

FAO: Andrea Gomes da Silva
Competition and Markets
Authority
The Cabot
25 Cabot Square
London E14 4QZ

Date: 30th October 2019

Dear Andrea

Re: Price Control Licence Modification Statutory Appeals Mechanism

1. I refer to (a) Ofgem's consultation on its RIIO-2 sector specific methodology¹ in December 2018; and (b) your letter of 21 February 2019 to the Secretary of State for Business, Energy and Industrial Strategy.² The purpose of this letter is to set out Ofgem's thinking on the issues raised in those contexts.
2. In the RIIO-2 sector specific methodology consultation we proposed, in designing RIIO-2, to consider the extent to which a successful CMA appeal by one or more licensees may have consequences for other components of the price control³. Ofgem's aims in doing so are to maintain the coherence of the regulatory settlement overall and to provide transparency to stakeholders around our decision-making process and the potential consequences arising from a successful appeal.
3. Consultation responses highlighted a degree of confusion surrounding the CMA's consideration of price control appeals, in particular in relation to interlinkages and materiality⁴. Responses also highlighted potential case management issues, including in relation to pre-appeal discussions and consolidation of appeals.

¹ [Sector Specific Methodology Consultation](#), 18 December 2018.

² [Letter CMA to Secretary of State BEIS](#), 21 February 2019.

³ See para 2.20 of the Sector Specific Methodology Consultation.

⁴ The consultation responses can be viewed [here](#).

4. We consider that it would be beneficial for the CMA to provide further clarity on these areas. Whilst there are previous CMA determinations touching on these issues, we consider that prospective appellants and wider stakeholders would benefit from clarification from the CMA in advance of the first RII0-2 appeal window opening in early 2021.

5. In your letter of 21 February to the Secretary of State you said (p.40):

The CMA handles references and appeals of certain decisions made by the sector regulators, concerning, among other things, licensing conditions, industry code modifications, tariff methodologies and price controls.

There is a strong case for removing responsibility for review of these economic regulatory decisions from the CMA. These could be consolidated in the courts. Were the courts to take on these functions, it would simplify appeal arrangements across the regulatory landscape, and also enable the CMA to put more resources into the investigation and remedy of consumer detriment.

6. We agree that the question of whether price control appeals should be handled by the CMA or the courts is a matter which warrants careful consideration. However, even so, we consider that stakeholders would benefit from the CMA providing further clarity on the appeals regime as it currently stands. We would not wish the prospect of changes which may or may not occur to prevent the CMA from providing much-needed clarification and certainty to prospective appellants and to wider stakeholders.

Materiality

7. Section 11E(4) of the Electricity Act 1989 and the equivalent provisions of the Gas Act 1986 provide that the CMA may allow an appeal only to the extent that it is satisfied that the decision appealed against was wrong on one of the statutory grounds. It is not *required* to allow the appeal. Accordingly, if the CMA decides that the result of an error is immaterial, it may decide not to

allow the appeal. Similarly, the CMA may decide that it is not in the interests of existing or future consumers to correct an error which is non-material.

8. Our understanding is that materiality is assessed on a case by case basis, but that a decision will not normally be overturned on appeal if:
 - a. an error is not material in terms of size of impact; and/or
 - b. the decision as to the approach taken is within the regulator's margin of appreciation.
9. We note that previous determinations have said that where the impact of a perceived error would be a 0.1% change in the price control level, such an impact is unlikely to be material and would fall within the acceptable margin of error for a regulator.⁵
10. We also note that the CMA has previously given a non-exhaustive list of factors relevant to its assessment of materiality. In addition to the impact of the error on the overall price control, these include: whether the cost of addressing the error would be disproportionate to the value of the error; whether the error is likely to have an effect on future price controls; and whether the error relates to a matter of economic or regulatory principle.⁶
11. We consider that materiality should in general be capable of being considered at the permission stage, because an appeal against a non-material error or decision is unlikely to have a reasonable prospect of success, and should not be permitted to proceed. However, we recognise that materiality must be assessed on a case by case basis and in some cases the materiality of an alleged error may not be capable of assessment until after permission has been granted.
12. **We invite the CMA to clarify its position in respect of materiality, both at the permission and substantive stage.**

⁵ See, e.g., [Carphone Warehouse Group plc v Ofcom](#) (CC, 31 August 2010) §1.62.

⁶ See, e.g., [British Gas Trading Ltd v GEMA](#) (CMA, 29 September 2015), §§3.60-3.61; [Northern Powergrid \(Northeast\) Ltd and Northern Powergrid \(Yorkshire\) plc v GEMA](#) (CMA, 29 September 2015), §3.58. See also [SONI Ltd v Northern Ireland Authority for Utility Regulation](#) (CMA, 10 November 2017), §3.39.

Interlinkages

13. The CMA has previously indicated that (i) price control decisions reflect an “in the round” assessment; and (ii) interlinkages between parts of the decision which are challenged and parts which are not challenged must be considered on a case by case basis.⁷

14. Some respondents to the December consultation said it was their understanding that the CMA will take interlinkages into account where it considers it appropriate. Other respondents argued that the appeals mechanism frustrates rounded consideration as it allows appellants to set the boundaries of the appeal, and it is not clear to what extent Ofgem can invoke non-appealed components in defence of the merits of the appealed components. Still others expressed the hope that the CMA would consider the price control as an overall package.

15. Our understanding is that, in order for the CMA to find that a decision which is not dissociable from other aspects of the price control was wrong, the appellant must demonstrate that it is wrong having regard to the interlinked aspects.

16. Again, whilst appreciating that each case will turn on its own facts, we invite the CMA to provide clarity in respect of the position on interlinkages.

Case management issues

17. Some respondents raised concerns about case management given the risk of multiple appeals to the RIIO-2 price control licence modifications, and confirmed that they are keen to ensure that matters in dispute are aired and focussed in pre-appeal discussions between all potential appellants and Ofgem.

⁷ *British Gas*, *ibid*, §§3.50-3.52; *Northern Powergrid*, *ibid*, §§3.49-3.51. See also [Firmus Energy \(Distribution\) Limited v Northern Ireland Authority for Utility Regulation](#) (CMA, 26 June 2017), §8.52.

18. We strongly support a process by which concerns can be aired before an appeal is filed, between all potential appellants and Ofgem. In our view, such a process would further the overriding objective pursuant to Rule 4 (to enable the CMA to dispose of appeals fairly and efficiently and at proportionate cost within the time periods prescribed by the Electricity Act 1989 and the Gas Act 1986). We believe that this could narrow the issues in dispute and support the CMA in the permission stage. It may also enable the parties and the CMA to better identify and focus upon interlinkages and materiality in the event that permission is granted.

19. We are considering the merits of engaging with potential appellants in pre-action correspondence and how this could be accommodated in the period between Final Determinations and the statutory consultation on licence modifications.

20. We invite the CMA to clarify its position on pre-appeal conduct, and insofar as possible to encourage appellants to engage in pre-appeal correspondence.

21. The CMA has broad statutory powers to join appeals. For example:

- a. The grant of permission may be subject to conditions, which may include conditions requiring an appeal to be heard together with other appeals (including appeals relating to different matters or decisions and appeals brought by different persons): paragraph 11(c) of Schedule 5A to the Electricity Act 1989 and equivalent provisions in the Gas Act 1986;
- b. The CMA Board may make rules of procedure regulating the conduct and disposal of appeals under s.11C of the Electricity Act 1989: paragraph 11(1) of Schedule 5A to the Act. Rules under paragraph 11 may make different provisions for different cases: paragraph 11(5) of Schedule 5A (and equivalent provisions in the Gas Act 1986);
- c. Rule 14.2(b) of the CMA Rules for Energy Licence Modifications Appeals provide that the CMA may at any time, on application or its own motion, give such directions as are necessary for the conduct of any appeal,

including “where there are two or more appeals pending in respect of the same decision, or in respect of decision which in the view of the CMA are closely related, that the appeals in whole or part should be consolidated and heard together”.

22. Ofgem considers that, even in circumstances where appeals are heard separately, in appropriate circumstances it is possible, and may be desirable, for the CMA to hold a joint hearing to determine remedies for successful appeals in the round.

23. We welcome clarity from the CMA as to its approach to cross-appeal issues, and its approach to remedies.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'J Brearley', written in a cursive style.

Jonathan Brearley

Executive Director, Systems & Networks