

**DECISION RELATING TO THE DISTRIBUTION EXEMPTION HOLDER ON THE LEASED NETWORK AT HEATHROW AIRPORT**

**Determination by the Gas and Electricity Markets Authority ("Authority"<sup>1</sup>) of a dispute referred to it by Heathrow Airports Limited ("HAL") under section 44B of the Electricity Act 1989 (the "Act") in relation to the exempt distribution system at Heathrow Airport and obligations arising under schedule 2ZA of the Act.**

**Introduction**

1. On 14 May 2012 HAL formally requested the Gas and Electricity Markets Authority make a determination on the identity of the distribution exemption holder for the Heathrow Leased Network.
2. By reference to the documentation submitted by the parties the dispute was defined as:

*"Whether the duties imposed by Schedule 2ZA of the Electricity Act 1989 on distribution exemption holders apply to UKPNS in the context of requests to take a supply of electricity from third party supplier by customers of HAL that are connected to the portion of the distribution network at Heathrow Airport that has been leased to UKPNS."*

3. The dispute was framed in this way, asking whether the duties imposed by Schedule 2ZA of the Electricity Act 1989 fall on UK Power Network Services (Contracting) Limited ("UKPNS") because the dispute was submitted by HAL. But it could equally well have been framed the other way round had the request for dispute resolution been made by UKPNS, asking whether the duties imposed by the Schedule apply to HAL. The nature of the dispute and our approach was explained in the course of the oral hearing. In this decision we answer the dispute as defined, but in reaching that decision we have considered the position of both UKPNS and HAL, and nothing turns on the way in which the question was put.
4. For ease of reference, in this decision we refer to the portion of the distribution network at Heathrow Airport that has been leased to UKPNS as the "**Leased Network**".

**Summary of decision**

5. We conclude that the duties imposed by Schedule 2ZA of the Act apply to UKPNS. This is in the context of requests to take a supply of electricity from third party suppliers by customers of HAL that are connected to the Leased Network.
6. The reasons for this decision are provided starting on page 17 below, in the section titled 'Our Views'. The process we have gone through and the reasons for reaching this decision are set out below. Even though this determination was requested by HAL, we have summarised UKPNS' arguments first as this determination formally concerns whether the duties under Schedule 2ZA of the Act apply to UKPNS. It therefore seems appropriate to take UKPNS' submissions as to its status first.

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<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority

## Process

7. In reaching our decision we have considered statements made at an oral hearing held on 6 September 2013 (the "**Hearing**"<sup>2</sup>). We have also taken account of information provided through correspondence, written submissions and an agreed statement of facts prior to the Hearing.
8. Witness evidence was also provided by HAL and UKPNS technical staff. The witness statements dealt with the question of the interaction between HAL and UKPNS in relation to the Leased Network and were largely concerned with operational matters in practice and as a matter of the relevant agreements between the parties. They were particularly concerned with who has responsibility for certain activities. This was intended to help establish who operates and who controls the Leased Network in all its specific aspects.
9. At the conclusion of the Hearing on 6 September 2013, the parties were invited to provide any further observations in writing in relation to the operation of the Distribution Agreement (the "**DA**") between them. Both parties provided further submissions
10. As had been indicated at the outset of the Hearing in September 2013, we then proceeded to issue a 'minded to' decision upon which both parties could comment. Following issue of the minded to decision, UKPNS identified that it had not been sent a copy of HAL's further submissions on the DA (and likewise HAL had not been sent a copy of UKPNS's further submissions on the same). The parties having not copied these further submissions to each other, we therefore decided that these should be provided to each party and each party be given an opportunity to comment on the other party's further submissions
11. In reaching the final decision we have considered, in addition to the material supplied earlier, each party's comments on the other party's further submissions on the DA together with each party's comments on the minded to decision

## Jurisdiction

12. We consider that we have jurisdiction to determine the present dispute. The basis upon which we have reached that conclusion is as follows.
13. The present dispute is an Article 37 dispute by reference to Article 37 of Directive 2009/72/EC (the "**Directive**" or the "**Electricity Directive**") as defined by, and to be determined in accordance with, sections 44B-D of the Electricity Act 1989 (the "**Act**") as follows:
  - a. The matter arises for determination under section 44B of the Act as a dispute arising from a written complaint made against a distribution exemption holder ("DEH") regarding an obligation of a person complained against. Section 44B provides, materially, as follows:

### *"44B Meaning of "Article 37"*

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<sup>2</sup> At the Hearing, UKPNS was represented by leading counsel, [REDACTED] and junior counsel, [REDACTED]. HAL was represented by leading counsel, [REDACTED]

*(1) For the purposes of sections 44C and 44D a dispute is an "Article 37 dispute" if --*

*(a) it arises from a written complaint --*

*(iv) made against a distribution exemption holder. ;*

*(b) it is wholly or mainly a dispute regarding an obligation of the person complained against under any relevant condition or relevant requirement in relation to that person imposed for the purpose of implementing the Electricity Directive; and*

*(c) it is a dispute between the complainant and the person complained against."*

- b. In the present case a written complaint was made by HAL against UKPNS on 14 May 2012 requesting that we determine the identity of the DEH for the Leased Network. HAL subsequently submitted further details of the complaint.
- c. Section 44C of the Act provides, materially, as follows:

*"44C Determination of disputes*

*(1) An [Article 37] dispute (other than one which may be referred to the Authority under or by virtue of any other provision of this Act) may be referred to the Authority under this section by the person who is the complainant in relation to the dispute.*

*(2) An [Article 37] dispute referred to the Authority under this section shall be determined by order made either by the Authority or, if the Authority thinks fit, by an arbitrator (or in Scotland an arbiter) appointed by the Authority.*

*"*

14. On 22 March 2013 UKPNS requested an oral hearing. We sent a letter to both parties prior to the Hearing setting out the basis upon which we considered there to be jurisdiction to determine this matter and the proposed basis for determining the dispute. At the outset of the Hearing, we set out that the central issue was whether the duties imposed by Schedule 2ZA of the Act apply to UKPNS, in the context of a request to take a supply for electricity from third party suppliers by customers of HAL who are connected to the Leased Network. We explained that the basis for proceeding to determine the dispute is that there is an extant expression of interest from [REDACTED], a customer of HAL.
15. Although we understood that [REDACTED] had by the time of the Hearing disconnected from the Leased Network, we stated at the outset that (a) we were not aware

that [REDACTED] had formally withdrawn its expression of interest, so there was, and remained an extant request in relation to which there was a dispute; (b) we also understood that there are a number of customers who have also expressed an interest in taking a supply from a third party; and (c) we were therefore of the view that this was not a hypothetical dispute. Neither party in their submissions sought to argue that Ofgem did not have jurisdiction.

### **Summary of parties' submissions**

16. We have considered all of the submissions made by both parties including written submissions made prior to the Hearing, oral submissions made at the Hearing, and additional post Hearing submissions.

17. In the following paragraphs we have summarised the main arguments made by each party in their various submissions. We first set out a summary and background of the parties' submissions and then summarise their respective positions against three broad headings.

- a. Who is the DEH? Can there be more than one DEH in respect of a relevant network/the Leased Network?
- b. What is the proper meaning of supply?
- c. Operate and Control

18. We follow the same structure in the section titled 'Our Views' at the end of this document. Throughout the submissions both parties commented on the workability of the DA. We also comment on this in 'Our Views'

### **Summary and Background**

#### **UKPNS**

19. UKPNS denies that it bears obligations under Schedule 2ZA of the Act. Its arguments, in summary, are as follows.

- a. There are four conditions which must be satisfied before paragraph 1(1) of Schedule 2ZA of the Act applies:
  - i. There must be an exempt distribution system (UKPNS says there is)
  - ii. There must be a customer who owns or occupies premises (UKPNS says [REDACTED] is)
  - iii. Those premises must be connected to that distribution system (UKPNS says that [REDACTED] premises are so connected) and
  - iv. That customer must be taking a supply of electricity through that distribution system from the DEH that operates or has control of that system.
- b. There is a host DNO entry point on the high voltage system. That connection is legally under the control of HAL. The connection agreement between the host DNO and the Leased Network is HAL's. The agreement

for the provision of electricity through that connection point is exclusively with HAL. The electricity is purchased by HAL from [REDACTED]. For the majority of airport occupants, the exit point is from the Leased Network onto HAL's exclusive low voltage system. The electricity then goes through HAL's system to its customers. In respect of about 40 high voltage customers, including [REDACTED], they are connected directly to the UKPNS Leased Network. Metering is exclusively HAL's.

- c. UKPNS believe that it is not the Distribution System Operator ("**DSO**") as it has no participation in control over the connection agreements in or out of the system.
- d. UKPNS accepts that it is a DEH, but contends that it is not the relevant DEH as it is not also the relevant "supplier".

## HAL

20. HAL's submissions, in brief, are as follows:

- a. Regulation 21 of the Electricity and Gas (Internal Markets) Regulations 2011 (the "**2011 Regulations**") amended the Act to give effect to the Directive, part of the Third Package on energy market liberalisation. Regulation 21 introduced a new section 5A and Schedule 2ZA into the Act, placing DEHs under relevant obligations in relation to third party access to their networks.
- b. The Directive repealed and replaced an earlier Directive on common rules for the internal market in electricity. Both Directives contained two identical paragraphs on third party access. The relevant third party access provisions had previously been considered by the ECJ in the *Citeworks* case, which concerned access to the exempt electricity distribution network at Leipzig airport. The ECJ concluded that the relevant national German law did not fall within one of the limited derogations to the general requirement of open access to networks and the restriction on third party access under German law was therefore in breach of EU law. HAL says that in like manner, UKPNS is under the same obligations of third party access under the new Directive, not being subject to any applicable derogation.
- c. The Directive was to be fully implemented in member states by March 2011 and there is a general obligation for the national law implementing the Directive to be construed harmoniously in accordance with the relevant Directive. So, the relevant provisions of the Act, including Schedule 2ZA, should be construed in conformity with Article 32 of the Directive.

21. HAL submits that UKPNS is the DSO in relation to the Leased Network. HAL points to the definition of a DSO in Article 2 of the Directive where "*Distribution system operator*" is defined to mean "*a natural or legal person responsible for operating, ensuring the maintenance of and, if necessary, developing the distribution system in a given area and, where applicable, its interconnections with other systems and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of electricity.*" HAL says that this is what UKPNS is paid significant

sums on an annual basis to do, under the DA. HAL notes that it is also what UKPNS states on its own website that it does in relation to Heathrow.

22. DSOs must provide cost-based charging methodologies to third parties who want to have electricity transported across any system for which a DSO has responsibility, pursuant to obligations arising from the Directive. HAL says that unless there is a specific exemption at European level, that must apply to the distribution system with which this dispute is concerned.
23. HAL contends that while the Directive tries to move along the process of unbundling transmission, distribution and supply that had been started in previous Directives (as noted by UKPNS), it does so as an incident of the purpose of opening the market and ensuring that obstacles to the sale of electricity on equal terms and without discrimination is achieved, and that there is competition in the internal market.

## **Parties Arguments**

### **Issue 1: Approach to the identification of the relevant DEH; can there be more than one distribution exemption holder in respect of a relevant network/the Leased Network?**

#### **UKPNS**

24. UKPNS submits that there is more than one potential DEH to which paragraph 1(1) of Schedule 2ZA might apply. Both HAL and UKPNS are DEHs within the meaning of section 64 of the Act and are DEHs for the purpose of regulation 48 of the 2011 Regulations which introduced, inter alia, Schedule 2ZA into the Act.
25. UKPNS considers that if, as HAL suggests, there can only be one person performing the role of the DSO that single person must be HAL. However, UKPNS does not agree that there can only be one DSO. The *Citeworks* decision suggested that it is not only a DSO who may be under the obligation to allow open access to systems. Article 32 of the Directive (to the extent that HAL says it only looks for one DSO, see paragraphs 28-32 below) is therefore in UKPNS' view a red herring in relation to this case.
26. UKPNS states that its argument that it might be possible for there to be two DEHs for present purposes was clearly expressed in its 30 January 2012 letter and was also dealt with in submissions. At paragraphs 16(1) and (2) of the letter, UKPNS put forward two possibilities in respect of the high voltage tenants:
  - a. The first possibility is that HAL counts as a "related person" (within the meaning of paragraph 1(1)(b)(ii) of schedule 2ZA to the Act) to UKPNS as DEH, but UKPNS put forward reasons why "related person" should not be interpreted this broadly. The first possibility is therefore that if UKPNS is outwith the scope of the test of "taking a supply of electricity through that system from" (properly construed) in paragraph 1(1)(b) of schedule 2ZA, then the high voltage tenants do not qualify under schedule 2ZA as having the ability to demand third party access. UKPNS recognises that this is not an attractive argument (since it would place the UK in breach of the Directive) and that a Court would strain to avoid such an interpretation/conclusion (see para 23(6)).

- b. UKPNS go on to set out the alternative option that there may be two DEHs: *"The second answer may be that BAA has retained sufficient control of the Leased Network through the HALDA [the DA] to be properly described as an exempt distribution holder of the Leased Network as well as the BAA network. This would require the court to interpret the legislation as permitting the possibility that there might be more than one distributor in respect of the same network. We see no reason in principle why this could not occur, for example where the freehold ownership of the network remains with one company who leases it to an operational company but who retains ultimate control over it. If that was the position then BAA would be an exempt distribution holder for the high voltage tenants as well."*

27. UKPNS also states at paragraph 23(5) of the 30 January 2012 letter that, *"In principle, two persons can be distributors in respect of the same distribution system. The 1989 Act, the Exemption Order and the Regulations are not inimical to that conclusion."*

#### **HAL**

28. HAL notes that Article 25 of the Directive places a general information requirement on all DSOs to provide system users with the information they need for efficient access to, including use of, the system. HAL contends that the wording of the Directive demonstrates that a DSO must be a single operator for an area, including Article 32 of the Directive which provides, inter alia, *"The transmission or distribution system operator may refuse access where it lacks the necessary capacity. The regulatory authorities shall also ensure, where appropriate and when refusal of access takes place, that the transmission or distribution system operator provides relevant information on measures that would be necessary to reinforce the network."*

29. The only exception under the Directive to the obligation to make available charging methodologies to third parties who want to transport electricity across the system is in Article 28 on closed distribution systems (which have to be specifically approved as such and do not apply here).

30. Article 32 of the present Directive (2009/72) replaced Article 20 of the predecessor Directive (2003/54) which concerned common rules for the internal market on electricity. Article 20 was in relevant respects in similar terms and was considered in the *Citiworks* case. Of particular relevance is the discussion of recital 4 at paragraphs 43 - 45:

*"43. Recital (4) in the preamble to Directive 2003/54 states that a fully open market must enable all consumers freely to choose their suppliers, and all suppliers freely to deliver to their customers. As the Advocate General rightly observed in point 72 of his Opinion, these two rights are necessarily linked. In order for customers to be able to choose freely their suppliers it is necessary that suppliers should have the right to access the different transmission and distribution systems which carry electricity to the customers.*

*44. It follows that open third-party access to transmission and distribution systems constitutes one of the essential measures which the Member*

*States are required to implement in order to bring about the internal market in electricity.*

*45. The principle of open access applies, according to Article 20(1) of Directive 2003/54, to electricity transmission and distribution systems. Points 3 and 5 of Article 2 of that directive define the notions of 'transmission' and 'distribution'..."*

31. HAL says that, contrary to UKPNS' submissions, paragraph 52 of *Citiworks* is not authority for the proposition that there can be two DSOs for a distribution system. At paragraph 55, the Court set out the obligation on members states:

*"Article 20(1) of that directive leaves the Member States free to take the measures necessary to establish a system of third-party access to transmission or distribution systems. It follows that in accordance with Article 249 EC, the Member States have authority over the form and methods to be used to implement such a system. Having regard to the importance of the principle of open access to transmission or distribution systems, that margin of discretion does not, however, authorise them to depart from that principle, except in those cases where Directive 2003/54 lays down exceptions or derogations."*

The Court then went on to conclude that there was no applicable exception or derogation in relation to FLH, the operator of Leipzig/Halle Airport, under EU law.

32. HAL submits that it is plain that there cannot be two DEHs/DSOs in relation to a single distribution system. This is a function of the way that the natural monopoly of a distribution network works: there cannot be two independent operators operating that network simultaneously.

## **Issue 2: What is the proper meaning of supply?**

### **UKPNS**

33. UKPNS submits that a number of matters are not in dispute, including that the electricity [REDACTED] buys is bought from HAL under contract with HAL; the electricity [REDACTED] buys from HAL flows through the Leased Network; HAL has entered into connection contracts both with [REDACTED] and the host DNO at the other end of the Leased Network.
34. UKPNS says there are two questions to be asked in light of these facts. First, in respect of UKPNS (1) Does [REDACTED] take a supply from UKPNS? (2) If so, does UKPNS operate or control the Leased Network? The next step would be to ask the same questions of HAL.
35. UKPNS states that [REDACTED] does not take a supply from UKPNS because that defies the ordinary language used in the Schedule and the structure of the Act. Schedule 2ZA is introduced pursuant to section 5A of the Act (which is within Part I) therefore UKPNS says that the Part I definitions of "supply" and "distribution exemption holder" must apply in Schedule 2ZA. UKPNS notes that the Directive defines supply to mean the sale of electricity to customers. UKPNS considers that

the same words in the same statute should be taken to have the same meaning as a matter of construction. When the Act wishes to speak of the "movement" of electricity it uses other expressions such as the "flow" or "conveyance" of electricity. UKPNS argues that a strained construction should only be adopted if necessary to give effect to the design and purpose of the Directive, otherwise the validity of the domestic legislation would be in doubt and the strained construction should not exceed the limits of what is reasonable. UKPNS considers that a strained construction of "supply" is unnecessary in this case.

36. UKPNS states that in relation to section 4 of the Act, the purpose is that of giving a supply to any premises or enabling a supply to be so given. There is, therefore, a stated purpose and there are two parts to that purpose. Sections 4 (b) and 4(b)(b) refer back to that purpose, but do not re-state the purpose. UKPNS considers that if one were looking simply at the prohibition on a distributor, the distributor is therefore a person who distributes electricity for the purpose of giving a supply to any premises or enabling a supply to be so given. UKPNS states that this language makes clear that there is a separation between distribution and supply, and it also makes clear that a distributor may distribute electricity for one of two purposes, either for giving a supply, which is the position at Heathrow, or for enabling a supply to be given, and that can only, therefore, mean two things. First, that distribution is distinct from supply. Secondly, it acknowledges that there may be distributors who are also suppliers. UKPNS considers that what this wording does is to make it impossible to construe the situation as being that the customer is taking his supply from the distributor, because the customer is taking his supply from the person who is giving the supply to him, and the person who is giving the supply to him will always be the supplier.
37. UKPNS notes that the words of the relevant part of Schedule 2ZA refer to electricity taken through a system from a DEH that operates or has control of the system, or a person related to the DEH. UKPNS considers that if the sole purpose of these words were to name the distributor, that is to say, only the person who was at the other end of the connection point or the other side of the connection, then the question who the supply was coming from and who it was being taken from would be redundant.
38. UKPNS states that under the test of supply, UKPNS does not supply but HAL does supply. UKPNS considers that it does not therefore need to rely on any arguments about its operation or control (or lack thereof) of the Leased Network.
39. UKPNS argues that it is not permissible to give supply a different construction by reference to section 4 of the Act: "giving a supply to" and "taking a supply from" must be mirror images of each other. Even if it results in a breach of the UK's EU law obligations one cannot read "supply" as HAL advocates. That would be a matter for additional legislation.
40. UKPNS considers that although there is no definition of supply as sale in the Act, it is not just simply the word "supply", but the expression here, "taking a supply of electricity through a system from", which, as a matter of ordinary construction, refers to two separate things. It refers to the supply being taken physically through, and secondly from whom it is being taken. If one then takes the part of the expression "from" whom, taking a supply from somebody can only sensibly be read as the mirror image of giving a supply to someone, which goes back to the section 4 analysis.

## HAL

41. By reference to the language of Schedule 2ZA of the Act, HAL says that [REDACTED] is a customer which owns or occupies premises connected to a distribution system for which UKPNS is the licence exemption holder – ie the DEH. The question is therefore whether [REDACTED] is a customer, *“taking a supply of electricity through that system from the distribution exemption holder that operates or has control of the system.”*
42. HAL says that although *“supply”* is used in various contexts in the Act, a DEH cannot be permitted to sidestep the requirements of paragraph 1(1)(a) of Schedule 2ZA of the Act merely because the DEH does not *“supply”* in the sense used in other parts of the Act as this would mean that UK law does not properly implement the relevant EU law. In the context of the Schedule, *“supply from”* should be read as meaning the physical provision of electricity.
- 43 HAL considers that as to the wording of paragraph 1 of Schedule 2ZA to the Act, UKPNS is not assisted by the fact that the DSO (the DEH operating the distribution system) only has to provide a charging methodology to a customer who proposes to take *“a supply of electricity through that system from the distribution exemption holder that operates or has control of the system”*. HAL states that this is not *“supply”* from a supplier in a *“capital S”* sense used in certain places in the Act and in EU material because (applied to this case) UKPNS does not sell electricity to [REDACTED] or other third parties. But in another sense the supply is through the system from UKPNS, in that the off-take of electricity by a third party, such as [REDACTED], is from that system, and the DSO, UKPNS, is delivering the electricity. It is physically supplying the electricity. HAL says that that is the meaning of *“supply”* that has to be read in paragraph 1 of Schedule 2ZA to the Act
44. HAL not only says that the provision can be read in that way, HAL says it must. If not, the application and the purpose of EU law, which is to ensure that DSOs afford access to third parties across their systems on the basis of approved charging methodologies, is undermined. It does not matter whether or not they are licensees under a domestic regime; the principle applies regardless. HAL considers that doing otherwise would put the UK in breach of EU law
45. HAL says that by reference to EU law, the recitals in the Directive clearly spell out that its purpose is to open up the internal market in electricity, in particular by separating out transmission, distribution and supply in relation to operations by different entities. In relation to transmission, recital 20 notes the separating out of Transmission System Operators (*“TSOs”*) entirely from downstream activities and ensuring that there is an opening of the market to competition, so that customers should be able to choose their suppliers. In doing so customers should be in a position to get prices for the transportation of that electricity across the networks that exist between where the electricity is generated and where it is actually to be consumed. At recital 32, the Directive talks about transparent and non-discriminatory tariffs, and recital 36 notes the importance of being able to fix and approve tariffs, or the methodologies underlying the calculation of tariffs, on the basis of proposals by TSOs or DSOs.
46. In relation to the operative parts of the Directive, Article 2 includes a definition at point five:

*"Distribution means the transport of electricity on high voltage, medium voltage, low voltage distribution systems with a view to its delivery to customers, but does not include supply."*

Over the page, "supply" means "sale, including resale of electricity to customers", and that is the "capital S" type of definition of supply, the technical meaning in both EU and domestic legislation. There is also the definition of DSO, which is the key definition for the purposes of the European legislation, as follows:

*"A natural or legal person responsible for operating, ensuring the maintenance of, and if necessary developing the distribution system in a given area, and, where applicable, its interconnections with other systems and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of electricity."*

What it is referring to is an operator of a system in a particular area. This cuts across the idea that there can be two DSOs in respect of the same area.

47. HAL states that in relation to the question whether UKPNS is the DSO for the Leased Network, the starting point is the DA itself. London Electricity Group changed its name to EDF, and London Electricity Services became EDF Energy Services (EDFS), and that is now UKPNS. The key clause is clause 4, distribution of electricity, which makes it clear that, "EDFS shall in respect of the distribution system accept electricity at each entry point up to the relevant maximum input capacity and distribute electricity to each exit point up the maximum export capacity." That is distributing electricity and operating the distribution system.
48. In relation to clause 4.2 of the DA, HAL states it is correct that this clause prevents UKPNS from permitting any third party to make or receive supplies of electricity without the prior written consent of HAL. However, HAL also notes that this clause states that this is unless HAL is required to do so by law, and HAL argues that in the present case UKPNS would be in the territory of "required to do so by law".

### **Issue 3: Operation and Control**

#### **UKPNS**

49. UKPNS submits that it does not have the means to comply with the requirements under the amended provisions of the Act flowing from the 2011 Regulations; it does not own the metering and does not have various data. UKPNS states that a consideration of the evidence demonstrates that HAL operates and controls the Leased Network.
50. UKPNS notes that Schedule 2ZA to the Act, does not set out to describe operation or control. That is a matter of application. It does not describe the relationship or necessary extent of operation or control. What has to be identified is the DEH who would otherwise fail to qualify within paragraph 1 of Schedule 2ZA and see whether that party has sufficient operation or control in respect of the Leased Network to be the person who should respond to the third party access request.
51. UKPNS states that the lack of relevant information in UKPNS' possession means that it would be reliant on obtaining information from HAL. Although HAL has

indicated that it would seek to assist with such information, this could not be enforced by UKPNS or Ofgem and is therefore unsatisfactory.

52. UKPNS considers that HAL's existing formulation of a tariff suggests it is able to assess costs and provide relevant information if the obligation is recognised to fall on it.
53. UKPNS states the purpose for which Schedule 2ZA is being introduced into domestic law, is in fact to unbundle monopolies such as that of HAL. UKPNS also submits that HAL's arguments in relation to clause 4.2 of the DA, that the prohibition on third party supply is "unless otherwise required by law" is a circular argument. It amounts to relying on the text of clause 4.2 to assist in construing UKPNS as the distributor under paragraph 1 in the first place.
54. In its additional submissions following the Hearing UKPNS summarises the reasons why it says that HAL has ultimate decision-making power. UKPNS provides examples such as the day to day control through engineers, control of energisation and de-energisation, load balancing on the network, balancing of consumption data connections with customer and systems modifications.
55. UKPNS says that the clause 4.2 reservation to the restriction on UKPNS allowing third parties to make supplies, in circumstances "*where it is required to do so by law*", does not alter the position with respect to UKPNS' inability to enter into connection agreements with customers, suppliers or the upstream distributor or transmitter. UKPNS argues that the fact that HAL must, under clause 13.3, liaise with UKPNS and customers including in relation to requirements for changed capacity and new supplies is "*to ensure that HAL procures in any connection agreement such access as is required for UKPNS to fulfill its obligations under the Distribution Agreement.*"
56. UKPNS also submits, inter alia, that:
  - a. The safety rules are in fact UK Power Network's ("UKPN"), UKPNS' affiliated company and a licensed distributor, not UKPNS' rules and the reason why these are specified is that HAL wanted the benefit of access to UKPN's Distribution Safety Rules as UKPN is a licensed DNO and its DNO safety standards comply with Electricity Supply Industry (ESI) standards which HAL wanted to apply to the Leased Network.
  - b. HAL retains a general right to require energisation and de-energisation on the Leased Network but that by contrast UKPNS' right to do so is prescribed by the limited permissions in clause 5.
  - c. Its discretion in relation to how it transmits electricity across the Leased Network is fettered, and it gives the example that it is not permitted "*to accept electricity at a volume below Maximum Capacity*".
  - d. Clause 4.2 indicates that HAL controls who may give or receive supply of electricity.
  - e. Clause 6.1 "*cannot be read in isolation*" but rather should be read together with the clause 11.3 providing day-to-day control with HAL control staff,

clause 23 which provides that UKPNS may not make any modifications or upgrades without HAL's consent, clauses 13.3 and 4.2 which provide that UKPNS may not enter into agreements with customers and third parties, clauses 3 and 5 which circumscribe UKPNS' discretion to energise and de-energise and clause 8 which provides that UKPNS may not carry out planned maintenance without HAL's approval.

- f. Its sole responsibility for authorisation of personnel to control, operate or work on the distribution system under clause 11.2 is a training issue and not a control issue.
- g. Although UKPNS is required to insure the distribution system under clause 12 of the DA, the interest of HAL must be noted on the insurance policy by way of general endorsement.
- h. While UKPNS has a right to meter data for entry points, it says that it does not have access to data from metering equipment at exit points and does not operate any exit point metering equipment on behalf of HAL. This is although clause 14.7 requires UKPNS to use reasonable endeavours to co-operate fully in relation to any metering equipment required to be installed at any exit point by HAL or a third party supplying through the distribution system. UKPNS notes that HAL can require UKPNS to install, operate and/or maintain such metering equipment on reasonable terms, and that where UKPNS operates such metering equipment on behalf of HAL it shall use all reasonable endeavours to ensure that data from such metering equipment is made available to HAL and, where relevant, such third party.

57. UKPNS recognises the possibility that if it is the relevant DEH it could have two income streams: from HAL and from third party suppliers. It then points to the fact that under the DA HAL would retain control of the expenditure of that income.

58. UKPNS says that HAL's ability to veto maintenance work is inconsistent with UKPNS being the independent DSO. It says that HAL's contention that it only controls access for maintenance and approval of improvements in order to protect the security and operational effectiveness of the airport is wholly consistent with HAL's objectives as the operator of Heathrow but is inconsistent with UKPNS acting as an independent DSO

59. UKPNS says that the provisions allowing HAL to terminate for material loss are inconsistent with UKPNS being the independent DSO.

## **HAL**

60. HAL contends:

- a. As the operator of the high voltage network across Heathrow, UKPNS is plainly an electricity distributor within the meaning of the Act. Relevant agreements between the parties make clear that UKPNS is in the business of electricity distribution. Relevant agreements impose an obligation on

UKPNS to operate the distribution system, for which it is paid substantial sums by HAL.

- b. Control is not relevant (and in any event HAL does not control the distribution system). UKPNS' argument is that it does not control the system and that HAL does, and it therefore suggests that HAL is the relevant DEH for the purpose of Schedule 2ZA. HAL believes this approach misconstrues paragraph 1(1)(b)(i) of Schedule 2ZA which must be read consistently with Article 32 of the Directive, which focuses on the "distribution system operator". Thus the key concept is that of the operator. That person must offer to distribute the third party's electricity and provide the charging methodology for doing so. There can only be one DSO for the purposes of the Directive. Paragraph 1(1)(b)(i) does not contemplate the identification of two different people being the operator and the controller. If a person is identified as the operator there is no basis to argue that their obligations are displaced by suggesting that someone else controls the system. It would not be feasible to have two parties both having the obligations to provide charging methodologies. Furthermore, it is wrong to see HAL as controlling the distribution system in a relevant sense for the purposes of the Directive as the clauses of the relevant agreements do not suggest such a conclusion.

61. HAL notes that the definition of a DSO talks about maintenance, this is reflected in clause 6 of the DA which provides:

*"Subject to the terms and upon the conditions of this Agreement, as set out in clause 13 of the Master Agreement, at all times during the term EDFs shall maintain, operate, repair and replace and (where appropriate) reinstate the Distribution System...."*

62. HAL states that clause 6.2 requires UKPNS, in carrying out its obligations under clause 6.1, to comply with the operation and maintenance of standards with which UKPNS would be required to comply if UKPNS were the holder of a distribution licence and the distribution system were a DNO distribution system, as a consequence of the provisions of a distribution licence.
63. HAL considers that where clause 11.1 refers to day-to-day control of the distribution system being the responsibility of HAL's control staff (subject to clause 1.2) that is referring to the drawdown of electricity and HAL's staff are in charge of that because HAL is selling electricity to its tenants and providing electricity to its own functions. UKPNS does not know what levels of electricity provision are required for those customers but the fact that HAL has control in that sense does not mean it is more generally controlling the way that distribution system is operated, run, maintained and repaired.
64. HAL notes that UKPNS is obliged to insure the whole the system at its own expense under clause 12, even though it says it is not the DSO and does not really take responsibility for the system. The requirement to insure clearly points in the other direction.

65. HAL states that it is not only the DA which makes clear that it is UKPNS which is operating the distribution system and fulfilling the role of DSO. On UKPNS' website under the heading infrastructure services it says:

*"Overview. Our long-term partnership with London airports' owners gives us the responsibility for the power infrastructure at Heathrow, Gatwick and Stansted airports. Heathrow and Stansted. UK Power Network Services owns, operates and maintains the HV networks at Heathrow and Stansted airports. As we own the infrastructure, we undertake all aspects of operation, maintenance, repair, renewal and project works from scheme design through to commissioning. A good example of this would be the delivery of the electricity infrastructure for Terminal 5, Heathrow. We have been operating in this way since 1993 with a 90-year contract, and indeed some of our staff are former airport employees, so we know all about airport operations and the associated restrictions on working in such a highly regulated and controlled environment. We additionally undertake specific project maintenance and call-out works at other BAA airports."*

66. HAL submits that Schedule 2ZA of the Act is intended to implement the Third Package Directive which particularly concerns the duty to give third party suppliers access to licence exempt networks in order to enable customers connected to those networks to switch supplier. UKPNS' case fails properly to engage with this, focusing on one specific issue of the proper construction of the word supply in Schedule 2ZA.

67. HAL submits that it could not undertake the role of DEH in any event; it could not comply with the guidance on charging methodologies as it does not have necessary information.

68. HAL considers that in relation to UKPNS' argument that even if it is operating the system it is not controlling it, the argument does not assist UKPNS given that the words in the legislation are operation or control. In any event, the central concept in EU law is the operation of the distribution network: control doesn't add anything here and it can't do so because if the addition of that word in UK law meant that EU law didn't operate properly then you would have to dispose of control in any event.

69. HAL states that the reserved responsibilities/powers of HAL control staff under clause 11.3 (by reference to clause 11.2) refer to switching which is important but does not affect the analysis on overall operation/control.

70. HAL considers that its further written submissions draw attention to the recitals of the DA, noting that they reflect the understanding that UKPNS' predecessor was "carrying on the trade of transporting electricity". HAL refers to "the distribution of electricity by [UKPNS]" and to UKPNS wishing "to use and operate the Distribution System for the purposes of carrying on its trade of distributing electricity." HAL says it is plain that the DA effected a much more fundamental transfer to UKPNS than merely passing over maintenance obligations.

71. In relation to the particular clauses of the DA, HAL says as follows (without addressing every clause, HAL comments upon):

- a. HAL is identified as one of the customers in the definitions section of the agreement HAL says this makes clear that its position is as customer and not as a principal, contracting down to UKPNS maintenance work on a sub-contracted basis.
- b. The definition of leases supports the view that UKPNS effectively has an ownership of the distribution system for the period of the 140 year lease HAL only retains rights of access and the ability to lay other cabling in. Any assets added to the distribution system are added to UKPNS' account.
- c. The applicable safety rules are UKPNS'.
- d. There are rights of connection/energisation for HAL's benefit under clause 3.1 (and associated provisions under clauses 3.2 and 3.4) which are inconsistent with the idea that it is the principal sub-contracting work down to UKPNS. If that was the case it would not need to write in these rights for itself to the agreement, it could simply ensure for itself its connection/energisation. Similarly the clause 3.4 requirement to give UKPNS notice of de-energisation would not be necessary as a contractual term if HAL was properly viewed as the controller of the system
- e. Clause 4.1 sets out the essence of UKPNS' role as DSO, accepting and transporting electricity across the system.
- f. Clause 4.2 (the contractual restriction on UKPNS itself or allowing a third party to supply through the Distribution System without HAL's consent, unless required to do so by law) is a provision which would be unnecessary if HAL were in fact in control of the system.
- g. By reference to clauses 5.2 and 5.5, UKPNS has much greater rights to de-energise entry/exit points or require HAL to do the same. HAL's rights are much more circumscribed.
- h. Clause 6.1 is a clear and crucial statement of UKPNS' role - providing that it shall "*maintain, operate, repair, replace and (where appropriate) reinstate the Distribution System*" so as to ensure that the system is in good repair and condition, continues to be configured in accordance with the configuration of the system at the date of the Agreement (save to the extent otherwise agreed) and that (subject to clause 5 and disconnection or de-energisation in circumstances of force majeure) provides a capability which enables UKPNS to comply with its obligations to accept and transport electricity across the system in accordance with clause 4 1.
- i. Clause 8.2, HAL only has defined and circumscribed circumstances in which it can veto UKPNS' maintenance plans.
- j. Clause 11.2, UKPNS has sole responsibility for authorising personnel to control, operate or work on the Distribution System.

- k. Clause 12, UKPNS is required to insure the Distribution System for its full reinstatement value.
  - l. Clauses 14.3 and 22.5 place HAL under an obligation to provide UKPNS with any data in its possession produced by metering equipment at entry points.
  - m. Various clauses refer to HAL and "other customers" which HAL says point to its true role as customer not principal.
  - n. Clause 22.11 makes clear that any financial benefit or risk from deterioration of the Leased Network more slowly/rapidly lies with UKPNS, this points to the ownership type interest of UKPNS' long lease.
72. HAL then identifies as of particular relevance to the issue of the consequences of UKPNS being the Independent DSO the following:
- a. Clause 4.2 (already discussed above).
  - b. Clauses 28.2 and 28.6, duties to use best endeavours to prevent, reduce or mitigate the effects of any Material Regulatory Intervention. HAL argues that if it suffers a Material Loss as a result of third party access, because it is charged in accordance with total flows across the network, then it can only terminate the DA if the parties have first been unable, using best endeavours, to agree amendments to mitigate this effect. So, in essence, the contract envisages and provides for how to update the DA to take into account the consequences flowing from UKPNS being recognised as the DEH. Termination of the DA is, as a matter of the contract, a measure of last resort.

## **Our Views**

### **Issue 1 – Approach to the identification of the relevant DEH: can there be more than one distribution exemption holder in respect of a relevant network/the Leased Network?**

73. We note that UKPNS has previously readily accepted that it is a distributor in respect of the Leased Network. For example, in the following extracts of UKPNS' letter of 30 January 2012, UKPNS stated:
- a. *"UKPNS agreed to operate, maintain, repair and when appropriate replace the leased assets (i.e. the leased part of the distribution system) for a period of 90 years. In return for this, BAA pays an annual fee to UKPNS which includes a fee for the use of the distribution system: this fee is appropriate because **UKPNS distributes through the system the electricity that BAA sells to the Tenants.**" (emphasis added) (para 2).*

- b. *"In a simple sense BAA is the exempt distribution holder in relation to the BAA network and UKPNS is the exempt distribution holder in relation to the Leased Network."* (para 11).

74. The relevant statutory provisions as to who is a distributor and a DEH are as follows:

- a. Section 4(4) of the Act defines "distribute" as follows:

*"In this Part, unless the context otherwise requires – 'distribute', in relation to electricity, means distribute by means of a distribution system, that is to say, a system which consists (wholly or mainly) of low voltage lines and electrical plant and is used for conveying electricity to any premises or to any other distribution system."*

- b. Section 64 (Interpretation provision for Part I within the Act) defines "distribute" and "distribution exemption holder" as follows:

*" 'distribute', in relation to electricity, has the meaning given by section 4(4), and cognate expressions shall be construed accordingly;*

*'distribution exemption holder' means a person who –*

*(a) is distributing electricity for the purpose mentioned in section 4(1)(bb); and*

*(b) is authorised to do so by an exemption.' "*

- c. Section 4(1)(bb) of the Act contains a prohibition of unlicensed supply, making it an offence for a person to distribute electricity *"for the purpose of giving a supply to any premises or enabling a supply to be so given"* unless authorised to do so by a licence
- d. Section 5 of the Act provides that the Secretary of State may by order grant exemption from section 4(1)(bb) either to a person or to a class of persons.
- e. Under Article 3(1)(b) of the Electricity (Class Exemptions from the Requirement of a Licence) Order 2001 an exemption is granted from section 4(1)(bb) of the Act to the persons of the classes specified in Schedule 3. Paragraph 3 of Schedule 3 covers *"Persons (other than licensed distributors) who do not at any time distribute electrical power for the purpose of giving a supply to domestic consumers or enabling a supply to be so given with that electrical power."*

75. Having accepted that it is a DEH in respect of the Leased Network, UKPNS argues that there may be two DEHs for present purposes. UKPNS' analysis proceeds as follows. First it says that there may be two parties who can fulfil the definition of a DEH under section 64 of the Act. However, it argues that whether a party is a

DEH for the purpose of section 64 is a distinct question from whether a party is a DEH under Schedule 2ZA.

76. A key question (which HAL poses) in response to UKPNS' argument that there may be two DEHs in respect of the same distribution system, is whether that can be right as a matter of the practicalities of the obligations imposed on relevant DEHs under domestic and European law:

- a. In the present case, UKPNS says (relying on its definition of supply) that this would not cause problems within the context of the application of Schedule 2ZA because UKPNS does not satisfy the (separate) supply condition. Although it is a DEH for the Leased Network, it is not a relevant DEH for the purpose of Schedule 2ZA. HAL is a second DEH, by whom all the practical obligations can be performed. UKPNS also says that to the extent that the European legislation contemplates a sole DEH (noting HAL's submission that the Directive contemplates only one DSO and therefore only one relevant DEH), that does not mean that there can only be one DEH for the purpose of sections 64 and 4 of the Act. UKPNS says that by reference to the definition of an exempt distribution system in section 64 of the Act an "exempt distribution system" is "a distribution system operated or controlled by a distribution exemption holder who is covered by an exemption granted to it in relation to that system." Although the definition of "distribute" in section 4(4) (see paragraph 74a above) does not take matters much further, as the word "distribute" is both the term defined and part of the definition and the term "convey" is not defined, UKPNS places emphasis on the definition of an "exempt distribution system", to argue that the reference to operation or control therein means that the domestic legislation envisages the possibility of more than one DEH for the purposes of sections 64 and 4.
- b. We do not agree with UKPNS that the definition of exempt distribution system leads to the conclusion that there may be more than one DEH in respect of a single system. The wording of the statutory definition of a DEH is consistent with there being a single relevant DEH who is either the operator or, alternatively, the controller of the system. Whilst we agree with UKPNS' point that, at least on the facts of this case, the possibility of there being more than one DEH for the purpose of sections 64 and 4 of the Act does not present the same problem of conformity with the European legislation as the possibility of there being more than one DEH for the purpose of Schedule 2ZA, that does not compel the conclusion that there can be more than one DEH for the purposes of sections 64 and 4 of the Act. We are not attracted to UKPNS' suggestion that the defined concept of a DEH should have different meanings in different parts of the Act, and we note that DEH connotes a status. The word is used in both sections 64 and 4 and in schedule 2ZA and we do not see any good reason why a party should be considered to have the status of a DEH for the purpose of one part of the Act but not for another. If the same meaning should be accorded to the term throughout the Act, then conformity with the European legislation strongly favours there being only one DEH.
- c. We also consider that the EU legislation supports the view that there can only be one relevant DEH in respect of the same distribution system. There is force in HAL's argument (as set out at paragraphs 28, 31 and 32 above) that the EU legislation essentially contemplates a single DSO for a particular area and that the obligation to provide a charging methodology

falls on the DSO. UKPNS seeks to rely on paragraph 52 of *Citiworks* and the observation of the ECJ that "Article 13 of Directive 2003/54 requires undertakings that own or are responsible for distribution systems to designate distribution system operators. It is not apparent either from that provision or from any other provision of that directive that only undertakings acting principally as distribution system operators are subject to the obligation to allow open access to the systems." UKPNS' point is that this suggests that identification of the DSO does not necessarily determine the identity of the correct person to give third party access. However, we do not read paragraph 52 of *Citiworks*, in the context of the surrounding provisions, to mean that the obligations of third party access do not necessarily fall on the DSO. We consider that the reference to "undertakings acting principally as distribution system operators" is referring to the argument that in respect of a system which is operated as an ancillary activity by an entity such as an airport owner, that entity's primary function is not one of a DSO, ie that is not its core business. This can be seen from paragraph 53 of the judgment where the ECJ continues, "It is appropriate to observe in that regard that the first point of Paragraph 110(1) of the EnWG does not stipulate whether the activity of operating the energy supply system must, for the operator, be a principal or ancillary activity for the purpose of defining the systems which come within its scope." Read together with the other parts of the decision and the Directives, we accept HAL's submission that the European legislation contemplates a single DSO for a particular area and envisages the obligations of third party access falling upon that singular relevant DSO. We do not accept that in circumstances where most DSOs will be licensed distributors subject to standard licence conditions requiring third party access, that the obligations on DSOs do not apply to DEHs because that is a concept created by the domestic statutory provisions. It seems to us that at a simple level both licensed distributors and DEHs are DSOs within the meaning of the European legislation.

- d. Practical considerations also militate against the conclusion that there may be more than one DEH. We accept that those practical conclusions do not arise in this case (on UKPNS' argument) because it says that it (as one of the two DEHs) does not meet the "supply" definition, leaving HAL as the only *relevant* DEH. But that will not always be the case. If there can be two DEHs in respect of a particular network it may be the case that both could satisfy the supply condition. That would seem to give rise to the possibility, if both satisfy the test of supply and the operation or control obligations are read disjunctively (see further discussion on this below at paragraph 86), so that (for example) the lessee is said to operate the network but the owner to control it, that the regulatory obligations in Schedule 2ZA would fall on both parties. That is in our view impracticable and inconsistent with legal certainty because it would mean that both have the obligation to allow access/to submit charging methodologies if they wish to charge for third party access. We note that the obligation to formulate and submit a charging methodology is not an insignificant obligation. Thus, the requirement to produce and submit one is only triggered when an end user serves a qualifying expression of interest. Equally, the charging methodology produced should be cost reflective. In all those circumstances it seems not to be a sensible conclusion that the legislative requirements, properly construed, envisage or require the provision of charging methodologies by two separate parties in respect of the same exempt network, or that if there is only one *relevant* DEH (for the purpose of the obligations in Schedule 2ZA) of multiple DEHs, the *relevant* DEH is ascertainable only upon reference to Ofgem for resolution of the question in each case.

- e. In simple terms, we consider that it has not been established why there could be two DEHs in respect of a single exempt distribution system any more than why there could be two licensed distributors in respect of a single (non-exempt) distribution system.
- f. If (contrary to the above) there can be more than one DEH (because of the reference to operation or control in the definition of an exempt distribution system) we consider that, for the reasons given below, there would not be two DEHs in the present case as we consider that on the evidence of the arrangements between the parties, UKPNS is properly described both as the operator and the controller of the Leased Network.

77. Thus, we conclude that in this case there can only be one relevant DEH for the purposes of the obligations flowing from Schedule 2ZA. As to who the relevant DEH is, we need now to consider the questions of supply and operation and control within the statutory test.

### **Issue 2 - What is the proper meaning of supply?**

78. This takes us back to the question of the true meaning of "supply", in the phrase "*taking a supply of electricity through that system from...*". If "supply" is to be construed so as to mean sale of electricity to the customer, then there is a real risk that where the supply is effected not by a monopoly distributor such as HAL but by a supplier who does not exercise distribution functions then there will be no relevant DEH subject to the Schedule 2ZA obligations. UKPNS has suggested that this was a matter which, if it arose, would be a matter for further legislation/legislative amendment. However, we are conscious that there is an obligation of harmonious interpretation not merely on domestic Courts but also on public authorities, such as this Authority. We need therefore to look at whether the domestic legislation can be construed in a manner which properly gives effect to the EU law obligations arising from the Directive.

79. We are persuaded, by reference to the recitals and operative provisions of the Directive, that the purpose of the Directive and the third package is broader than simply unbundling monopoly distribution and supply, and is concerned more broadly with facilitating third party access and consumer choice as part of the proper functioning of a competitive market. We therefore conclude that a construction of "supply" which could lead to particular classes of customer being deprived of third party access rights risks putting the UK in breach of its primary European legal obligations and is a factor which would strongly militate in favour of a construction which avoided such a result.

80. The statutory provisions on the definition of supply within the Act are as follows:

- a. Section 64 (Interpretation of Part I) provides as follows.

*" 'supply', in relation to electricity, has the meaning given by section 4(4) above, and cognate expressions shall be construed accordingly;"*

b. Supply is defined at section 4(4) as follows:

*" 'supply', in relation to electricity, means its supply to premises in cases where—*

*(a) it is conveyed to the premises wholly or partly by means of a distribution system, or*

*(b) (without being so conveyed) it is supplied to the premises from a substation to which it has been conveyed by means of a transmission system, but does not include its supply to premises occupied by a licence holder for the purpose of carrying on activities which he is authorised by his licence to carry on;"*

81. We note that the statutory definitions in Part I of the Act do not therefore specifically identify supply as being the "sale" of electricity to a customer. Instead UKPNS relies on more subtle arguments as to the conclusion to be drawn from section 4 of the Act. Whilst there is some force in those arguments, we consider that use of "supply" in the phrase in which it is situated in Schedule 2ZA can be construed so as to mean supply in a physical sense without doing violence to the natural meaning of the word in context. Construing supply to mean the physical provision of electricity gives effect to the purpose of the Directive which it was introduced to implement.

82. Furthermore, there might be circumstances - for example a large consumer of electricity such as a factory or a remote installation which generates its own electricity and conveys it to a number of premises on its site (but not necessarily premises owned or operated by it) - where it would not be appropriate to characterise the supply effected by the DEH from the generation source to the end user recipients as a relationship of sale. In circumstances where the end users were not charged at all or directly for the electricity supplied by the generator, they would still have rights to choose a different supplier, and for third party access to be facilitated to effect the same. For example, the lack of sale would not necessarily obviate other reasons for seeking to facilitate supply from another party exercising third party access rights, for example seeking to replace an intermittent/unreliable supply with a constant and reliable supply. That suggests that the section 4(4) definition of supply should not be construed simply to mean "supply" as "sale". UKPNS says that section 4(4) makes clear that the functions of supply and distribution are distinct. However, we do not consider that the language of section 4(4) creates as clear a distinction as UKPNS suggests. Furthermore, we recall that schedule 2ZA is concerned with obligations on a distribution exemption holder and although the meaning of supply is different to many parts of the Act where the word "supply" appears, schedule 2ZA is specifically concerned with the position of distribution exemption holders. That is a relevant consideration when approaching the meaning of the word "supply" within the Schedule.

83. UKPNS looks to community law (the Directive and the *Citworks* case) to support its case. In particular it refers to the following (which definitions are all identical to the definitions in the current, successor Directive (2009/72/EC)):

a. The definition of distribution at Article 2 of Directive 2003/54 "*distribution means the transport of electricity on high-voltage, medium voltage and*

*low voltage distribution systems with a view to its delivery to customers, but not including supply."*

- b. The definition of DSO at Article 2 of Directive 2003/54, "*distribution system operator means a natural or legal person responsible for operating, ensuring the maintenance of and, if necessary, developing the distribution system in a given area and, where applicable its interconnections with other systems and for ensuring the long term ability of the system to meet reasonable demands for the distribution of electricity;*"
- c. The definition of supply at Article 2 of Directive 2003/54, "*supply means the sale, including resale of electricity to customers."*

84. However, these are definitions from the European legislation, not from the domestic Act. These are not reflected in the domestic legislation. It does not appear that there was intent to create standardised terminology between the Act and the Directive and thus the definitions within the Directive appear to us to be only of peripheral relevance in considering the proper construction of language in the Act.

85. In conclusion, we determine that UKPNS is supplying [REDACTED] and the other HV tenants connected directly to the Leased Network for the purposes of Schedule 2ZA of the Act.

### **Issue 3 - Operation and Control**

86. The question which then arises is whether UKPNS can be said to be operating or controlling the system in addition to supplying in the physical sense in which we have determined above that expression must be construed in Schedule 2ZA.

87. Paragraph 1(1)(b)(i) refers to "*the distribution exemption holder that operates or has control of the system*". We make the following observations on this:

- a. Operation and control are, linguistically, disjunctive conditions.
- b. If there can only be one DEH, the disjunctive nature of the condition is less significant as the test, although focusing on the two separate elements of operation and control, is a single one. The two limbs may have been designed with the *intention* of ensuring, from an abundance of caution, that the DEH is not able to evade the third party access obligation on the basis of a delegation of operational roles to (potentially a number of different) subcontractors.
- c. We note that the language of operation and control does not derive from the Directive and that as HAL submits the prime focus in the European legislation is on operation/operators (albeit that the distinction may in any event be less significant given that there has been some suggestion that operation even in the European context bears the sense of operational control). The relevant provision on third-party access is Article 32 of the Directive which provides as follows:

## **"Article 32**

### **Third-party access**

1. Member States shall ensure the implementation of a system of third party access to the transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users. Member States shall ensure that those tariffs, or the methodologies underlying their calculation, are approved prior to their entry into force in accordance with Article 37 and that those tariffs, and the methodologies - where only methodologies are approved - are published prior to their entry into force.

2. The transmission or distribution system operator may refuse access where it lacks the necessary capacity. Duly substantiated reasons must be given for such refusal, in particular having regard to Article 3, and based on objective and technically and economically justified criteria. The regulatory authorities where Member States have so provided or Member States shall ensure that those criteria are consistently applied and that the system user who has been refused access can make use of a dispute settlement procedure. The regulatory authorities shall also ensure, where appropriate and when refusal of access takes place, that the transmission or distribution system operator provides relevant information on measures that would be necessary to reinforce the network. The party requesting such information may be charged a reasonable fee reflecting the cost of providing such information."

- d. Thus, noting that the concept of operation or control is something which derives only from the domestic implementing regulations (the 2011 Regulations) in the amendments made to the Act we have also taken account of the fact that in the UK Government's EU Third Package Transposition Note on Directive 2009/72/EC Electricity the stated objective and implementation notes of Article 32 do not make any mention of control but only of operation, as follows:

#### Objective:

*"Requires Member States to ensure the implementation of a third party access system for transmission and distribution. Transmission and Distribution **operators** need to give substantiated reasons if they refuse access on the basis that the network lacks the necessary capacity."* (emphasis added)

#### Implementation:

*" ..Regulation 21 inserts Schedule 22A to the Electricity Act, which sets out the duties of **operators** of licence exempt distribution networks, including third party access requirements. Regulation 29 amends sections 44B-D of the Electricity Act in order to (among other things) widen the Authority's dispute resolution functions so that they apply to disputes arising out of complaints about **operators** of licence-exempt distribution systems ." (emphasis added)*

- e. We consider there to be force in HAL's contention at paragraph 65 of its 17 May 2013 submission that in respect of paragraph 1(1)(b)(i) of Schedule

2ZA, "Those terms must be read consistently with Article 32 of the Directive which focuses upon the 'distribution system operator'. That is the key concept which the domestic legislation is focussed upon: a single person operating a distribution system who can provide access to the system they run and who can produce a charging methodology on the basis of the costs they incur in running (operating) the system."

88. In any event, for the purpose of the present question it is not necessary to reach a definite conclusion on whether control as referenced in Schedule 2ZA is superfluous by reference to the European legislation. This is because it is clear that UKPNS both operates and controls the Leased Network:

- a. As UKPNS noted in paragraph 2 of its letter of 30 January 2012, "... UKPNS agreed to **operate**, maintain, repair and when appropriate replace the leased assets (ie the leased part of the distribution system) for a period of 90 years." (emphasis added).
- b. UKPNS argues that it is an operator but this is subject to overarching control by HAL (see UKPNS' submissions, paragraph 23(5)(f)): "UKPNS agreed under certain conditions to operate (with permission from BAA's control authority which has day to day control of the system), maintain, repair and when appropriate replace the leased assets (ie the leased part of the distribution system) for a period of 90 years". The section of UKPNS' submissions which deals with "The Issue of Operation and Control" (paragraphs 30-43), is mainly concerned with arguments about how HAL has "control" (see paragraphs 35-43).
- c. HAL says in response to this that control is not relevant in this case, noting at paragraph 67 of its 17 May 2013 submission "If a person has been identified as operating a distribution system, there is no basis on which somehow they are displaced from consideration by suggesting that someone else controls the system. Equally there would be no sense in having two persons who could be identified under paragraph 1(1)(b)(i) as responsible for the distribution systems who could potentially be the person to provide access and attendant charging methodology." While we do not go so far as to say that control is not relevant, in a case where day to day operation, including the decision making associated with that operation, clearly lies with one party, it would take a very clear case of control by another to displace the analysis that the operator is the DEH.

89. In respect of control, clause 6 of the DA, which places UKPNS under an obligation to maintain, operate, repair and replace the Leased Network, seems to compel the conclusion, as a starting point, that it controls the Leased Network. We note the other provisions which UKPNS says should be considered together with clause 6.1, but do not consider that they significantly detract from the main force of clause 6.1, which requires UKPNS to operate the distribution system. The fact that HAL retains certain rights and that UKPNS' rights under the lease are defined and in certain respects circumscribed is unsurprising.

90. We accept that UKPNS does not have absolute control of the Leased Network, but this is not a surprising conclusion when considering that the Leased Network is situated within and connected to critically important airport infrastructure. We would expect there might be similar reservations of control in the context of other examples of critical infrastructure.

91. We note that much of the debate between the parties about the effect of the DA concerns clause 11 of the DA, which makes (in one sub-paragraph) a reference to HAL having "day-to-day control". UKPNS relies heavily on this, and on its witness evidence in support. On the basis of the evidence provided this clause in particular means that UKPNS does not have absolute control over the Leased Network. However, by reference to other provisions of the DA we consider that UKPNS has the more significant control and we refer to the list of provisions of the DA pointing to UKPNS' significant control as set out in paragraph 71 above.
92. In respect of UKPNS' reliance upon other provisions of the DA, as set out at paragraph 56 above, we are not persuaded that these point to a different conclusion. In particular.
- a. In respect of clause 3.1 (connection and energisation of entry and exit points), UKPNS says that HAL retains a general right to require energisation and de-energisation on the Leased Network but that by contrast UKPNS' right to do so is prescribed by the limited permissions in clause 5. However, we see force in HAL's point that it would not need a specific right to energisation and de-energisation if UKPNS were not generally in control of the system. This is not answered by UKPNS identifying its own limited rights to require energisation/de-energisation. We see force in HAL's observation that the need to write such rights into the DA suggests that the party benefitting from the rights does not have control, as otherwise it would not need a contractual right.
  - b. UKPNS considers that its discretion in relation to how it transmits electricity across the Leased Network is fettered, and it gives the example that it is not permitted "*to accept electricity at a volume below Maximum Capacity*". However, this appears inconsistent with the wording of clause 4.1 which provides that UKPNS shall accept electricity "*up to the Maximum Import Capacity*" and shall distribute it to each Exit Point "*up to the Maximum Export Capacity*". That simply applies a maximum and does not prohibit volumes being accepted below maximum capacity.
  - c. In respect of clause 4.2 (third party access), UKPNS argues that the clause indicates that HAL controls who may give or receive supply of electricity. However control of who may give or receive supply of electricity across the system is distinct from control of the system. UKPNS is paid by HAL under the terms of the lease to perform a role which is set out in summary under clause 6.1. It is unsurprising that the Agreement curtailed UKPNS' ability to allow other third parties to use the system. The caveat, "unless required to do so by law" allows the third party access regime flowing from the Directive to be accommodated. We note the obligation of liaison with UKPNS. Even though HAL enters into contracts with the upstream distributor and the downstream customers, we do not consider that this points to HAL's control of the intermediary system. We see force in HAL's observation that it would not need to liaise with UKPNS if HAL in fact controlled and operated the distribution system itself.
  - d. In respect of clauses 5.2 and 5.5 (rights to de-energise entry and exit points), although UKPNS makes the point that it does not have a general right to de-energise the Leased Network, we consider that it nevertheless has more right to do so than HAL. Having noted the clause 5.2 right for UKPNS to require HAL to de-energise any exit point at premises occupied

by HAL and to use all reasonable endeavours to de-energise or procure the de-energisation of exit points at any other premises, clause 5.3 provides that where HAL fails to de-energise (or use reasonable endeavours to procure the de-energisation of) any exit point or entry point in accordance with clause 5.2 following a request from UKPNS to do so, then HAL shall *"indemnify and keep indemnified [UKPNS] against all claims, liabilities, losses, costs and expenses which [UKPNS] may suffer or properly incur or which may be made against UKPNS arising out of or in respect of such failure to de-energise/procure de-energisation"*.

- e. In respect of clause 8.2 (maintenance programmes), UKPNS argues that it is significant that the authority to permit works remains with HAL. We do not consider this to be a significant indicator of control in circumstances where HAL is required to agree the maintenance programme unless it would be reasonable for it not to do so taking into account, inter alia, airport safety and security implications. Similarly, we do not consider that HAL's right under clause 8.4 to require maintenance works to be rescheduled upon written notice to UKPNS (if HAL reasonably and in good faith considers that any planned activity is likely to compromise airport safety or security or cause disruption to airport operations) is an indicator that HAL has effective control, or UKPNS does not have control of the distribution system. These provisions flow from the critical nature of airport infrastructure, as noted at paragraph 90 above.
- f. In respect of clause 11.2 (authorisation of personnel), we consider that the "control staff" issue is not a strong factor either way. We note that the control staff are HAL's but we do not consider it to be insignificant that they are authorized by UKPNS (and that UKPNS retains, under clause 11.4, the power to withdraw authorisation from an individual where it has reasonable grounds to believe that the continued authorisation of that person is liable to adversely affect the safety and security of the Distribution System).
- g. In respect of clause 12 (insurance of the distribution system), we do not consider that the requirement that the interest of HAL be noted on the insurance policy taken out by UKPNS, by way of general endorsement, detracts from the significance of UKPNS being required to insure the distribution system.
- h. In respect of clauses 14.3 and 22.5 (metering data), whilst we recognise that UKPNS does not (on the present state of arrangements between the parties) operate, install or maintain metering equipment at exit points, we note that the DA provides that HAL can require UKPNS so to do and in those circumstances to use its reasonable endeavours to ensure that data from such metering equipment is made available to HAL. To the extent that UKPNS requires data to discharge the obligations imposed on the relevant DEH under schedule 2ZA, we address this in paragraph 95 below.

93. We therefore conclude that UKPNS clearly has the more significant, though not absolute, control over the Leased Network. We have not found a case to be made by UKPNS to displace the prima facie inference of UKPNS' control of the Leased Network by reference to clause 6 of the DA. We are also satisfied that it is not necessary for UKPNS to be found to have absolute control in order to satisfy the test at Schedule 2ZA. The disjunctive statement of operation and control means

that having concluded that it satisfies the test of supply and operation that is sufficient for it to be recognised as bearing the DEH obligations that flow from Schedule 2ZA.

94. Our conclusion that UKPNS operates and controls the Leased Network is supported by a number of other provisions of the DA, not least of which are the length of the lease and the requirement on UKPNS (at its own expense) to insure the Leased Network (see clauses 2 and 12 of the DA). Although not impossible, we also agree that it would be somewhat odd for UKPNS to be paid substantial sums under the DA only not to operate or control that system.

#### Workability of the Distribution Agreement

95. By reference to the parties' submissions on the workability of the DA, the strongest point in favour of UKPNS is that the consequences flowing from the fact that UKPNS being recognised as having the relevant obligations as DEH under Schedule 2ZA may allow HAL to terminate the agreement early (see clause 28 of the DA). However, we also note that, as HAL has pointed out, there is a strong obligation on both parties using its best endeavours to seek to agree any necessary amendments to accommodate a material regulatory intervention. It should therefore be possible for the DA to continue to be operated in circumstances where, as a result of this decision, UKPNS is recognised as having the obligations of the relevant DEH under Schedule 2ZA of the Act in respect of the high voltage network tenants. We consider it unlikely that there would be some problem in the operation of the DA (including the need for one party to provide certain data to the other) that is not capable of resolution by amendment upon both parties' best endeavours. We therefore do not consider that this is a sufficiently weighty consideration to overcome the clear conclusions we have otherwise reached on the questions set out above.

## **Decision**

96. On the basis of our analysis of issues two (What is the proper meaning of supply?) and three (Operation and Control) above we conclude that UKPNS is the relevant DEH in this case.

97. By reference to the question set out in paragraph 2 above we conclude that the duties imposed by Schedule 2ZA of the Act apply to UKPNS. This is in the context of requests to take a supply of electricity from third party supplier by customers of HAL that are connected to the Leased Network.

98. With regards to the arguments made we conclude that:

- a. In this case there can be only one relevant DEH for the purposes of the obligations flowing from Schedule 2ZA;
- b. UKPNS is supplying HV tenants connected directly to the Leased Network within the meaning of Schedule 2ZA of the Act; and
- c. UKPNS operates the Leased Network and has the more significant, though not absolute, control of the Leased Network.



**Andy Burgess (31/03/2014)**  
**Associate Partner, Transmission and Distribution Policy**  
**Duly authorised on behalf of the Gas and Electricity Markets Authority**