

An Unappealing Prospect

The CMA has recently published its conclusions on the appeal by SONI (the Northern Ireland system operator) against the Utility Regulator's decision on its price control. This might seem an inconsequential decision for those playing on the bigger GB stage but it's an important reminder of the unappealing prospect that at the end of the upcoming RIIO2, the CMA could be trying to deal with half a dozen appeals.

Looking back at the RIIO ED1 appeals it's worth remembering, in the context of debates about the level of network returns, that the CMA actually rejected Ofgem's effort to tighten the price control on the grounds that smart grids technology would in future allow the companies to reduce costs. Ofgem failed because it couldn't prove that costs would come down. Talking tough isn't enough. Ofgem in developing its RIIO2 proposals will need to be on top of both the economic theory and the real-world practicalities. Ofgem has lost a lot of expertise and will need to rebuild it quickly if it is to face off against the companies at the CMA.

Turning back to Northern Ireland, the SONI appeal is the second one that the Utility Regulator (URegNI) has faced under the new appeals regime in energy where companies can appeal on individual issues rather than the settlement as a whole.

Although there is the facility for third party appeals – such as that by British Gas on RIIO ED1 – it is inevitable that the network companies themselves will have more resources and more motivation to mount appeals. Indeed, the experience of having found themselves on the wrong end of an appeal in RIIO ED1 will only increase the motivation for networks to get their own appeals in, just in case.

SONI appealed on 3 grounds with a total of 11 alleged errors. Out of such a long list it was unsurprising that a few points hit home, with the CMA ultimately supporting SONI on 5. In particular they were able to secure an addition to their cost of capital to take account of particular risks they face as an asset light business, some procedural clarifications around arrangements for additional costs to be allowed in period, and additional cost allowances on pensions and information systems. The CMA estimate the gain to SONI as being £5.4m over the 5 years. This is good news for SONI, with benefits arguably running beyond this particular control, but less good for customers. It supports the sense that an appeal is now a one way bet for companies.

The only risk companies face is on costs. Earlier this year the CMA ruled on the price control for Firmus Energy, one of the gas distribution companies in Northern Ireland. In this case URegNI lost on 3 points out of 12 but the points which Firmus won on were a small (£850k) adjustment to its opex and improvements in its connections incentive. The CMA have just published their cost decision which sees Firmus picking up two thirds (£437k) of the CMA's costs and having to bear all their own costs. On that basis it can hardly have been worth their while appealing – though for the GB networks with more money at play, costs will be less of a barrier.

For regulatory aficionados these CMA reports make crucial reading on how the CMA might view similar points on appeal in RIIO2. In Firmus, for example, the CMA built on its RIIO-ED1 decision, making clear that the test was not whether there was a better alternative but whether the original decision was wrong, a relatively high hurdle.

Where it's helping shape the regulatory framework and providing an expert appeal the CMA plays an important role – and does a thorough and professional job. However, if it becomes an automatic stage in the process where companies can be confident of getting back at least some of what the regulator has taken away, then we will be in a sorry place.

The CMA have sought to discourage this by setting the bar high and taking a tough line on costs. However, it's not clear that will be enough to deter RII02 appeals where the stakes are much higher. The CMA should reflect on whether there is more it can do to ensure that the appeals regime serves the public interest and not simply that of the companies.

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