectors and that, by contrast, GEMA's experience was confined to the energy sector. It went on to contend that we should therefore show no deference to GEMA's decision-making on these points.¹⁹⁸

- 3.78 We accept that the CMA is itself an expert body, in particular in relation to CAPM and cost of equity, and that it benefits from cross-sector experience. We also agree that we must not uncritically accept GEMA's assessment and weighting of the considerations before it simply because GEMA is an expert body. However, we do not accept that these points mean GEMA has no margin of appreciation when these matters are appealed to us. Nor do we accept that allowing GEMA a margin of appreciation equates to the adoption of a judicial review standard. We note that even in a full merits appeal of an infringement decision imposing quasi-criminal penalties under the Competition Act 1998, it can be consistent with such an appeal to allow the decision-maker a margin of appreciation.¹⁹⁹ We shall carefully scrutinise the substance of GEMA's decision-making in line with the grounds of appeal advanced before us and we shall intervene where we are persuaded GEMA has erred.
- 3.79 We note that in their replies WWU, NGET/NGG, and Cadent all objected to GEMA including the following quote from the *Cellcom* case: 'the court should be very slow to impugn decisions of fact made by an expert and experienced decision-maker, it must surely be even slower to impugn his educated prophesies and predictions for the future.'^{200,201,202,203} The appellants noted that these observations were made in the context of judicial review proceedings and so are not applicable in the present appeals. While we agree with the appellants that *Cellcom* is a judicial review case, as explained above, we will apply appropriate restraint when reviewing issues which entail the exercise of GEMA's judgement, which may include GEMA's predictions for the future.

¹⁹⁸ SSSEN-T Response to PD, paragraphs 2.22 to 2.25. Cadent and SPT made similar representations on the PD: see Cadent Response to PD, paragraphs 7.3 to 7.4, and SPT Response to PD, paragraphs 6 to 9.

¹⁹⁹ See the discussion in *Pfizer and Flynn v CMA (Phenytoin)* [2020] EWCA Civ 339, paragraph 146 and *Roland v CMA* [2021] CAT 8 at paragraphs 30 to 33. Even in these cases, which engage the appellants' fundamental rights under the European Convention of Human Rights, the Court of Appeal and the CAT have stressed that the CAT must not interfere if the decision-maker cannot be said to have erred. *A fortiori*, it follows that in a case such as this, which does not involve the same sorts of concerns, a decision-maker must be able to enjoy a margin of appreciation.

²⁰⁰ [WWU Reply](#), paragraph 3.12.

²⁰¹ [NGET and NGG joint Reply](#), paragraph 5.10.

²⁰² [Cadent Reply](#), paragraph 22.

²⁰³ *R v DG of Telecommunications (ex parte Cellcom)* [1999] ECC 314, at paragraph 26.

Nature of the decision under review

Interlinkages

- 3.80 In its response to the appellants' NoAs, GEMA invited the CMA to take into account interlinkages between different elements of the price control assessment when reviewing the Decision, maintaining that:

Issues that appear large in value may not be 'material' when considered in the broader framework of an appellant's price control, in particular where there are interlinkages between different elements of the price control assessment. For example, an appeal which sought to overturn one decision which forms part of a series of interlinked decisions might be rejected on the grounds that overall the proposed change to the decision under appeal is not a material issue when considered with the interlinked impacts.²⁰⁴

- 3.81 Several appellants criticised GEMA's interpretation of the concept of interlinkages for being too broad and stressed that the burden is on GEMA to adduce evidence of interlinkages:

- (a) NGN argued that 'if GEMA wants to rely on interlinkages, it has to identify these clearly and show that without these interlinkages a decision could not stand on its own. The Response fails adequately to identify any such interlinkages in sufficient detail for the appellants to be able to make representations on their appropriateness or for the CMA to assess them.'²⁰⁵
- (b) SGN objected 'to GEMA's elastic interpretation of the concept of interlinkages', arguing that 'This is plainly not a redetermination and the CMA has previously resisted pleadings for it to conduct an "in the round" assessment'.²⁰⁶
- (c) WWU submitted that Ofgem 'appears to come very close to saying that almost every aspect of each price control is interlinked to every other, that price controls are interlinked across appellants, and that regardless of any individual component of a price control which needs to be amended in the light of an identified error, the overall allowance should not be disturbed because it must be assumed to be correct on an "in the round" basis. This

²⁰⁴ GEMA Response B, paragraph 70.

²⁰⁵ NGN Reply, paragraphs 25–28.

²⁰⁶ SGN Reply, paragraph 17.

bears no relation to the concept of interlinkages originally recognised by the CMA,²⁰⁷ and stretches it to breaking point.²⁰⁸

- 3.82 In the ED1 Determinations, the CMA received submissions that GEMA's decision would have been 'an interrelated and integrated whole' and that disturbing one element of that decision may have knock-on effects on other parts of the decision. It also received submissions that 'cherry picking' would make the appeal process unfair, for example, if considering one element in isolation would undermine the global bargain struck by the relevant licence holders.²⁰⁹ The CMA rejected this argument, citing the Competition Commission (CC) Energy Licence Modification Appeals Rules (CC14) which require each appellant to state in its notice of appeal the grounds of appeal on which it relies and to include a statement of facts and reasons supporting each ground of appeal on which it is relying. The CMA considered that 'these provisions clearly envisaged that we must determine the appeal 'through the prism of the specific errors' alleged by the appellant.'²¹⁰
- 3.83 The CMA recognised, however, that price control decisions may be taken and accepted on a global basis or reflect an 'in the round' assessment by GEMA and the licence holders. It also acknowledged that in some circumstances it might be necessary to take care that overturning one aspect of a complex regulatory decision did not have knock-on consequences for other, unappealed aspects of the decision.²¹¹
- 3.84 Furthermore, the CMA considered that the question as to whether there are sufficient links between the parts of the decision which are challenged and parts which are not challenged must be decided on a case-by-case basis, taking into account the circumstances of each case.²¹²
- 3.85 Similarly, in *SONI*, the CMA recognised the risk of knock-on effects from changing one aspect of a complex regulatory decision. The principle that the CMA adopted in that decision is 'to consider on a case-by-case basis any evidence submitted to the CMA regarding links between the parts of the decision which are challenged and parts which are not.'²¹³
- 3.86 In line with the CMA's decisions in the ED1 Determinations and *SONI*, we have adopted an approach in relation to the issues of cherry-picking and 'in-the-round' that strikes the right balance between recognising our role as an

²⁰⁷ WWU refers in its Reply to *Northern Powergrid*, at paragraph 3.51.

²⁰⁸ *WWU Reply*, paragraphs 4.4–4.5.

²⁰⁹ *Northern Powergrid*, at paragraphs 3.42–3.43 and *British Gas*, at paragraphs 3.46–3.47.

²¹⁰ *Northern Powergrid*, at paragraph 3.47 and *British Gas*, at paragraph 3.48.

²¹¹ *Northern Powergrid*, at paragraph 3.49 and *British Gas*, at paragraph 3.50.

²¹² *Northern Powergrid*, at paragraph 3.51 and *British Gas*, at paragraph 3.52.

²¹³ *SONI*, at paragraph 13.3.

appeal body whilst at the same time recognising that price control decisions are complex. We have accordingly considered interlinkages where appropriate on a case-by-case basis as raised by GEMA in its Response.

Precedents

- 3.87 Past decisions taken by the CMA in other regulatory appeals are not binding. This means that we are not required to adopt an identical approach to determining the issues, nor to ensure that our decision in the present appeals mirrors assessments made and conclusions reached by the CMA in other regulatory appeals. While the CMA may have regard to such past decisions in considering the present appeals, it will also take into account the fact that other regulatory appeals may be subject to different statutory regimes and relate to different sectors.
- 3.88 For example, the CMA may decline to adopt an approach taken in the recent CMA PR19 Redetermination which was a full redetermination of the PR19 price control by the CMA.²¹⁴ By contrast, our role in these appeals is limited to finding whether GEMA was wrong on any of the specific grounds raised by the appellants. As indicated above (see paragraph 3.22), the appeals do not entitle the CMA to proceed with a re-run of the original investigation or have a de novo re-hearing of all the evidence.

Materiality

- 3.89 We note that it was common ground between the parties that we should only interfere with the Decision if we consider that the error identified is material, and this is consistent with the approach the CMA has adopted in previous relevant cases.
- 3.90 In deciding what is wrong, the CMA may hypothetically look at an aspect of GEMA's decision-making process and conclude that there was an error (applying the principles above). The CMA may conclude nevertheless that that error was not material, and thus the Decision, or that element of the Decision, was not 'wrong'.
- 3.91 In the ED1 Determinations, the CMA adopted the approach that 'We consider that an error will not be a material error where it has an insignificant or negligible impact on the overall level of price control set by GEMA.'²¹⁵

²¹⁴ We discuss the PR19 Redetermination further in Chapter 5 at paragraph 5.5.

²¹⁵ *Northern Powergrid*, at paragraph 3.58 and *British Gas*, at paragraph 3.60.

- 3.92 Offering a non-exhaustive list of criteria that the CMA may take into account in determining materiality, the decisions in the ED1 Determinations stated:

Whether an error is material must be decided on a case-by-case basis taking into account the particular circumstances of each case. Relevant factors would include the impact of the error on the overall price control, 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.²¹⁶

- 3.93 In *Firmus*, the CMA noted that in the context of a telecoms appeal, the CMA has stated that where the impact of the error as a percentage of the charge control is below 0.1%, the error is unlikely to be capable of producing a material effect on the charge control. The CMA noted further that this is ‘not intended to be a “bright-line test”; it is but one factor in an overall assessment based on all the circumstances of the case.’²¹⁷

- 3.94 In the present appeals, we were invited by a few appellants to find that the aggregation of immaterial errors may result in a material error:

- (a) NGN argued that ‘large errors may only arise due to the ‘aggregation of smaller and potentially immaterial errors.’²¹⁸
- (b) SPT maintained that ‘An error is an error, even if it could theoretically be subdivided into a multitude of smaller errors.’²¹⁹

- 3.95 GEMA strongly disagreed with this proposition and argued that:

the test of materiality should be applied to each of the specific errors advanced by an Appellant. The important statutory safeguard would be subverted if it were open to Appellants to advance a series of individual errors each of which had a de minimis impact on the price control but which were alleged in the aggregate to have a material effect. ... The CMA must be satisfied with respect to each alleged error that it is sufficiently material to warrant further attention.²²⁰

²¹⁶ [Northern Powergrid](#), at paragraph 3.58 and [British Gas](#), at paragraph 3.61.

²¹⁷ [Firmus](#), at paragraph 3.24.

²¹⁸ [NGN NoA](#), paragraph 133.

²¹⁹ [SPT NoA](#), paragraph 10.

²²⁰ [GEMA Response A](#), paragraph 50.

- 3.96 Whilst we acknowledge that in principle, we should determine whether each alleged error is material in itself, we note that in *Firmus* the CMA, quoting the CC's approach,²²¹ did not exclude the possibility that in certain cases an aggregation of immaterial errors could amount to a material error:

no formal general approach has been identified that would determine when, if at all, immaterial errors should be aggregated. The CC was mindful that to aggregate immaterial errors would have the effect of converting an error that was in and of itself immaterial into a material error through its combination with other immaterial errors. Those other errors may be unrelated and may lie in different and discrete aspects of the price control. The CC did not rule out the possibility that there may be cases in which such aggregation was justifiable where the cumulative effect of discrete errors had a highly significant impact on the price control set by the regulator. However, as a general approach, the CC stated it would be cautious about elevating the immaterial into the material. It observed that aggregation might encourage a scattergun approach on the part of appellants, which was not the purpose of the appeal process.²²²

- 3.97 In the present appeals, we have thus considered, where appropriate, whether the cumulative effect of immaterial errors could have a highly significant impact on the price control.

The CMA's powers on determination of the appeals

- 3.98 In the event and to the extent that the CMA does not allow an appeal, the CMA is required to confirm the decision appealed against.

- 3.99 If the CMA allows to any extent an appeal in relation to a price control decision,²²³ it must do one or more of the following:

- (a) quash the decision (to the extent that the appeal is allowed);
- (b) remit the matter back to GEMA for reconsideration and determination in accordance with any direction given by the CMA;

²²¹ CC's determination in Case 1149/3/3/09 *The Carphone Warehouse Group v Ofcom (Local Loop Unbundling)* Final Determination of 31 August 2010 at paragraph 1.64.

²²² *Firmus*, at paragraph 3.26.

²²³ Section 11F(7) of EA89 and section 23E(7) of GA86 provide that for the purposes of section 11E of EA89 and section 23D of GA86, a decision is a price control decision, in relation to the modification of a condition of a licence, if the purpose of the condition is, in the CMA's opinion, to limit or control the charges on, or the revenue of, the holder of the licence.

- (c) substitute the CMA's decision for that of GEMA (to the extent that the appeal is allowed) and give any directions to GEMA or any other party to the appeal.²²⁴

²²⁴ EA89, section 11F(2) and GA86, section 23E(2).

4. The appeals and conduct of the appeals

- 4.1 This chapter sets out appeals received by the CMA and the conduct of those appeals.
- 4.2 The CMA is conducting these appeals in accordance with the procedure set out in Schedule 4A to GA86, Schedule 5A to EA89, the [Energy Licence Modification Appeals: Competition and Markets Authority Rules \(CMA70\)](#) (the **Rules**) and the associated [Energy Licence Modification Appeals: Competition and Markets Authority Guide \(CMA71\)](#).
- 4.3 Throughout these appeals, we have had regard to the overriding objective of the Rules which is to enable the CMA to dispose of appeals 'fairly and efficiently and at proportionate cost' within the time period prescribed by GA86 and EA89.²²⁵

Permission to appeal

- 4.4 On 3 March 2021 nine²²⁶ licence holders sought permission to appeal GEMA's Decision (in this respect, see paragraphs 1.4 to 1.6). The grounds of appeal by appellant are as follows:
- (a) Cadent: 1A: LTS Rechargeable diversions; 1B: London regional factors; 1C: Ongoing efficiency; 2: Cost of equity; 3: Outperformance wedge.
 - (b) NGET: 1: Cost of equity; 2: Outperformance wedge.
 - (c) NGG: 1: Cost of equity; 2: Outperformance wedge.
 - (d) NGN: 1: Cost of equity; 2: Outperformance wedge; 3: Ongoing efficiency; 4A: Business Plan Incentive Stage 4; 4B: Efficient costs benchmark.
 - (e) SGN: 1: Cost of equity; 2: Outperformance wedge; 3: Ongoing efficiency; 4: Efficiency benchmark.
 - (f) SSEN-T: 1: Cost of equity; 2: Outperformance wedge; 3: Licence modification process; 4: Transmission Network Use of System Charges.
 - (g) SPT: 1: Cost of equity; 2: Outperformance wedge; 3: Ongoing efficiency; 4: Licence modification process.

²²⁵ Rule 4.1 of [the Rules](#).

²²⁶ Southern Gas Networks plc and Scotland Gas Networks plc (together, SGN) submitted a joint application.

- (h) WWU: A: Cost of debt; B: Cost of equity; C: Repex; D: Licence modification process; E: Ongoing efficiency; F: Tax clawback.
- 4.5 On 17 March 2021, the CMA received representations and observations on the applications for permission to appeal from GEMA. The CMA subsequently received additional correspondence from particular appellants and from GEMA containing further submissions in relation to the applications for permission to appeal.
- 4.6 The CMA's grant of permission may be made subject to conditions,²²⁷ which may include 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).
- 4.7 On 31 March 2021, the CMA granted permission to appeal on all grounds pleaded by all appellants.²²⁸ Each grant of permission was conditional upon common grounds of appeal being considered together with those pleaded by other appellants.
- 4.8 The joined grounds of appeal are as follows:
- (a) **Joined Ground A:** Cost of equity (all appellants: Cadent 2, NGET 1, NGG 1, NGN 1, SGN 1, SSEN-T 1, SPT 1 and part of WWU B).
 - (b) **Joined Ground B:** Outperformance wedge (all appellants: Cadent 3, NGET 2, NGG 2, NGN 2, SGN 2, SSEN-T 2, SPT 2 and the remainder of WWU B).²²⁹
 - (c) **Joined Ground C:** Ongoing efficiency (Cadent 1C, NGN 3, SGN 3, SPT 3 and WWU E).
 - (d) **Joined Ground D:** Licence modification process (SSEN-T 3, SPT 4 and WWU D).
- 4.9 The CMA also granted NGET's and NGG's requests for their appeals to be joined.

²²⁷ Under paragraph 1(11) of Schedule 4A to GA86 and paragraph 1(11) of Schedule 4A to EA89.

²²⁸ [Cadent decision on permission to appeal](#); [NGET decision on permission to appeal](#); [NGG decision on permission to appeal](#); [NGN decision on permission to appeal](#); [SGN decision on permission to appeal](#); [SSEN-T decision on permission to appeal](#); [SPT decision on permission to appeal](#); [WWU decision on permission to appeal](#).

²²⁹ On 6 May 2021, the CMA directed that WWU's representations regarding the Outperformance wedge, included as part of its Head B entitled 'Cost of equity', be joined with Ground B (Outperformance wedge).

Extension of period for determination of the appeals

- 4.10 On 20 April 2021, following representations from the parties, we decided to extend the deadline for the determination of the appeals by one month to 30 October 2021.²³⁰

Interveners

- 4.11 On 23 April 2021, the CMA received applications for permission to intervene in particular grounds from five entities:

- (a) BGT:²³¹ Ground A (Cost of equity) and Ground B (Outperformance wedge).
- (b) Citizens Advice:²³² Ground A (Cost of equity) and Ground B (Outperformance wedge).
- (c) Electricity North West Limited (**ENWL**):²³³ WWU Head A (Cost of debt).
- (d) The Water Services Regulatory Authority (**Ofwat**):²³⁴ Ground A (Cost of equity) and WWU Head A (Cost of debt).
- (e) SPT:²³⁵ SSEN-T Ground 4 (TNUoS).

- 4.12 On 6 May 2021, the CMA granted permission to BGT²³⁶ and Citizens Advice²³⁷ to intervene in the Cost of Equity and Outperformance Wedge grounds of appeal, on the basis that they each had a material interest in the beforementioned grounds of appeal, and their respective intervention applications were proportionate to the matters to be determined and would assist the CMA to determine the appeals.

- 4.13 On 6 May 2021, the CMA rejected ENWL's,²³⁸ Ofwat's²³⁹ and SPT's²⁴⁰ applications to intervene, on the basis that the applications did not pass the

²³⁰ [Notice of extension.](#)

²³¹ [BGT Intervention Notice.](#)

²³² [Citizens Advice Intervention Notice.](#)

²³³ [ENWL application to intervene.](#)

²³⁴ [Ofwat application to intervene.](#)

²³⁵ [SPT application to intervene.](#)

²³⁶ [BGT decision on permission to intervene.](#)

²³⁷ [Citizens Advice decision on permission to intervene.](#)

²³⁸ [ENWL decision on permission to intervene.](#)

²³⁹ [Ofwat decision on permission to intervene.](#)

²⁴⁰ [SPT decision on permission to intervene.](#)

legal threshold and it would not be appropriate or proportionate to allow them to intervene in the appeals.²⁴¹

- 4.14 On 18 May 2021, the CMA invited Ofwat and ENWL, pursuant to Rule 14.4(e) of the Rules, to make representations by submitting the evidence in their respective applications to intervene, to be admitted as evidence in the appeal.

Submissions

GEMA's response to the NoAs

- 4.15 On 23 April 2021, GEMA responded to the appellants' NoAs.²⁴² This was in two parts: Response A, covering finance issues and TNUoS charges; and Response B covering totex modelling, efficiency and licensing.

Submissions in relation to the CMA PR19 Redetermination

- 4.16 The appellants each referenced in their respective NoAs the CMA PR19 Provisional Findings. As the CMA PR19 Redetermination (ie final report) was not published until 9 April 2021, after the deadline for the NoAs, we allowed the appellants to make targeted submissions concerning the PR19 Redetermination, and GEMA to respond to these submissions.
- 4.17 On 23 April 2021, we received submissions from the appellants in relation to the CMA PR19 Redetermination.²⁴³
- 4.18 On 10 May 2021, we received GEMA's Response to the appellants' submissions on the CMA PR19 Redetermination.²⁴⁴

Appellants' replies to GEMA's response

- 4.19 On 10 May 2021, the appellants each submitted their replies to GEMA's Response.

²⁴¹ The CMA considers a number of factors in deciding whether or not to grant permission to intervene under Rule 10. The CMA does not typically regard interventions duplicative of the arguments of the parties to the appeal or an intervener as assisting it to determine the appeal, or where permitting an intervention risks creating a proliferation of documents or evidence or otherwise risks having an adverse effect on the CMA's ability to determine the appeal in accordance with the overriding objective. The CMA may regard as being of assistance in its determination of an appeal an intervention that adds something material over and above the arguments or evidence already submitted by the parties to the appeal or by other interveners. CMA71, paragraph 4.16.

²⁴² GEMA response on Finance Issues and TNUoS ([GEMA Response A](#)); GEMA response on Totex Modelling, Efficiency and Licensing ([GEMA Response B](#)).

²⁴³ [Cadent PR19 submission](#); [NGET and NGG joint PR19 submission](#); [NGN PR19 submission](#); [SGN PR19 submission](#); [SEEN-T PR19 submission](#); [SPT PR19 submission](#); [WWU PR19 submission](#).

²⁴⁴ [GEMA PR19 response on Finance](#); GEMA PR19 response on Efficiency and Totex Modelling ([GEMA PR19 Response on Totex](#)).

- 4.20 NGN also sought permission pursuant to Rule 8.1 of the Rules²⁴⁵ to withdraw sub-grounds 4A(i) and 4B of Ground 4 of its appeal, in light of GEMA's invitation to the CMA to correct the error identified in NGN's Ground 4A(ii). On 17 May 2021, the CMA granted permission to NGN to withdraw sub-grounds 4A(i) and 4B of Ground 4 of its appeal.²⁴⁶

Teach-ins, site visits and hearings²⁴⁷

- 4.21 On 8 and 9 April 2021, the parties delivered factual 'teach-ins' providing background and context to the CMA. Cadent, NGG, NGN, SGN and WWU delivered a teach-in providing industry background on Gas Distribution and Transmission. NGET, SPT and SSEN-T delivered a teach-in providing industry background on Electricity Transmission. GEMA delivered a teach-in on regulation and the RIIO-2 process.
- 4.22 In May 2021, all appellants except SPT supplied us with pre-recorded virtual site visits, which focused on operational matters and descriptions of the companies' activities.²⁴⁸
- 4.23 Between 13 and 24 May 2021, we held clarification hearings with each of the appellants and GEMA.
- 4.24 Between 21 June and 9 July 2021, we held main hearings. We held joint hearings for each of the joined grounds, for which all appellants to the relevant ground and GEMA attended. The appellants prepared joint responses to questions provided in advance and allocated a spokesperson to answer on behalf of the appellants of each joined ground. The interveners attended as observers. We also held individual hearings with each of the appellants and GEMA, where the focus was on the individual grounds pleaded and any company specific matters relating to the joined grounds. In addition, we held hearings with the interveners and Ofwat (under Rule 14.4(e)).
- 4.25 The appellants and interveners were permitted to observe the sections of other party's hearings insofar as they related to the grounds of appeal they were party to or intervening on. Legal advisers who were part of the

²⁴⁵ Under Rule 8.1, the CMA's permission is required to withdraw an appeal.

²⁴⁶ 'By a submission to the CMA dated 10 May 2021, NGN sought permission pursuant to Rule 8.1 of the CMA's Energy Licence Modification Appeal Rules (the Rules) to withdraw part of its appeal, namely sub-grounds 4A(i) and 4B of Ground 4 of its appeal, in light of GEMA's invitation to the CMA to correct the error identified in NGN's Ground 4A(ii), which increases NGN's Business Plan Incentive Stage 4 reward'; [CMA Decision on NGN's application to withdraw sub-grounds of appeal](#).

²⁴⁷ In light of the Coronavirus (COVID-19) pandemic, these appeals (including the teach-ins, site visits and all hearings) were conducted virtually.

²⁴⁸ As these appeals were conducted virtually, we invited the appellants to submit virtual site visit videos in lieu of conducting site visits in person.

confidentiality rings for the appellants were permitted to observe all sections of all hearings.

- 4.26 The parties to the appeal were given the opportunity to submit closing statements (the **Closing Statements**) after the completion of all the main hearings.

Provisional determination of the appeals

- 4.27 On 11 and 12 August 2021, the CMA issued our provisional determination of the appeals to the parties and interveners.
- 4.28 On 3 September 2021, the parties and interveners submitted their responses to the provisional determination.
- 4.29 In light of the responses received, the CMA held one further hearing on Friday 17 September 2021. The CMA also held roundtable meetings on 27 and 28 September 2021.

Reconsultations

- 4.30 After considering the submissions in response to our provisional determination and subsequent information gathering, we reconsulted the parties on aspects of two grounds (Joined Ground C: Ongoing Efficiency and Joined Ground D: Licence Modification Process) where we were minded to change from a provisional decision in our provisional determination.

Other information gathering

- 4.31 We issued a number of RFIs to parties over the course of the appeals.
- 4.32 We also issued a request under Rule 14.4(e) to NGET and NGG in relation to Joined Ground C (Ongoing efficiency).
- 4.33 GEMA submitted additional evidence to correct for inaccuracies in one of its witness statements. We issued a direction on 10 June 2021, pursuant to Rule 14.2, admitting that evidence in the appeals.²⁴⁹

²⁴⁹ *Wagner 8 (GEMA)*.

Transparency

- 4.34 Various documents, including the NoAs, GEMA's Response, the appellants' Replies, the CMA PR19 Redetermination submissions and the interveners' intervention notices have been published on the [CMA case page](#).
- 4.35 Confidentiality rings including relevant advisers for the parties and representatives from GEMA were established in order to facilitate the sharing of evidence that was relevant to the appeals but which contained sensitive information.

Final determination

- 4.36 This report contains our final determination of the grounds of appeal and has been circulated (with appropriate redactions of sensitive information) to all parties to the appeal and to the interveners. It is accompanied by an Order to implement relief, where we have allowed the appeals. A non-sensitive version of the final determination and Order will be published on our case page as soon as practically possible after it is issued.
- 4.37 A summary of the final determination was published separately on our case page.