

Standard Terms of Connection

From Roger Barnard at EDF Energy

1. Introduction

The purpose of this paper is to provide Ofgem and Consolidation Group members with further information on certain aspects of the so-called signposting approach to the problem of establishing an appropriate legal nexus between distributors and consumers in respect of established connections to distribution networks.

In previous discussions, Consolidation Group members from both distribution and supply have indicated a strong industry consensus, in principle, for the adoption of such an approach, provided that it can be shown to be legally robust.

By way of reminder, the signposting approach would require to be given effect in accordance with the following key elements:

- the supplier would be under an obligation to act as the distributor's agent for the purpose of procuring the relevant contract with the consumer;
- the contract thus procured would be on the distributor's standard terms of connection in respect of established connections;
- those standard terms would be (i) common across all distribution service areas, (ii) expressly approved by the Authority, and (iii) unable to be varied except with its prior consent; and
- the terms would be incorporated, by reference only (the 'signpost'), via the supplier's contract with the consumer.

The remainder of this paper summarises the background to the proposed new approach and analyses its main legal features.

2. Understanding the background

The background to the proposed solution can be set out as follows:

- The old PES distribution businesses traditionally had a legal nexus with the consumers connected to their system through the ongoing mechanism of the statutory tariff supply relationship between the consumer and the PES supply business.
- During the preparations for the opening of the competitive supply market in 1998, the distributors' desire to maintain this legal relationship, with regard to the vast majority of end consumers, was driven mainly (if not exclusively) by the desire to limit their liability for loss and damage, since they would otherwise be exposed to unlimited liability resulting from the duties they owe in respect of established connections.

- Generally speaking, such loss and damage can arise in one of two ways: through some electrical calamity (say, a voltage surge, or a dangerous connection), or because the flow of electricity through the wires (etc) is interrupted (leading, say, to loss of computer data).
- The distributors will always want some of their larger customers to have special connection agreements, and these will always need to be separately negotiated. Many of them will arise on the making of a new connection. But for those who refuse special agreements, or who are never likely to need them, and in any event for all consumers being supplied through established connections, distributors will nonetheless need to be able to rely on a limitation of liability protection.
- The statutory tariffs offered that protection. However, a major erosion of the concept of tariff supply began in 1998. Ofgem agreed to a short term resolution of this problem by accepting the idea of a formal standard connection agreement (the SCA). At the opening of the competitive market, therefore, all second tier suppliers were required, by (i) a licence obligation and (ii) a mandatory term in their use of system agreement, to procure an SCA with each contract supply customer on behalf of the PES distribution business. The contents of the SCA were approved by Ofgem and could not be changed without Ofgem's consent.
- When PES supply and PES distribution were finally separated pursuant to the Utilities Act 2000, Ofgem removed all references to the SCA from the new standard supply licence conditions. By that time, there were, of course, a large number of extant SCAs in place. For that reason, and also because of the continuing need of the distributors for a limitation of their liability, Ofgem agreed that the former tariff customer schemes (FTCSs), which the PESs were obliged to prepare and implement under Schedule 7 to the Utilities Act, should include provision for licensed distributors to enjoy such protection.
- The FTCSs required Ofgem's statutory approval, and came into force on 1 October 2001. They had the effect of transferring roughly 20 million electricity customers, overnight, from tariff-based supply arrangements to contractual supply arrangements. The approach adopted in the deemed supply contracts created by the FTCSs enabled distributors to enforce the limitation of their liability in respect of established connections through reliance on the provisions of the Contracts (Rights of Third Parties) Act 1999 – a piece of legislation providing rights which had not been available when the SCA was formulated.
- While this approach was different from the SCA approach, the drafting of the relevant contractual terms under the FTCSs and the actual scope of the limitations established by them were the same as the corresponding provisions of the old SCA – only the legal route to their application and enforcement had changed. Those terms (and the drafting thereof) are replicated now within Schedule 2 (attached for ease of reference) of the consolidated DUOSA currently before the Consolidation Group.

3. Elements of continuity

The purpose of the above detour through recent industry history is to expose some important elements of continuity which would remain unchanged under the proposed new approach.

First, the need to enable distributors to protect their position on liability with regard to established connections has been recognised and accepted by the industry and Ofgem since well before the launch of the competitive supply market some seven years ago.

An ideal solution, which was talked about a little at the time of the Utilities Act but not pursued, would have been the creation of a power to set a limitation in a statutory instrument made under the Electricity Act (the supply regulations under section 29 being the most obvious example). Without a statutory solution of that kind, however, it remains necessary to protect distributors' position through ongoing contractual provision.

Second, in the absence of any better solution, Ofgem has consistently accepted (i) that it is appropriate for such provision to be put in place through the vehicle of the customer supply contracts, with the supplier acting as the agent of the distributor for that purpose; (ii) that the terms of the contractual nexus thus established should be standard terms common to all distributors; and (iii) that those terms should be explicitly endorsed by the Authority and be incapable of amendment without its prior consent.

Third, the nature and the scope (particularly in relation to economic loss) of the limitation provisions and the extent of financial exposure embedded therein – all with Ofgem's express approval – have remained unchanged for the whole of the period in question and are not, at this time, proposed to be varied in any way at all under the new approach.

4. A genuinely new feature

It can be seen from the above analysis that the only proposed new element in the signposting approach would be the legal incorporation of standard terms, as between the distributor and the end consumer, by reference – and by reference only – in the customer supply contract.

For the avoidance of doubt, this would not preclude the industry, if a signpost approach is to be adopted as part of the implementation of DCUSA, from considering during that process whether any additional standard terms would be appropriate or necessary going forward – for example, to ease some of the difficult network management and control problems that will accompany any substantial growth of domestic micro-generation.

With that caveat, however, it is worth emphasising that the only innovating feature of the proposed new approach is its creation of a different and 'cleaner' legal mechanism for fixing the contractual nexus, so that suppliers would no longer be required to replicate the full extent of distributors' standard terms within their customer supply contracts.

5. Analysis of legal issues

Against the background outlined above, the principal legal features of the new approach can now be analysed as follows.

Supplier agency: The legal principles currently embedded in Clause 3 of the DUOSA would remain unchanged. The agency will be the strictly limited role of procuring the contractual incorporation of the distributor's standard terms of connection. If the supplier does not procure the incorporation of the terms, the distributor can sue for breach of warranty under Clause 3 and recover any damages flowing from the breach.

Incorporation by reference: The distributor will be relying on the terms of the supplier's customer supply contract to bring the standard terms into contractual force as between itself and the consumer. Therefore, the relevant mandatory provision for inclusion in the supply contract, arising from the agency obligation on the supplier, should be emboldened and boxed, to catch the attention of the customer. Appropriate standard wording would be to the following effect:

This contract is subject to the National Terms of Connection (NTC). They govern the connection at which your local network operator delivers the electricity supply to your premises, and will apply to you from the time that you enter into this contract. You can obtain a copy of the NTC from the Energy Networks Association at 18 Stanhope Place, London W2 2HH, or on [website].

This will be sufficient to secure the incorporation of the terms by reference, since reasonable notice along with an opportunity to see and study the terms has been provided. It will be irrelevant that most end customers may not bother to avail themselves of that opportunity. In accordance with the law on incorporation by reference, provided that the existence of the terms is expressly brought to the attention of the party to be bound by them and a sufficient opportunity to see them is provided, the terms will be effective.

To summarise, while this proposed new approach does not automatically provide the standard connection terms to the customer, the existence of those terms and their legal effect have been drawn to the customer's attention, and the terms themselves are directly accessible (or available on request). Hence, by entering into the supply contract with the supplier, the customer becomes contractually bound, in relation to the distributor, by the standard terms of connection and the distributor/customer nexus is thus established.

Other legal issues: As with the standard connection terms that have applied since the opening of the competitive market, it will be necessary to ensure that the contents of the NTC are, and remain, robust for all relevant purposes of the general consumer protection legislation covering business relationships with consumers on standard contractual terms. The two critical enactments in this respect are the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations 1994 (UTCCR).

Taking these enactments in turn:

(i) Section 3 of UCTA is particularly relevant because it regulates attempts to limit or otherwise restrict liability arising in contract. In particular, any such contract term ‘must satisfy the requirement of reasonableness’. There is no good reason to believe that the distributor’s limitation of their liability under the current standard connection terms (the substance of which is not proposed to change under the NTC) does not satisfy that requirement, having regard to all the circumstances of the case.

However, the question of the compliance of the standard terms with UCTA is put beyond any doubt at all by section 29 of the Act. This provides that a contract term is automatically to be regarded as satisfying the requirement of reasonableness ‘if it is incorporated or approved by, or incorporated pursuant to a decision or a ruling of, a competent authority acting in the exercise of any statutory jurisdiction or function’. A ‘competent authority’ is defined as ‘any court, arbitrator, government department, or public authority’. Though there is no further definition of ‘public authority’ here, it is clear that Ofgem falls easily within the definition of ‘competent authority’.

Accordingly, Ofgem’s approval of distributors’ standard terms of connection has the consequence that the limitation of their liability under those terms is to be taken as automatically satisfying the requirement of reasonableness, in any event, for the purposes of UCTA.

(ii) UTCCR gives effect in the UK to EC Council Directive 93/13. By way of summary, these regulations outlaw, among other things, contract terms which have not been individually negotiated (such as the distributors’ standard terms of connection) and which, contrary to the requirement of good faith, create a significant imbalance between the parties’ rights and obligations under the contract. In effect, therefore, the regulations impose a requirement of fairness on standard contractual terms. (They also require such terms to be expressed in plain and intelligible language.) As such, UTCCR clearly has a potential impact, at least in principle, on the standard terms of connection.

In direct consistency with UCTA, however, Schedule 1 of UTCCR states that the regulations ‘do not apply to any term that is incorporated in order to comply with, or which reflects, statutory or regulatory provisions of the UK’. This schedule reflects the EC Directive, which states that statutory or regulatory provisions of a member state which ‘directly or indirectly’ determine the terms of consumer contracts are, as a matter of policy and principle, ‘presumed not to contain unfair terms’. It is also in line with the DTI’s official guidance on UTCCR, which states that the specific exclusion created by Schedule 1 ‘should be given a wide interpretation to encompass practices permitted by specific industry regulators’ and that ‘those who regulate such matters are best placed to consider the fairness of particular terms in the round’.

Historically, currently, and prospectively, every detail of distributors’ standard connection terms has been (or will have been) approved by Ofgem. So, here again, it is (and always has been, and will continue to be) strongly arguable that UTCCR does not apply to contracts formed on the terms, since the terms comply with and/or reflect regulatory provisions within the UK electricity industry and, as such, fall within the Schedule 1 exemption.

The position in relation to the 1994 regulations would, however, be enhanced further if the distribution licence were to recognise expressly that it is a required purpose of the DCUSA to make provision for the collective promulgation of standard contractual terms of connection, approved by the Authority and variable only with its consent, as between the licensee and persons supplied by the users of the licensee's system. This would minimise, to the point of disappearance, any possible risk of exposure for distributors under UTCCR if the signposting solution is to be adopted going forward.

EDF Energy's recent revision of Ofgem's draft proposed text for new standard condition 9B, submitted to Ofgem on 1 December, contains appropriate licence drafting in this respect (see paragraph 5(e)(iii) thereof).

5. Conclusions

It would be sensible during the transition from the DUOSA arrangements to the implementation of DCUSA arrangements to aim to introduce a more optimal solution, from the viewpoint of all industry parties, to distributors' enduring need to be able to limit their liability on the basis of contracts formed with end consumers on standard terms in respect of established connections.

As noted earlier, there appears to be a strong industry consensus in favour of a signpost approach designed to secure the incorporation of a single standard set of connection terms on a country-wide basis, at minimal inconvenience to suppliers and with least possible disturbance to the form and content of their customer supply contracts. The proposed approach maintains key elements of continuity with current and past solutions, and on that basis Ofgem would be expected to provide to the fullest extent necessary the regulatory support required to put in place the new solution on the strongest possible basis.

In line with its agenda item 3 objective, the Consolidation Group is invited to adopt this paper as an appropriate current expression of the consensus of the industry relating to standard terms of connection.

RB/MVB 09.12.05

Attachment SCHEDULE 2 Mandatory Terms For Contracts

By virtue of Clause 3.1 of this Agreement, the terms set out below (or other terms having the same effect as such terms) (**the mandatory terms**) are required to be presented by the User within any Supply Contract or Power Purchase Contract in the same manner and with the same prominence as the other terms of that Contract.

- (A) Part A below sets out the mandatory terms for every Contract in respect of premises at which the supply of electricity is taken wholly or mainly for domestic purposes.
- (B) Part B below sets out the mandatory terms for every Contract in respect of premises at which the supply of electricity is taken wholly or mainly for business purposes, these being purposes other than domestic purposes.

PART A: DOMESTIC PURPOSES

0. Electricity Connection Provisions

- 0.1 This paragraph 0 applies in respect of each connection of your premises to the distribution system owned or operated by your local electricity network operator.
- 0.2 Your local electricity network operator will maintain, and may interrupt, and is entitled to cut off, each such connection in accordance with and subject to the provisions of the Electricity Act 1989 and any other legal requirements or rights (including those arising under any code or agreement with which your local electricity network operator is obliged by its distribution licence to comply) that may from time to time apply.
- 0.3 Subject to any contrary written agreement that you may have with it, your local electricity network operator is not liable to you under this contract or otherwise for any loss or damage which:
 - (a) is beyond its reasonable control; or
 - (b) is consequential or indirect, or arises from or amounts to economic loss,and this paragraph applies regardless of the termination of this contract.
- 0.4 Your local electricity network operator is entitled to enforce the provisions of this paragraph 0 by virtue of the Contracts (Rights of Third Parties) Act 1999 (or, in Scotland, by virtue of the common law of Scotland insofar as it recognises and confers rights equivalent to those codified by that Act for England and Wales) and such provisions may not be varied without its express consent.
- 0.5 In this paragraph 0:

economic loss means loss of profits, revenues, interest, business, goodwill, or commercial, market, or economic opportunity, whether direct or indirect and whether or not foreseeable; and

local electricity network operator means the distribution licence holder who owns or operates the electricity distribution system through which electricity is conveyed to your premises.

PART B: BUSINESS PURPOSES

0. Electricity Connection Provisions

- 0.1 This paragraph 0 applies in respect of each connection of your premises to the distribution system owned or operated by your local electricity network operator.
- 0.2 Your local electricity network operator will maintain, and may interrupt, and is entitled to cut off, each such connection in accordance with and subject to the provisions of the Electricity Act 1989 and any other legal requirements or rights (including those arising under any code or agreement with which your local electricity network operator is obliged by its distribution licence to comply) that may from time to time apply.
- 0.3 Subject to any contrary written agreement that you may have with it, your local electricity network operator is not liable to you under this contract or otherwise for any loss or damage which:
- (a) is beyond its reasonable control; or
 - (b) is consequential or indirect, or arises from or amounts to economic loss.
- 0.4 Your local electricity network operator is only liable to you for loss or damage in accordance with the limitations in paragraph 0.3 and up to a maximum of £100,000 in respect of all claims arising in any calendar year.
- 0.5 Paragraphs 0.3 and 0.4 apply regardless of the termination of this contract.
- 0.6 Your local electricity network operator is entitled to enforce the provisions of this paragraph 0 by virtue of the Contracts (Rights of Third Parties) Act 1999 (or, in Scotland, by virtue of the common law of Scotland insofar as it recognises and confers rights equivalent to those codified by that Act for England and Wales) and such provisions may not be varied without its express consent.
- 0.7 In this paragraph 0:

economic loss means loss of profits, revenues, interest, business, goodwill, or commercial, market, or economic opportunity, whether direct or indirect and whether or not foreseeable; and

local electricity network operator means the distribution licence holder who owns or operates the electricity distribution system through which electricity is conveyed to your premises.