

Regulatory Appeals to the CMA

Regulatory Policy Institute Annual Westminster
Conference

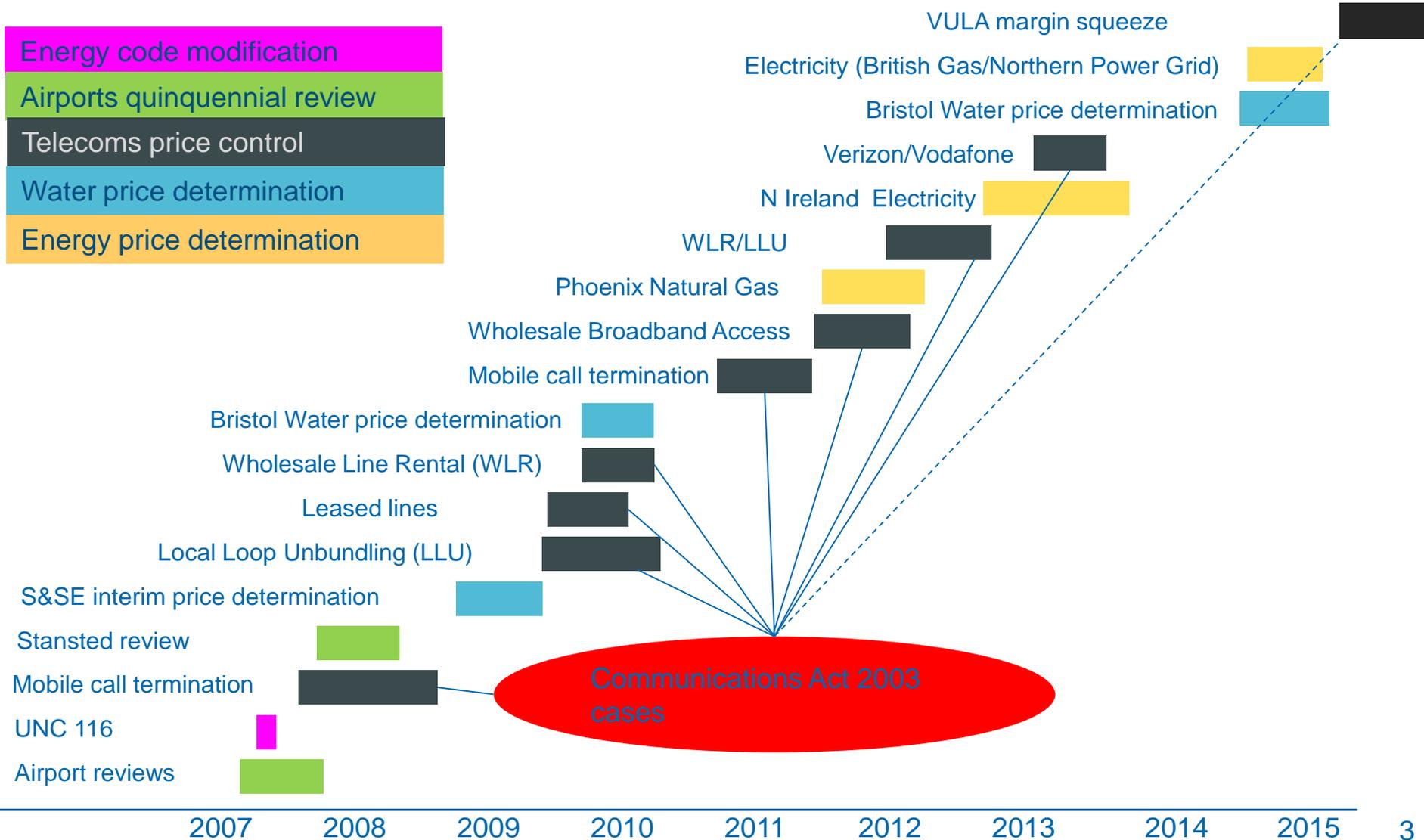
27 April 2016

John Wotton
Inquiry Chair

Regulatory references and appeals: the CMA's functions (summary)

Sector	Regulator	CMA function	Timescale
Water and sewage	Ofwat	Redetermination	Six months
Gas and electricity licences	Ofgem; NIAUR	Appeal	Four/six months
Electricity codes	Ofgem	Appeal	One month
Gas and electricity (non-licence)	Ofgem	Redetermination	Six months
Rail	ORR	Redetermination	Six months
Air traffic licences	CAA	Redetermination	Six months
Airport licences	CAA	Appeal	Six months from decision publication
Postal services	Ofcom	Appeal	Four/six months
Telecommunications	Ofcom	Appeal	Usually six months
NHS tariffs	Monitor	Appeal	One month
Healthcare licences	Monitor	Redetermination	Six months
Payment systems	PSR	Appeal	Six months

Volume and frequency



Regulatory appeals: British Gas Trading and Northern Powergrid (Mar-Sep 2015): appeal grounds summary

British Gas Trading Ltd

1. Ofgem's mechanism for recovering revenues double-recovered in the previous price control period were too generous to DNOs at the expense of consumers.

NOT UPHELD

2. Customer service incentive targets for DNOs were too lenient.

NOT UPHELD

3. Changes to the information quality incentive scheme were too generous to the DNOs.

PARTIALLY UPHELD

4. Transitional arrangements to smooth a long-term change in asset life policy was harmful to consumers.

NOT UPHELD

5. Change in the indexation of the cost of debt was too generous to DNOs at the expense of consumers. **NOT UPHELD**

Northern Powergrid

1. Ofgem wrongly reduced the revenue DNOs could recover during the price control period based on a flawed assessment of potential savings resulting from the introduction of smart grids.

UPHELD

2. Ofgem used incomplete data when estimating DNOs' future labour costs and failed to use more accurate data available from the DNOs.

NOT UPHELD

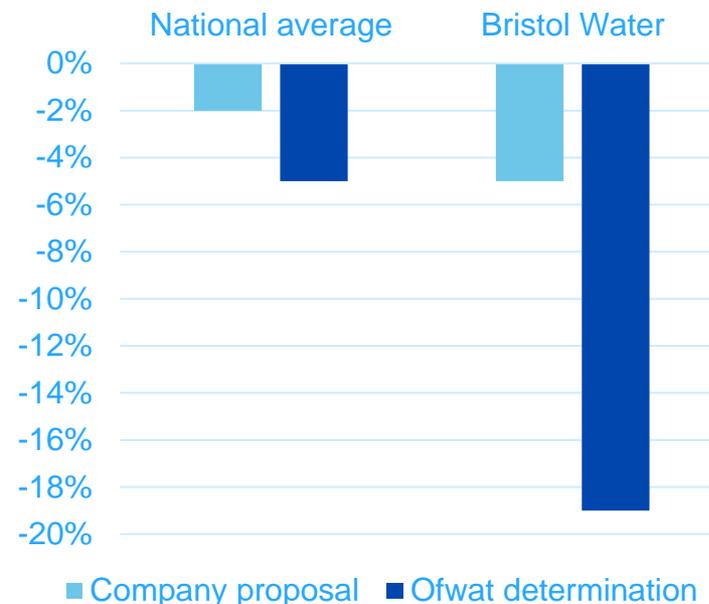
3. Ofgem used incomplete and misleading data to adjust labour costs to reflect regional differences and underestimated NPg's labour costs as a result.

NOT UPHELD

Bristol Water redetermination

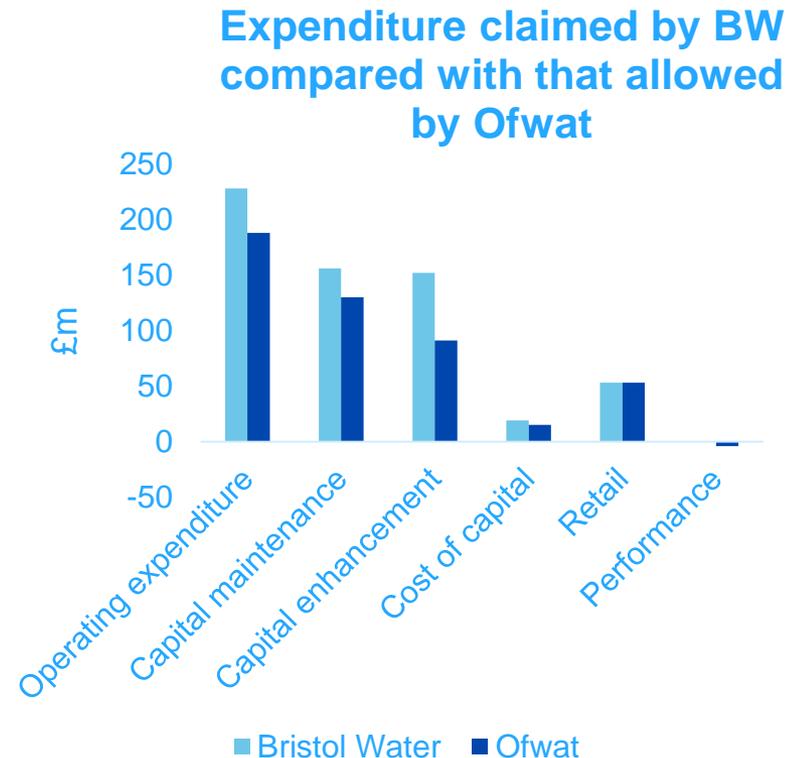
- Ofwat sets 5 yearly price control based on company expenditure requirements.
- There was a substantial difference between the Ofwat determination and Bristol Water's (BW) proposal for expenditure allowance over the 5 years.
- Key area of difference was wholesale total expenditure (totex) allowance – Ofwat allowed BW £409m vs the BW plan of £537m. The reduction in bills required by Ofwat was twice as large as the next highest reduction required by Ofwat.
- BW claimed that Ofwat had relied too much on econometric modelling and had not considered whether the reduction was achievable in practice. It asked the CMA to look at the detail of BW's business plans.
- BW also criticised other areas of the Ofwat determination including the cost of capital and some performance targets set by Ofwat.

% change in Bristol Water bill compared with other companies



Bristol Water redetermination: CMA approach

- In deciding on our methodology we considered all aspects of the redetermination but focussed particularly on wholesale totex.
- Given the limitations of the econometric benchmarking analysis, we undertook a more expansive review of Bristol Water's needs and circumstances. We assessed separately base and enhancement expenditure and used the base expenditure assessment as a cross-check on the econometric benchmarking. We drew on Ofwat's review of special cost factors, Bristol Water's and its advisers' views on efficient expenditure for opex and capital projects and our own further review. We were assisted by engineering consultants.
- We did a full assessment of cost of capital and the financeability of BW (we are required by legislation to ensure that BW is able to finance its functions).
- We did not examine retail in detail, since this was of less concern to BW and Ofwat and to third parties.



Bristol Water redetermination: Findings

- We found that there were significant risks that Ofwat's totex benchmarking did not fully reflect BW's costs.
 - We opted for simpler and more intuitive model specifications for base expenditure.
- Our review of the BW plans found opex and capex should be reduced substantially from the levels proposed by BW.
 - For example, we found the proposed investment in the Cheddar 2 reservoir of £44m in the period (£130m total future expenditure) was not required for the foreseeable future.
- We determined totex should be £429m vs £537m in the BW plan and £409m in the Ofwat determination.
- We determined BW was financeable (using a notional financial structure).