NORTON ROSE FULBRIGHT

Keeping your head above water:

A practical guide to non-price control licence modification appeals

March 2022

The Competition and Markets Authority (CMA) will shortly be consulting on new appeal rules and guidance for non-price control licence modifications in the water sector. This follows the significant change brought about by the Environment Act 2021, pursuant to which the CMA will hear non-price control licence modifications by way of appeal rather than redetermination. Given strong sector parallels, the CMA's proposed rules and guidance are likely to be based heavily on the equivalent documents in the energy sector.

We set out below some thoughts and practical tips for water companies based on our experience of energy licence modification appeals, including the recent RIIO-T2 and GD2 appeals.

A watershed moment

The shift away from a redetermination regime in the water sector has been foreshadowed for some time, and forms part of a broader movement towards harmonising the appeal processes across the regulated sectors (see further below). Therefore, whilst not a surprise in itself, it is noteworthy that the CMA is under pressure to get rules and guidance in place for the water sector quickly. This is because there are a number of important non-price control licence modification decisions on the horizon for Ofwat. For example, there are those which fall under the broad headings of board leadership, transparency, governance and resilience. These include: changes to improve financial resilience (e.g. "*the need to align the licence to [Ofwat's] broader expectations for dividend policy*" and a requirement for additional board assurance statements, among others), potentially some of the requirements around long-term delivery strategies (see our earlier Regulatory Trends article on this), and transparency, monitoring and audit requirements more generally (noting recent enforcement cases concerning the adequacy and management of resources, how boards satisfy themselves before signing the adequacy certificate, and also the new unpermitted sewage discharges investigation). Clearly, such licence modifications may be highly contentious and result in multiple applications to appeal.

The change from redetermination to appeal is significant for water companies for a number of practical reasons. First, Ofwat no longer needs to secure company agreement in order to make a non-price control licence modification. It can now make such modification unilaterally, subject to the company's right of appeal. Second, an appeal – as distinct from a redetermination where the CMA considers the matter afresh – requires the water company to identify specific legal grounds on which Ofwat's decision was "*wrong*", i.e. failure to have regard to or give appropriate weight to its statutory duties or strategic priorities, error of fact or law, procedural failing(s), failure to achieve stated effect. It is therefore a more limited process, and necessarily 'front-loaded' in terms of submission of argument and evidence by the appellant. Third, despite this 'front-loaded' process, the time limit for bringing an appeal is very short – just twenty (20) working days from the first working day after Ofwat's licence modification decision is published. This is extremely challenging – as is the timescale for the appeal process more generally. The CMA must determine an appeal within four (4) months beginning with the date permission to appeal is granted (extendable to a maximum of five (5) months only if there are "*special reasons*" to do so).

Meeting these timescales will require a substantial amount of pre-appeal preparation and planning on the part of a water company, and a flexible but robust process on the part of the CMA.

With regard to the latter, the CMA has already carried out an early stage consultation on the rules and guidance that it should adopt for its non-price control licence modification appeal function in the water sector. This focused – sensibly in our view – on areas where a mixture of experience (including recent experience of multiple, linked appeals in the RIIO-T2 and GD2 appeals) and technological advances indicate that the energy model can be improved, and also on identifying any sector-specific features which might require different provision. Our response to that consultation can be found here. Whilst we must wait and see the CMA's proposals coming out of this consultation, it seems reasonable to assume that its draft rules and guidance for the water sector will be based on, and continue to bear a striking similarity to, the energy sector versions. With this in mind, we set out below some top tips for water companies based on our energy experience.

Practical tips

1. Pre-appeal preparation and planning

It is difficult to overstate the importance of pre-appeal preparation and planning. If, as a water company, you can see a potential need for an appeal based on Ofwat's licence modification proposal(s), we recommend that you begin work with your advisers to assess the position and marshal your arguments as soon as possible. This pre-work will also help your board reach a prompt 'stop'/ 'go' decision once Ofwat's final decision has been published and the appeal clock is ticking. Remember that it takes a significant amount of time to draft a notice of appeal and collate the strong evidence base required to make the case that the regulator has made material error(s) (such that its decision is "*wrong*" within the meaning of the statutory framework) and tight timescales mean that appeals are not an iterative process. It is also important for appellants to think about remedies upfront – and in fact this process can be helpful in demonstrating that there is a material error which needs to be corrected.

2. Anticipation

During the pre-appeal stage, take the time to consider whether other companies may appeal, and factor that into your appeal strategy. This can be relevant for a number of reasons. For example, a single appellant must be prepared to address the defensive counter-narrative from the regulator that 'no one else has appealed' and 'everyone else has stepped up and risen to the challenge'. Multiple appellants, on the other hand, will likely need to address the suggestion of endemic industry issues and be mindful of the fact that any discrepancies cutting across the arguments of others will be exploited by the regulator to bolster its submissions in favour of a wide regulatory discretion.

3. Alignment

That bring us to the value of achieving alignment where there are multiple appellants. Achieving such alignment within the short timescale for preparing a notice of appeal is difficult, so work needs to begin at the pre-appeal stage. This will include liaising with other potential appellants and putting in place the building blocks for early substantive engagement, such as a common interest privilege agreement (which allows the sharing of privileged communications amongst companies with a sufficient "*common interest*").

4. Resources

Appeals are a resource-intensive process, so it is essential that you have a good team in place from the outset, including project manager(s), economists and legal advisers. Some water companies may also wish to instruct an independent person or panel to provide a challenge function, which can prove valuable in terms of strategy, positioning, and cross-sector issues. In our experience, it can be very effective if appeals are business-led before the CMA. However, this obviously means that you need to plan ahead to ensure that key individuals (such as Regulatory Directors) can carve out the time necessary not only to attend hearings but also to prepare for those hearings (including attending mock hearings and subsequent feedback or 'lessons learned'

sessions). Joint hearings will require even greater preparation, in particular to avoid the 'cutting across arguments' issue highlighted above, and also potentially to divide up topics and questions. More generally, the internal governance process – including any 'pinch points' – should be clearly plotted and understood by all team members.

5. Confidentiality

Confidentiality issues can present a practical challenge in circumstances where there are multiple appellants. In our experience, the amount of genuinely confidential information included in appeal documentation tends to be limited. Blanket confidentiality claims over submissions generally don't withstand close scrutiny and serve only to incur delay. We therefore recommend the prompt production and circulation to all parties of non-confidential versions of submissions in order to ensure the smooth running of the appeal process.

Next steps and the bigger picture

The CMA intends to consult on drafts of its new appeal rules and guidance for non-price control licence modifications in the water sector this month, which will provide water companies with an opportunity to review and provide input from a practical perspective and with the benefit of their sector insight. We do not anticipate that the consultation period will be lengthy, as the CMA is keen to have final versions in place by Easter if possible. Companies should therefore be ready to review and respond to the drafts promptly.

Looking to the bigger picture, the redetermination regime now remains in place only for water and sewerage price control licence modifications and rail licence modifications – but the recent BEIS 'Economic Regulation Policy Paper' (January 2022) indicates that these outliers may also be in jeopardy. Specifically, that policy paper notes that current differences in the appeal regimes are "typically a by-product of sectoral policy development, rather than cross-sectoral design" and increased consistency will make it easier for investors involved in multiple sectors to navigate the process and make the UK "a more attractive prospect for investment". It is therefore worth bearing in mind that the rules and guidance put in place for non-price control licence modifications in water sector may acquire greater scope and importance in due course, so companies should engage now to help influence the shape of the appeal process going forward.

Finally, we note that the government proposes to consult on "*a package of measures designed to ensure the UK model of economic regulation fits the need of the modern age*" later this year, and will provide an update on developments when that occurs.

Contacts

Susanna Rogers
Partner, London
Tel +44 20 7444 5724
Susanna.Rogers@nortonrosefulbright.com

Jason Logendra
Counsel, London
Tel +44 20 7444 3624
Jason.logendra@nortonrosefulbright.com

Anne Meadows
Counsel, London
Tel +44 20 7444 2632
Anne.meadows@nortonrosefulbright.com