

**DETERMINATION BY THE GAS AND ELECTRICITY MARKETS AUTHORITY  
OF A DISPUTE REFERRED TO IT UNDER THE BETTA RUN-OFF  
ARRANGEMENTS SCHEME AND STANDARD LICENCE CONDITION 4E  
PARAGRAPH 3 OF THE DISTRIBUTION LICENCE CONCERNING THE TERMS  
OF A CONNECTION AGREEMENT.**

**1. INTRODUCTION**

1.1 The Gas and Electricity Markets Authority ("the Authority") has been asked by [REDACTED] ("the Distribution Licensee") to determine a dispute between the Distribution Licensee and [REDACTED] ("the Generator"). The dispute concerns variations to the connection agreement between the Distribution Licensee and the Generator in respect of the connection at [REDACTED] ("the Agreement") proposed by the Distribution Licensee under the Agreement, to take account of the implementation of British Electricity Trading and Transmission Arrangements ("BETTA"). These variations were proposed in conjunction with other variations proposed by the Distribution Licensee pursuant to the BETTA Run-off Arrangements Scheme<sup>1</sup> ("the Scheme").

**2. BACKGROUND**

2.1 The objective of the Scheme is the running-off<sup>2</sup> of terms of certain agreements to the extent that such agreements would otherwise prevent or in any way hinder the successful implementation of BETTA.

2.2 As required by the Scheme, on 14 January 2005 the Distribution Licensee made a proposal to the Generator to run-off certain terms ("the Run-off Proposal") of the Agreement. In addition to making this Run-off Proposal, the Distribution Licensee also proposed a number of variations under condition 22.2 of the Agreement that the Distribution Licensee considered appropriate to take account of the implementation of BETTA ("the BETTA Amendments").

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<sup>1</sup> Being the Scheme designated as such by the Secretary of State on 22 December 2004.

<sup>2</sup> The Scheme defines "Running-off" as "bringing to an end".

- 2.3 Despite correspondence between the Distribution Licensee and the Generator, the parties were unable to reach agreement on the variations to the Agreement proposed by the Distribution Licensee. On 14 February 2005, the Distribution Licensee therefore referred the terms that remained in dispute to the Authority for settlement under the Scheme and standard licence condition 4E ("SLC 4E") paragraph 3 of the distribution licence, as appropriate.
- 2.4 On 24 March 2005, the Authority issued an interim determination (to settle the dispute on an interim basis), until a final determination was made and subject to that final determination. This was to avoid confusion about the terms of the Agreement that would apply on and from the BETTA go-live date when the default arrangements under the Scheme were to take full effect, given that not all the proposals made by the Distribution Licensee fell within the scope of the Scheme.
- 2.5 The Authority now intends to make a final determination on the matters in dispute. The Authority notes that the matters in dispute relate to the BETTA Amendments, and not to the Run-off Proposal made by the Distribution Licensee pursuant to the Scheme. The Authority will therefore determine on the matters in dispute in accordance with the provisions of SLC 4E of the distribution licence pursuant to section 7(3)(c) of the Electricity Act 1989 ("the Act"), and not in accordance with the determination provisions under the Scheme.
- 2.6 This document sets out the views of the parties on the matters in dispute and contains the Authority's final determination, under SLC 4E paragraph 3.

### **3. VIEWS OF THE GENERATOR**

#### **Indemnity**

- 3.1 The Generator has stated that the Agreement did not previously have an indemnity condition, but the Distribution Licensee is seeking to introduce one (as condition 15.9 of the Agreement). The Generator advised that the Distribution Licensee has explained to the Generator that the Distribution Licensee has a potential liability under the Connection and Use of System Code ("CUSC") to other CUSC parties for the consequences of the Generator's actions. The Distribution Licensee therefore feels entitled to be indemnified for any such

liability. The Generator does not accept the validity of this argument. The Generator has stated it is of the view that the Distribution Licensee has adequate protection and remedies elsewhere in the Agreement without seeking the additional benefit that an indemnity confers.

### **Agreements with the GB system operator**

- 3.2 The Generator has stated that the Distribution Licensee has introduced provisions which require the Generator to have entered into certain agreements with National Grid Electricity Transmission plc ("the GB system operator") in order for the connection to be energised. The Generator recognises that it is reasonable for it to be obliged to enter into agreements with the GB system operator where these have effectively been specified by Ofgem via the Grid Code or the CUSC. However, the Generator had a number of concerns about the Distribution Licensee's proposed wording for conditions 3.3 and 4.2.6 of the Agreement:
- 3.3 Paragraphs 6.5.1 and 6.5.2 of the CUSC lay down the preconditions for energising the connection to an Embedded Exemptable Large Power Station ("EELPS"), not for establishing the connection in the first place. The Generator considers that the Distribution Licensee's proposed condition 3.3 of the Agreement is therefore inappropriate, whereas there is justification for condition 4.2.6.
- 3.4 Paragraph 6.5.1(b) of the CUSC places an obligation on the Distribution Licensee not to energise the Generator's connection (the Generator being an EELPS) until (i) the Generator has entered into a CUSC Accession Agreement (as defined in the CUSC), and (ii) the GB system operator has confirmed to the Distribution Licensee that any transmission reinforcement works have been completed. The Generator believes that this second requirement refers only to new plant or connections and will not therefore be relevant to the Generator. The wording proposed by the Distribution Licensee makes energising the Generator's connection dependent not only on whether the Generator has entered into a CUSC Accession Agreement, but also on whether the GB system operator has correctly communicated the relevant facts to the Distribution Licensee. The Generator believes that it is not equitable for it to be placed in

this position. The Generator considers it should be entitled, if necessary, to provide evidence directly to the Distribution Licensee that it has entered into a CUSC Accession Agreement. Further, the Generator has stated that its experience with the GB system operator over recent months gives it little confidence that it could rely on the GB system operator to communicate accurately or timeously on such matters.

- 3.5 The proposed wording for condition 4.2.6 of the Agreement makes reference to the requirements of 6.5.1 of the CUSC which include the requirement for the Generator (being an EELPS) to have entered into a CUSC Accession Agreement. The proposed condition 4.2.7 (and 3.4) is therefore superfluous.

#### **Variations to the Agreement**

- 3.6 The original Agreement contained a condition 22 which provided a mechanism for variations to the Agreement and for the matter to be referred to Ofgem in the event that the parties themselves could not agree on the wording of any such variation.
- 3.7 The Distribution Licensee has proposed an additional condition 22.3 which would give the Distribution Licensee the authority to make any amendments to the Agreement which the Distribution Licensee, in its sole opinion, considered were required as a result of BETTA. There would be no recourse to Ofgem should the Generator disagree with the proposed change.
- 3.8 The Generator considers that as it is now beyond the introduction of BETTA, the likelihood of further amendments to the Agreement being required as a result of BETTA must be greatly diminished. The Generator believes that the existing condition 22.1 of the Agreement provides sufficient protection to the Distribution Licensee against any remaining uncertainty on this matter. However the Generator also believes, and has stated in correspondence with the Distribution Licensee, that there may be some justification for a minor adjustment to the wording of condition 22.1 or for the insertion of a condition stating that the Generator will not unreasonably withhold consent regarding the introduction of modifications to the Agreement that subsequently enable the Distribution Licensee to comply with its statutory legal requirements to implement BETTA.

- 3.9 The Generator believes that the Generator's proposals in respect of the Agreement, which it has outlined in correspondence with the Distribution Licensee, are fair and equitable.

#### **4. VIEWS OF THE DISTRIBUTION LICENSEE**

- 4.1 The Distribution Licensee has provided information to Ofgem on the Run-off Proposal and the BETTA Amendments proposed to the Agreement. This section sets out the Distribution Licensee's views on those matters in dispute only.

##### **Indemnity**

- 4.2 The Distribution Licensee remains of the view that proposed condition 15.9 (which requires each party to indemnify the other against loss or liability incurred under the CUSC or any Bilateral Connection Agreement (as defined in the CUSC) to the extent that such loss or liability arises out of a breach of the Agreement) is required.
- 4.3 The Distribution Licensee considers that the further amended wording for condition 15.9, proposed by the Distribution Licensee in a letter to the Generator of 8 April 2005, accurately reflects the liabilities that may arise out of the contractual arrangements under BETTA. The Distribution Licensee has, as a result of BETTA, been obliged to accede to the CUSC and enter into a Bilateral Connection Agreement with the GB system operator. The Distribution Licensee noted that the Generator may also have been obliged to accede to the CUSC and enter into a Bilateral Connection Agreement with the GB system operator. The Distribution Licensee considers that either party may therefore, by breaching the terms of the Agreement, cause the other party to breach the CUSC.
- 4.4 The Distribution Licensee considers that although this indemnity is uncapped within the Agreement, the CUSC and any Bilateral Connection Agreement are capped under the terms of the CUSC and this condition contains the requirement for the injured party to mitigate their loss or liability. Further, embedded generators in Scotland are more likely to be exporting electricity to the transmission system than embedded generators in England and Wales. Without this condition neither the Generator nor the Distribution Licensee could recover damages from the other for a loss or liability incurred under the CUSC or any Bilateral Connection Agreement, caused by the other's breach of the Agreement.

- 4.5 The Distribution Licensee is of the view that if this condition is not allowed by the Authority it may place extra cost on the Distribution Licensee. As no allowance has been made within the current price control for this additional cost, the Distribution Licensee would require to be able to pass this cost directly onto customers under the price control.

#### **Agreements with the GB system operator**

- 4.6 Following the Distribution Licensee's proposed changes of 14 January 2005 and subsequent correspondence between the Distribution Licensee and the Generator, the Distribution Licensee has proposed in its submission of facts to Ofgem on the matters referred for the Authority's determination that condition 3.3 of the Agreement is deleted as the obligation condition 3.3 was designed to back-off in relation to the energisation of a connection and not the provision of the connection itself.

- 4.7 Also following the Distribution Licensee's proposed changes of 14 January 2005 in respect of the addition of condition 4.2.6 to the Agreement, the Distribution Licensee wrote to the Generator on 8 April 2005 proposing further amendments to condition 4.2.6 and an additional condition 4.2.7. The Distribution Licensee has stated that these further changes to the amendments proposed on 14 January 2005 are to take account of comments that the Distribution Licensee has received from various affected parties concerning the drafting of condition 4.2.6. This condition was originally drafted widely as at the time of issuing the Distribution Licensee's proposal there was uncertainty surrounding the scope of the Distribution Licensee's obligations to ensure that generators had entered into all appropriate agreements with the GB system operator. The Distribution Licensee believes that the situation has now been clarified and that revised wording takes account of the concerns of affected parties whilst ensuring that the Distribution Licensee complies with its obligations under the CUSC.

#### **Variations to the Agreement**

- 4.8 At the time of issuing its proposal to amend the Agreement in January 2005, the Distribution Licensee was not in receipt of its Bilateral Connection Agreement from the GB system operator in respect of this connection. The Distribution Licensee has advised that it was, however,

aware that further amendments may be required and accordingly inserted condition 22.3.

- 4.9 However, to take account of requests from a number of affected parties to be more specific in respect of this condition, the Distribution Licensee proposed further amendments to condition 22.3 to the Generator on 8 April 2005. The Distribution Licensee has advised that this condition (as originally proposed or as amended on 8 April 2005) has been accepted by the majority of affected parties.
- 4.10 Having had the opportunity to confirm the amendments required to reflect any terms included within the Distribution Licensee's Bilateral Connection Agreement with the GB system operator and any terms of the CUSC or BSC that are relevant to the Generator, the Distribution Licensee has stated that it is now in a position to be more specific regarding the amendments required. The Distribution Licensee provided as part of its submission to Ofgem a list of further amendments that it considers are required to the Agreement for BETTA, and suggested the Authority may wish to consider determining directly on these amendments.

## **5. STATUTORY OBLIGATIONS**

- 5.1 Pursuant to standard licence condition 4B (Requirement to offer terms for Use of System and Connection) ("SLC 4B") of the licence granted to the Distribution Licensee, the Distribution Licensee is required to offer to enter into agreements to connect to or use its distribution system on application made by any person.
- 5.2 If either party to an agreement entered into pursuant to SLC 4B proposes to vary the contractual terms of such an agreement in any manner provided for under such agreement, pursuant to SLC 4E the Authority may at the request of that party settle any dispute relating to such variation in such manner as appears to the Authority to be reasonable.
- 5.3 The Distribution Licensee has applied to the Authority to settle the terms in dispute of the Agreement under SLC 4E, paragraph 3. The terms in dispute may be referred to the Authority to be settled pursuant to section 7(3)(c) of the Act.

## **6. DISCUSSIONS AND CONCLUSIONS**

- 6.1 Both parties have agreed in writing that their arguments are reasonably reflected in sections 3 and 4.

### **Indemnity**

- 6.2 The Authority notes that the Generator does not accept the validity of the Distribution Licensee's argument that the Distribution Licensee is required to introduce an indemnity condition in order that the Distribution Licensee is indemnified against potential liabilities under the CUSC as a consequence of the Generator's actions.
- 6.3 The Authority notes that the Distribution Licensee considers the proposed indemnity condition is required, and that the Distribution Licensee considers that the amended wording proposed by the Distribution Licensee to the Generator on 8 April 2005 accurately reflects the liabilities that may arise out of the contractual arrangements under BETTA.
- 6.4 The Authority notes that as a result of BETTA the Distribution Licensee has been obliged to accede to the CUSC and, as a result of this potentially, faces liabilities under the CUSC (or Bilateral Agreements (as defined in CUSC) entered into pursuant to CUSC) as a result of the Generator breaching the Agreement, that it did not face prior to the implementation of BETTA. The Generator, as an EELPS, is also required to accede to the CUSC, and therefore may also potentially face liabilities that it did not face prior to the implementation of BETTA.
- 6.5 The Authority considers that it is reasonable that the Agreement should reflect the potential for either party to incur liability under the CUSC (as a result of the other party breaching the Agreement), and to provide for that party to pass this liability onto to the defaulting party under the Agreement. The liability (which is limited by the provisions of 6.12 of the CUSC) would be triggered only when the Agreement was breached, and the circumstances in which liability would arise are set out in the CUSC.
- 6.6 However, the Authority also notes that there are circumstances where the CUSC limitation of liability provisions do not apply, ie where either party has provided an indemnity under a Bilateral Agreement entered into pursuant to CUSC.
- 6.7 The Authority considers that liabilities arising pursuant to an indemnity contained in a Bilateral Agreement entered into pursuant to the CUSC, which in

these circumstances may not be limited to £5million, should be reflected in the Agreement only where the party that is not party to the Bilateral Agreement in question is made aware of the circumstances in which the increased liability may arise. To the extent that either party considers that the liability it may incur pursuant to such an indemnity requires to be reflected in the Agreement, then the Authority would expect that that party would provide adequate information to the other party with regard to the circumstances in which liability is likely to arise and the level of such liability. In these circumstances the parties can negotiate the appropriateness of the terms reflecting such liability (or indemnity) in the Agreement and refer any dispute over those terms to the Authority to be determined in accordance with the Agreement.

6.8 However, the Authority notes that in this case the Distribution Licensee has not specified if there are circumstances in its Bilateral Agreement with the GB system operator under which it may incur liability and for which it is asking the Generator to provide an indemnity. The Authority considers it is unreasonable to require the Generator to provide an indemnity in relation to a Bilateral Agreement where the Generator (and the Authority) is not aware of the provisions of the Bilateral Agreement between the Distribution Licensee and the GB system operator.

6.9 The Authority therefore considers that it is appropriate that the Agreement reflects the liabilities that may be incurred under the CUSC (where the provisions of CUSC 6.12 have not been excluded) by either party as a result of a breach of the Agreement by the other party. In introducing an indemnity provision into the Agreement, the Distribution Licensee should have regard to the principles set out in paragraphs 6.4 to 6.8 above.

#### **Agreements with the GB system operator**

6.10 The Authority notes that the Generator considers that proposed condition 3.3 is inappropriate. The Authority also notes that the Distribution Licensee has advised that proposed condition 3.3 is deleted as the obligation it was designed to back-off is in relation to the energisation of a connection and not the provision of the connection. The Authority therefore considers this matter is resolved as the Distribution Licensee agrees with the Generator that the proposed condition is not required.

- 6.11 The Authority notes that the Generator considers that there is justification for the inclusion of proposed condition 4.2.6 but considers that the CUSC requirement in respect of completion of reinforcement works does not apply to the Generator and considers that the Generator should be entitled to provide evidence to the Distribution Licensee that it has entered a CUSC Accession Agreement. The Generator also considers that condition 4.2.7 is superfluous.
- 6.12 The Authority notes that the Distribution Licensee has advised that the intention of proposed conditions 4.2.6 and 4.2.7 is to enable the Distribution Licensee to ensure it can comply with its obligations under the CUSC such that it is not in breach of its obligations under paragraph 6.5 of the CUSC.
- 6.13 The Authority understands that the intention behind proposed conditions 4.2.6 and 4.2.7 is to enable the Distribution Licensee to comply with its obligations under the CUSC. Under the CUSC, amongst other things, the Distribution Licensee:
- cannot energise a connection for any power station (except EELPS) or permit use of its distribution system until the person owning or operating the plant in question has entered into a Bilateral Agreement in the appropriate form (if any) with the GB system operator;
  - cannot energise an EELPS until the EELPS has acceded to the CUSC and until the GB system operator has confirmed that any necessary transmission reinforcement works associated with the EELPS are completed; and
  - is required to use best endeavours to procure that EELPS with whom the Distribution Licensee has an agreement accede to the CUSC.
- 6.14 The CUSC also provides that the GB system operator shall notify the Distribution Licensee in writing as soon as these conditions are satisfied in a particular case.
- 6.15 The Authority considers that it is reasonable that provision is included in the Agreement to enable the Distribution Licensee to reflect in the Agreement its obligations under the CUSC in respect of this connection.

- 6.16 The Authority notes that the Generator considers that certain aspects of paragraph 6.5 of the CUSC are not relevant to it. The Authority notes that proposed condition 4.2.6 states that the notification under 6.5.3 of the CUSC is required by the Distribution Licensee under the Agreement only "where applicable" and that this will apply to the extent that any of the provisions on 6.5 do not need to be fulfilled by the Distribution Licensee in respect of the Generator.
- 6.17 The Authority also notes that the Generator considers that proposed condition 4.2.7 of the Agreement is superfluous. The Authority notes that whilst proposed condition 4.2.6 refers to the entirety of the Distribution Licensee's obligations under 6.5.1 and 6.5.2 in relation to the Applicant, proposed condition 4.2.7 refers specifically to the obligation on the Distribution Licensee under CUSC 6.5.1 (c) to use "reasonable endeavours" to procure that an EELPS with whom the Distribution Licensee has contracted has acceded to the CUSC. The Authority notes that this CUSC obligation requires the Distribution Licensee to take specific action. The Authority therefore considers that it is reasonable that the Distribution Licensee should be able to reflect in the Agreement its obligation under the CUSC to procure that an EELPS connected to its distribution system has acceded to the CUSC.
- 6.18 The Authority considers that it is appropriate that proposed conditions 4.2.6 and 4.2.7 are included in the Agreement.

#### **Variations to the Agreement**

- 6.19 The Authority notes that the Distribution Licensee considers that condition 22.3 is required in order that it can make changes required for BETTA that it had not had the opportunity to identify at the date at which it was required to issue its Run-off Proposal to the Generator. The Authority also notes that the Distribution Licensee provided to the Authority an indication of those changes the Distribution Licensee anticipated making under proposed condition 22.3.
- 6.20 The Authority notes that the Agreement currently provides for either party to the Agreement to propose a variation, and where the parties cannot reach agreement on the proposed variation, the dispute may be referred to the Authority for determination.

- 6.21 The Authority considers that changes that the Distribution Licensee considers are required to the Agreement can be proposed under this existing provision. To the extent that the parties fail to reach agreement any dispute can be referred to the Authority for determination. In reaching its decision in respect of any dispute, the Authority would have regard to, amongst other things, the statutory and licence obligations of the Distribution Licensee, including those obligations arising as a result of BETTA. The Authority is therefore of the view that the proposed condition 22.3 is not required and in the absence of this proposed condition the parties may still propose variations to the Agreement.
- 6.22 The Authority does not intend to determine on the additional changes that the Distribution Licensee has indicated it considers are required and that it would make under condition 22.3, as the Authority does not consider such changes to be in dispute at this time. The Authority notes that the Distribution Licensee may propose these changes to the Agreement under the existing variation provisions within the Agreement and that should the parties fail to reach agreement on the proposed changes, the dispute can be referred to the Authority for determination.

## **7. DETERMINATION**

- 7.1 Having regard to the points raised above, the Authority accordingly determines that:
- it is reasonable that the Agreement should reflect the potential for either party to incur liability under the CUSC (to the extent that the liability arising under the CUSC is subject to the CUSC limitation of liability provisions set out in paragraph 6.12 of the CUSC), arising as a result of a breach of the Agreement by the other party, and to provide for this liability to be passed to the defaulting party under the Agreement (where the liability under the CUSC has arisen as a result of the actions of the other party breaching the Agreement)
  - however, in including a condition reflecting the liability of either party under the CUSC that would arise as a result of a breach of the Agreement resulting from the actions of the other party, such a provision should refer to the circumstances (as set out in the CUSC) in which such a liability would arise and these circumstances should

be limited solely to the circumstances in which either party faces such liability (triggered as a result of breach of the Agreement by the other party). The Authority considers it is unreasonable to require the Generator to provide an indemnity in relation to a Bilateral Agreement where the Generator (and the Authority) is not aware of the provisions of the Bilateral Agreement between the Distribution Licensee and the GB system operator

- it is reasonable that proposed conditions 4.2.6 and 4.2.7 are included in the Agreement, and
- proposed condition 22.3 is not appropriate and should not be included in the Agreement.

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



**Martin Crouch (31/03/2006)**

**Director, Distribution**

Duly authorised on behalf of the Gas and Electricity Markets Authority