

**DETERMINATION BY THE GAS AND ELECTRICITY MARKETS AUTHORITY OF A DISPUTE REFERRED TO IT UNDER SECTION 23 OF THE ELECTRICITY ACT 1989 CONCERNING THE CHARGES FOR ELECTRICITY CONNECTIONS TO THE PREMISES**

**1 INTRODUCTION**

- 1.1 The Gas and Electricity Markets Authority (“the Authority”) has been asked by the Customer’s Agent acting on behalf of the Customer to determine a dispute between the Customer and the Company. The dispute concerns the terms of the connection agreement to provide electricity supplies to the Customer’s development (“the Premises”). The Customer engaged the Customer’s agent in order to investigate the charges in dispute.
- 1.2 The Customer received quotations from the Contractor. The quotations included charges for non-contestable works, the details of which were provided to the Contractor by the Company. This dispute relates solely to the non-contestable element of the quotations which the Contractor quoted on behalf of the Company. At the time the agreement for connection was entered into between the Contractor and the Customer, the Contractor was a subsidiary of and contractor for the Company in respect of the delivery of connections projects as well as an independent connections provider.
- 1.3 The request for a formal determination was received by Ofgem on 29 August 2007. The Authority has power to determine connection disputes under Section 23 of the Electricity Act 1989 (“the Act”). Ofgem is the office set up to assist the Authority to discharge its statutory responsibilities.

**2 BACKGROUND**

- 2.1 On 8 February 2005 the Contractor provided the Customer with a budget estimate for electricity connections to their development as “an independent third party connector”. The estimated budget cost of the works was £130,500. The Contractor stated that the budget price included contestable and non-contestable elements<sup>1</sup> but that diversionary and reinforcement costs for existing mains were excluded.

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<sup>1</sup> Non-contestable work consists of alterations or reinforcement needed on the existing network owned by the Company to accommodate the requirements of the development; this can only be carried out by the Company.

- 2.2 Following a meeting between the Customer, Contractor and the Company the Customer wrote to the Contractor on 10 November 2005 referring to the above budget estimate enclosing a full set of drawings and requested a full formal quotation with the instruction that the quotation should clearly indicate the charges associated with the 'contestable' and 'non-contestable' elements of the work.
- 2.3 On 19 May 2006 the Contractor provided the Customer with a formal quotation totalling £217,285.75 excluding VAT. The quotation included contestable costs of £51,755.63 and non-contestable diversionary works of £35,398.49 as well as £130,131.63 for the non-contestable (electrical) work. The Contractor did not provide an explanation for the increase in the cost of the non-contestable work. On 8 June 2006 the Customer's Agent queried this increase with the Company.
- 2.4 The Company replied to the Customer's Agent on 16 June 2006 stating that the increase had arisen due to "the change in Ofgem's charging rules which brought in apportionment of upstream reinforcement" referring to section 2.3 of the Methodology Statement detailing the basis of Charges for Connection to the Company's Electricity Distribution System (the "Company's Charging Methodology").
- 2.5 On 20 June 2006 the Customer's Agent requested a detailed breakdown of the non-contestable charges and received a reply from the Company on 23 June 2006 stating that the Company did not operate an "open book" policy but stated that the Company had installed a new primary substation 12 months previously to provide additional capacity to the locality and that this substation would be used to supply the Customer's Premises. The Company explained that the reinforcement apportionment charges for new loads from this substation were £187.17 per kVA, which was applicable to the 570kVA connection the Customer had applied for.
- 2.6 Subsequently on 8 September 2006 the Company wrote to the Customer's Agent apologising for understating the costs in their letter of 23 June 2006 which had not included £34.09 per kVA for 33kV reinforcement. The reinforcement apportionment charge therefore was £221.26 per kVA which was as per the Contractor's initial quotation of 19 May 2006.
- 2.7 On 17 October 2006 the Customer's Agent wrote to Ofgem (following a verbal complaint by the Customer's Agent about the reinforcement apportionment charges

or “claw back” charges) stating that they found the “claw back” charges unacceptable and that they were advising the Customer only to accept a quotation and pay on a “without prejudice” basis.

2.8 Following a request by the Customer for a revised quotation the Contractor provided a further quotation dated 14 February 2007 as “an independent third party connector” for a revised capacity requirement of 475kVA (previously 570kVA) which included a non-contestable £ per kVA reinforcement charge. The Customer accepted this quotation on a “without prejudice” basis on 22 February 2007 and made part payment of £150,604.63.

2.9 On 22 February 2007 the Customer wrote to Ofgem challenging the Company’s application of “claw back” charges and requesting a formal determination. The Customer was referred to energywatch.

2.10 During correspondence between the Company and energywatch the Company wrote to energywatch on 10 April 2007 with a breakdown of costs of the past reinforcement schemes. On this occasion, the Company withdrew the charge of £34.09/kVA (see paragraph 2.6) stating that the five year period for charging in accordance with the Company’s Charging Methodology had expired earlier in March 2007.

2.11 On 13 August 2007 the Customer’s Agent wrote to Ofgem requesting a discussion regarding the connection charges.

2.12 On 24 August 2007 the Customer wrote to energywatch requesting formal determination. Ofgem received this request on 29 August 2007.

### **3 VIEWS OF THE CUSTOMER**

3.1 The Customer’s Agent contended that the connection charge “apportionment rules” set out in the Company’s Charging Methodology came into effect on 1 April 2005 to replace the previous “25% Rule”. The Customer believes the Company are seeking to apply the new rules retrospectively including £ per kVA “claw back” reinforcement charges in order to recover costs incurred for a new primary substation planned prior to April 2005.

- 3.2 The Customer's Agent believes the reinforcement was to "provide additional capacity to the locality" (see letter dated 23 June 2006) to meet general load growth and has for some time been included in the Company's Long Term Development Statement.
- 3.3 The Customer's Agent states that following their application for formal quotation, the Company re-examined their scheme and as a result are attempting to levy a proportion of costs against the new connection quoting 1 April 2005 changes as the basis for their stance.
- 3.4 The Customer's Agent is of the view that comments in the "Connection charging apportionment rules", Ofgem, ISG discussion note, 25 April 2006 suggest there is no legal basis for charging for general load growth reinforcement.
- 3.5 The Customer's Agent advises that since the quotation of 14 February 2007 the Company have acknowledged that part of the 33kV £ per kVA charges have expired since this work was completed in March 2007.
- 3.6 The Customer's Agent states that no other distribution network operator is seeking to impose £ per kVA charges for reinforcement requirements identified before April 2005.
- 3.7 The Customer's Agent contends that only customer related reinforcement planned and constructed since April 2005 should be apportioned for a period of five years and levied for new connections.

#### **4 VIEWS OF THE COMPANY**

- 4.1 The Company contended that it understands that the Customer was initially provided with competitive (adopted) quotations for this site in February 2005 and May 2006. A further quotation was provided in February 2007.
- 4.2 The Company states that in February 2005 (i.e. between the first two quotations) they sought approval for a change to the Company's Charging Methodology statement to clarify the apportionment of costs of existing assets installed to accommodate new connections. The proposed change was to cover cases where subsequent comers made use of available "headroom" capacity within a 5 year period of its provision. Ofgem approved the proposed methodology which took effect from 1 April 2005. In December 2006 some further changes were approved by Ofgem, but these did not

affect the principle whereby a contribution to costs of newly constructed assets is required from subsequent connections.

- 4.3 The Company states that in 2003 they began construction of a primary substation in order to accommodate a number of connections and connection requests in the area concerned. The primary substation was energised at the beginning of 2006 and the reinforcement work was completed (i.e. energised) on 10 January 2006. The Company authorised expenditure of £1.404m (2006/7 prices) to create 7.5MVA of additional capacity on their network. On completion the actual expenditure by the Company was £1.433m.
- 4.4 The Company states that the 5 year period used for applying the apportionment rules runs from September 2003, to September 2008. Effectively any new connections from 1 April 2005 will contribute in proportion to the capacity required until September 2008 or until the 7.5MVA capacity charged for on a £ per kVA basis has been fully utilised.
- 4.5 The Company states that the reinforcement project was referred to in the Long Term Development Statement of the Company in November 2004 with an expected completion date of 2005. The preamble states that this relates to “...major changes resulting from the future development of the system...” That is to say, the information is not confined to projects resulting from general load growth, and further on it is made clear that due to considerations of client confidentiality, information relating to the connection of commercial developments will be excluded until a Connection Agreement has been signed. The Company also states that the project was initiated as a result of a number of connection requests.
- 4.6 The Company states that on further reviewing this case they identified that the contribution in respect of previous reinforcement in 14 February 2007 quotation was incorrect, as it included a contribution in respect of another reinforcement scheme that was required as a result of general load growth and hence fell outside the relevant criteria for charging. The Company states that they issued a revised Point of Connection offer to the Contractor for a corrected contribution in respect of new connections relating to this reinforcement during the 5 year period of £88,905 exc. VAT. (i.e.  $\text{£}1.404\text{m}/7500\text{kVA} = \text{£}187.17 \times 475 \text{ kVA} = \text{£}88,905$ ).

## **5 STATUTORY OBLIGATIONS**

- 5.1 Under section 19(1) of the Act, an electricity distributor may require any expenses *reasonably incurred in providing any electric line or electrical plant pursuant to section 16(1)* to be defrayed by the person requiring the connection to such an extent as is reasonable in all the circumstances. Under section 19(4) of the Act, such expenses include the recovery of the capitalised value of any expenses likely to be incurred in continuing to provide the electric line or electrical plant.
- 5.2 Any dispute arising under sections 16 to 21 of the Act between an electricity distributor and a person requiring a connection may be referred to the Authority under Section 23 of the Act for determination.
- 5.3 The works necessary to provide the connection fall within the statutory obligations set out above.

## **6 OTHER STATUTORY PROVISIONS AND LICENCE CONDITIONS**

- 6.1 The Act also sets out the circumstances in which a licensee can charge for a connection where the new connection (second comer) will use an electric line or electrical plant which the licensee has already installed.
- 6.2 Under section 19(2) of the Act, the licensee may require the second comer to pay the reasonable expenses already incurred in providing any electric line or electrical plant that will be used for the customer's connection, if (a) the connection is required within five years of the provision of the line or plant; **and** (b) a person ("the initial contributor") has made a payment to the licensee in respect of those expenses incurred in providing that electric line or electrical plant.
- 6.3 Section 19(3) provides that the Regulations may require an electricity distributor, having recovered any amount in respect of expenses, to exercise his rights under the Regulations in respect of those expenses and to reimburse the initial contributor and any person previously required to make payments under the regulations, as appropriate.
- 6.4 The Secretary of State has made Electricity (Connections Charges) Regulations 2002 (SI 2002/93) as amended by Electricity (Connection Charges) (Amendment) Regulations 2002 (SI 2002/3232) ("the Regulations") under the above provisions.

6.5 Regulation 5 of the Regulations provide an entitlement for an electricity distributor to require a person requiring a connection under section 16(1) at any time after the coming in to force of the Regulations to pay to the electricity distributor such an amount in respect of the relevant expenses as may be reasonable if-

(a) the connection is required within the prescribed period (5 years)

(b) an initial contributor has made a payment to the electricity distributor in respect of the relevant expenses.

(c) the electricity distributor has not recovered the relevant expenses in full; and

(d) the electricity distributor has made available to the person requesting the connection such information (if any) as may have been reasonably requested by that person for the purpose of ascertaining:-

1) the amount of relevant expenses;

2) the date of the first provision of electric line or plant; and

3) the amounts paid in respect of relevant expenses by the initial contributor or persons previously required to make a payment under the Regulations.

6.6 Regulation 6 of the Regulations further stipulate that where the relevant expenses have been wholly or mainly defrayed by the initial contributor or by that contributor and any other person previously required to make a payment in accordance with the Regulations the Company must exercise its rights under Regulation 5 .

6.7 The Regulations define the “initial contributor” as meaning a person in relation to whose premises or distribution system any electric line or electrical plant was first provided for the purpose of making a connection and who made a payment in respect of the relevant expenses.

6.8 Standard licence condition 4B of the Company’s Electricity Distribution Licence required the Company by 1 April 2005 to determine a connection charging methodology approved by the Authority. The Company is further required for the purpose of ensuring that the connection charging methodology continues to achieve the relevant objectives <sup>2</sup>to review the connections charging methodology at least

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<sup>2</sup> The relevant objectives are;

- (a) That compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it by the Act and by the Electricity Distribution Licence.
- (b) That compliance with the connection charging methodology facilitates competition in the generation and supply of electricity, and does not restrict, distort, or prevent competition of in the transmission or distribution of electricity.
- (c) That compliance with the connection charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the Licensee in its distribution business.

once in every year and make such modifications as necessary for the purpose of better achieving the relevant objectives set out in the condition.

6.9 The Authority notes that in paragraph 2.1 d) of the Company's Charging Methodology it recognises the need for compliance with The Electricity (Connection Charging) Regulations where it states that: "In certain circumstances, however, the party seeking connection will be required to make a payment in respect of assets which have been installed previously and which are used for the purpose of providing the new supply. The circumstances are laid down in detail in The Electricity (Connection Charges) Regulations 2002 and The Electricity (Connection Charges) (Amendments) Regulations which came in to force in June 2003. The method for charging will be based on the apportionment rules as detailed in section 2.3 of the methodology".

6.10 The Authority views section 2.3 of the Company's Charging Methodology which sets out the reinforcement apportionment rules and in particular paragraph 2.3.3 to lack clarity but interprets this paragraph (which clearly makes reference to "subsequent party", "second comer" and the need to refund an "initial contributor") to mean that contribution can only be required in compliance with the Regulations for previously installed assets where there has been an initial contributor.

*"In cases where reinforcement assets have been installed to allow connection of a party and due to the incremental plant sizes spare capacity has been created a proportion of this cost will be recovered through Use of System tariffs. However if a subsequent party then connects to the network using some or all of the spare capacity, a proportion of the reinforcement costs should be charged to the second comer within the prescribed period of 5 years.*

*When the company adds transformer capacity to the network, then this is treated as connection asset unless any spare capacity is used to reinforce the existing network. In such cases the work is treated as reinforcement and the apportionment rules apply. **If the assets are initially treated as connection** and within 5 years another customer is connected to assets then the initial contributor is refunded based on the apportionment rules and the second comer pays in accordance with the apportionment rules."*

6.11 The Authority requested the Company to explain how its apportionment rules set out in paragraph 2.3.3 of the Company's Charging Methodology complied with requirements of the Regulation. The Company submitted as follows: :

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(d) That as far as is consistent with a), b) and c) the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution ,

“The rules set out in paragraph 2.3.3. of [the Companies] connection charging methodology are in our view consistent with regulation 5 of the Electricity (Connection Charges) Regulations 2002.

That is to say;

- a) We apply charges where a new connection utilises spare capacity previously provided to allow the connection of a party;
- b) We apply charges only up to 5 years after the original reinforcement was carried out;
- c) We do not charge once all their costs have been recovered;
- d) We make provision for charging a second comer and refunding an initial contributor where the latter has wholly or mainly paid for capacity that is used for subsequent connections.”

## 7 DISCUSSION

7.1 Both parties have agreed in writing that their arguments are reasonably reflected in Sections 3 and 4.

7.2 A summary of quotations and payments detailed in section 2 is set out below. The amount in dispute is £104,594 (all sums rounded to nearest £).

Date	Total £	Contestable £	Non-contestable £		
			Final Connection	Reinforcement	Diversiory
Budget Quote 8 Feb 05	130,500	Included	Included	Not Inc	Not Inc
Quote 19 May 06	217,286	51,756	Included	130,132 Inc final con	35,398
Quote 14 Feb 07	225,052	114,030	4334	<b>104,594</b>	2,094
Acceptance 22 Feb 07 Phase 1 only	<b>Phase 1 only Paid</b> 150,604.63 inc VAT	41,951			

7.3 Having sought further clarification as to the facts from both parties and carefully considered the arguments reflected in Sections 3 and 4 in conjunction with the written submissions of both parties further to the Authority’s requests for clarification, the Authority considers the following two issues pertinent to this determination:

1. Whether the connection is pursuant to section 16(1) of the Act; and
2. Whether it is appropriate for the Company to recover the cost (as a connection charge) of reinforcement work already undertaken where there has not been an initial contributor.

**1. Is the connection made pursuant to section 16 of the Act?**

- 7.4 The Regulations only apply to connections requested in accordance with section 16 of the Act. The Company states that it does not believe that this dispute falls within section 16 of the Act, as it has not received a request for connection from the owner or occupier of the premises, a supplier with the consent of the owner or occupier, or from another distributor, the Customer having been provided with a quotation by their chosen Contractor. The Company accordingly expressed doubt as to the Authority's jurisdiction to determine the dispute under section 23 of the Act.
- 7.5 The Authority is of the view that the non-contestable element of a connection is by definition provided *pursuant to section 16* because it is work that only the Company, as the distribution network operator, can undertake. The Company was "making a connection" pursuant to section 16 by undertaking the non-contestable works of the connection because it is under a section 16 duty to provide a connection when requested to do so.
- 7.6 Further, the Authority considers that the Contractor was acting as an agent of the Customer when requesting a connection from the Company
- 7.7 The Authority considers it is clear that the Contractor was acting on behalf of the Customer as they jointly attended a meeting on 27 October 2005 with the Company to discuss the Customer's general connection requirements. Therefore, the Company knew from an early stage that the Contractor (which was its subsidiary) was not acting on its own account but on behalf of the Customer. Moreover, the Company was also well aware of Customer's interest in the matter from the fact that the Customer directly queried the cost of the non-contestable work on 16 June 2006 and it justified the costs directly to the Customer in June and September 2006.
- 7.8 Section 16A of the Act requires a connection request to be made by "a notice" requiring the distributor to offer terms. The notice must specify the premises, date connection is required by and the power required. In February 2007 the Customer

requested a revised quotation for connection, and subsequently the Contractor made submissions to the Company using the company connection registration and management IT system ("CRAM"). In entering details onto the CRAM system, the Contractor is required to complete the site details, indicative date of connection and a load summary. This information corresponds with what is required by section 16A (2) of the Act. Therefore, the Contractor fulfilled the Customer's notice obligations under section 16A in completing this notification, acting as agent for the Customer.

7.9 The Authority is of the view that it is clear that non-contestable works were approved by and subject of an offer by the Company not as a matter of pure contractual arrangement outside the statutory scheme entirely: rather, the legislative scheme contemplates, and the arrangements between Company and Contractor reflected, that non-contestable work will be performed subject to section 16 procedures.

**2. Is it appropriate for the company to recover the cost of reinforcement work already undertaken where there has not been an initial contributor?**

7.10 Under Section 19(1) of the Act where any electric line or electrical plant is provided by the Company in pursuance of section 16(1) the Company may require any expenses reasonably incurred in providing it to be defrayed by the Customer requiring the supply as is reasonable in all circumstances. In this instance the company has clearly stated that their increase in network capacity was carried out before the request for connection in question was made and therefore was not installed in pursuance of section 19(1) of the Act. Furthermore, there had been no initial contributor to the reinforcement expenditure, as required by section 19(2) of the Act and the Regulations. Accordingly, the increase in network capacity does not fall within either section 19(1) or 19(2) of the Act. The Authority therefore considers that the work having been carried out prior to the connection request was "reinforcement" and not work done "pursuant to providing the connection".

7.11 The Authority notes that the Act, the Regulations and the Company's Charging Methodology (paragraph 2.3.3 above) are clear that connection charges for reinforcement of the existing network only apply where the customer triggers the reinforcement of the line or where there has been an initial contributor. In this case the customer has not triggered the reinforcement nor was there an initial contributor.

- 7.12 The Authority also notes that the Company has not provided records detailing any amounts recovered in respect of relevant expenses from any persons previously required to make a payment under the Regulations or expenditure recovered through system tariffs, in order to demonstrate the Company's management of the overall recovery of the reinforcement costs.
- 7.13 The Authority notes that the Company states that the reinforcement project was not confined to projects resulting from general load growth but was initiated in part as a result of a number of connection requests. The Company has explained there was no initial contributor because prior to April 2005 the Company applied the "25% rule" in its charging methodology. Under those arrangements connection charges were not normally made for reinforcement of the existing distribution system where the new or increased load requirements did not exceed 25% of the existing effective capacity at the relevant points on the system. The connection applications that led to the reinforcement scheme being carried out did not trigger contributions under the 25% rule, so that there were no "initial contributors" in this case.
- 7.14 This explains why the Company had not required any customer to make an initial contribution however it does not provide a reason to override the provisions of the Act and Regulations with regard to charging the Customer in question.
- 7.15 The Authority notes that the non-contestable work was commenced in 2003 prior to any approach from the Customer and completed on 10 January 2006 prior to the Customer accepting the quotation on a without prejudice basis on 22 February 2007. It is therefore clear the customer did not trigger the reinforcement.

## **8 CONCLUSIONS**

- 8.1 Is the connection made pursuant to section 16 of the Act?

The Authority is of the view that the connection *is made pursuant to section 16*, and accordingly, the Authority *has jurisdiction to determine the dispute under section 23 of the Act*.

- 8.2 Is it appropriate for the company to recover past reinforcement expenditure from the Customer in this case?

The Company's case is that past reinforcement costs are recoverable *under paragraph 2.3.3 of their charging methodology*.

The Authority considers that the Act, the Regulations and the Company's Charging Methodology all allow the Company to recover previous expenditure where the previous expenditure was triggered and paid for by an "initial contributor" i.e. where that expenditure has been incurred in providing a previous connection.

The company states clearly that there was no initial contributor and as such the Authority is of the view that the Company is not entitled under the Regulations or under section 19 of the Act to charge the Customer for this reinforcement.

## **9 DETERMINATION**

9.1 The Authority has considered its jurisdiction to determine this dispute where the Customer has approached the Company via a Contractor. The Authority is of the view that this case relates to a non-contestable service subject to Section 16 procedures where the Contractor has acted as agent of the Customer. Therefore, the Authority has jurisdiction to determine under section 23 of the Act.

9.2 The Authority determines that there is no basis to recover from the Customer the cost of reinforcement work already undertaken. In this case the Customer did not trigger the reinforcement in question nor was there an initial contributor and as such the work cannot be considered to be connection related.

9.3 Having regard to the points outlined above, the Authority determines that the Company shall:

- Recalculate the non-contestable charges for connection to the Customer's Premises in accordance with this determination, and
- In accordance with the requirements of paragraph (2) of standard licence condition 4B review the Company's Charging Methodology for clarity and consistency with the Regulations and this determination.

**This document constitutes a notice stating the reasons for the Authority's decision for the purpose of Section 49A of the Act.**



**Rachel Fletcher**

**Director, Networks**

**Duly authorised on behalf of the Gas and Electricity Markets Authority**

