To Licensed Gas Transporters, Shippers and Suppliers; Health and Safety Executive; Consumers; Customer groups and other interested parties

Promoting choice and value for all gas and electricity customers

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Dear Colleague

Declaration concerning ownership of and responsibility for Uniform Network Code Sub-Deduct Arrangements

On 18 March 2011 we published an open letter consultation[1] on Uniform Network Code ("UNC") Sub-Deduct Arrangements. That letter considered who has responsibility for the continuity of supply, maintenance, repair and renewal of the pipework and relevant assets within UNC Sub-Deduct Arrangements and set out our provisional view. Seven responses were received and were published[2] on our website on 18 May 2011.

This letter sets out the Authority's declaration of its understanding of the current factual and legal position on ownership and responsibility for UNC Sub-Deduct Arrangements. This is that, other than where a site owner or operator has made a specific choice to convey gas through a Sub-Deduct Arrangement we consider that National Grid Gas ("NGG") is the default owner/operator of each Sub-Deduct Arrangement in Great Britain ("GB"). It also sets out reasons for that declaration and the potential implications of the declaration.

Background and identification of key issues

A UNC Sub-Deduct Arrangement is a configuration of pipework downstream of a gas transporter's ("GT") network. A primary meter measures the total flow of gas from a GT's network. Secondary meters are placed downstream of that primary meter to measure the gas conveyed to individual secondary gas users. The secondary meters within Sub-Deduct Arrangements are open to competitive gas supply so the primary and secondary sub-deduct meters may each be supplied by a different licensed gas supplier. Sub-Deduct Arrangements have come about because, where a number of premises requiring connection were situated at some distance from the most suitable gas main, but were relatively close to each other, a Sub-Deduct Arrangement could require less pipework and be cheaper to install than individual conventional connections.

Sub-Deduct Arrangements were built during an earlier regulatory regime when British Gas Corporation ("BG") and its predecessors had a statutory monopoly of both the distribution of natural gas through pipes and the supply of gas in GB. Since then the industry has seen many changes including the separation of the conveyance and supply activities, changes in

[1] http://www.ofgem.gov.uk/Networks/GasDistr/GasDistrPol/Documents1/OpenLetterSubDeductv1%2018.pdf

[2] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=OpenLetterSubDeductv1%2018.pdf&refer=Networks/GasDistr/GasDistrPol

corporate ownership including the sale of the Distribution Networks in 2005 ("DN Sales") and revisions to the regulatory environment.

The current statutory and regulatory arrangements do not set out explicitly who is responsible for the continuity of supply, maintenance, repair and renewal of individual Sub-Deduct Arrangements.

In principle, the Sub-Deduct Arrangements could be the responsibility of persons owning land on which a Sub-Deduct Arrangement exists ("site owners"); the local Gas Distribution Network ("GDN"); or NGG as the GDN to whom the general pipeline ownership was passed from BG. Uncertainty as to where responsibility lies means that in most cases, no party has expressly indicated that it considers itself responsible for a Sub-Deduct Arrangement.

This raises concern regarding security of supply and gas safety, with associated risks for end users and the general public. In the light of the Authority's principal objective to protect the interests of existing and future consumers in relation to gas conveyed through pipes, we consider this uncertainty needs to be removed.

Treatment of Sub-Deduct Arrangements to date

We raised the matter of ownership and maintenance responsibility for Sub-Deduct Arrangements at the current Gas Distribution Price Control Review ("GDPCR1") in 2007. At that point, some GDNs indicated[3] that they did not consider that they were responsible for Sub-Deduct Arrangements.

However, as part of that process, and having discussed the matter with the Health and Safety Executive ("HSE"), there was general agreement in principle that the preferred solution was for the GDNs to adopt the Sub-Deduct Arrangements. The intention was that the GDNs would ultimately have ownership and maintenance responsibility for the Sub-Deduct Arrangements.

Ofgem therefore set a £1.8m GDPCR1 revenue allowance for GDNs to conduct technical surveys of all Sub-Deduct Arrangements attached to their systems. The surveys sought to collate all available technical and access information and broadly establish whether each site owner or operator considered themselves, either as a "relevant person" under the Gas (Exemptions)Order 2011[4] ("the Order") or as a licensed GT, responsible for the Sub-Deduct Arrangement. The GDNs were also required to assess the potential difficulties and estimate the approximate costs of works necessary to re-engineer Sub-Deduct Arrangements into conventional connections."

The GDNs have since re-stated that they would only consider adopting the Sub-Deduct Arrangements on the condition that the relevant assets had been risk assessed, replaced or re-engineered.

The GDNs largely completed the surveys by March 2010 but they did not provide any substantive evidence regarding ownership of, or responsibility for, Sub-Deduct Arrangements. However, they indicated that the approximate cost of re-engineering works that may be necessary to re-engineer Sub-Deduct Arrangements is estimated to be £44m.

We subsequently considered this matter further and concluded that this complex and technical issue should be subject to a consultation.

Consultation

On 18 March 2011 we published a consultation setting out a provisional view on ownership and maintenance responsibilities for Sub-Deduct Arrangements, based on our review of the

[3] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=249&refer=Networks/GasDistr/GDPCR7-13
[4] Section 8(1) of the Gas (Exemptions) Order 2011

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legislative framework, regulatory arrangements and other information available to us and seeking industry views on the current ownership position. Our provisional view stated that:

1. either a GT or the site owner or operator is the responsible party;

2. it is unlikely that the site owner or operator would be responsible without knowledge of such responsibility, given the legal requirements to follow the Order and the Gas Safety (Management) Regulations 1996 ("GSMR"); and

3. if responsibility lies with GTs, we consider that Sub-Deduct Arrangements are currently owned, operated by and the responsibility of BG's relevant statutory successor, NGG, unless there is evidence that this responsibility was either transferred at the time of DN sales to the Independent Distribution Networks ("IDNs") or to specific site owners or operators.

Summary of consultation responses

We received seven non-confidential responses in total. Six respondents expressed concern over the uncertainty of responsibility for Sub-Deduct Arrangements and supported our view that the issue needed resolving. One respondent did not consider there to be any imminent danger from Sub-Deduct Arrangements and considered that downstream of the primary meter, the rights of the parties depend on private arrangements between the individuals.

One respondent highlighted revenue protection burdens on customers caused by Sub-Deduct Arrangements because the customer of the primary meter is exposed to charges for all of the gas not recorded as supplied via the secondary meter(s). They suggested this could be due to any unauthorised connections (metered or unmetered) made to the sub-deduct network. The same respondent also highlighted the indirect impact Sub-Deduct Arrangements have on competition in metering services and smart metering.

All GDNs expressed willingness to co-operate with measures to resolve the Sub-Deduct Arrangements ownership and maintenance responsibility issue. However they re-stated their position that any adoption of Sub-Deduct Arrangements should be conditional on and follow funded re-engineering works.

There was no evidence submitted that IDNs are currently responsible for Sub-Deduct Arrangements although there was support for this approach from two respondents who thought that GDNs' continued receipt of transportation revenues for Sub-Deduct Arrangements was a possible justification.

Two respondents, including NGG, considered Sub-Deduct Arrangement pipework to be installation pipework[5], owned or the responsibility of the owner or occupier of the premises. These respondents cited *Melluish (H.M. Insp. Of Taxes) v BMI* [1996] AC 454 to support this view. That case applies the so-called "fixtures" rule to installation pipework; the fixtures rule means that anything that is sufficiently attached to land becomes part of the land and passes into the ownership of the landowner.

Two respondents took the view that NGG is likely responsible for Sub-Deduct Arrangement pipework and two respondents expressed no view on who was responsible.

One respondent supported our provisional position that the responsibility lies either with the site owner/operator or NGG and that it is unlikely that the site owner / operator would be responsible without knowledge of such responsibility.

[5] Pipework and fittings downstream of the emergency control valve and owned or operated by consumers and subject to the Gas Safety (Installation and Use) Regulations 1998

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One respondent highlighted that Ofgem's presentation to the UNC Distribution Workstream in 2006 stated that "none of the BG successor entities holds responsibility for the pipelines beyond the emergency control valve."

Our declaration

In consideration of its principal objective and general duties, the Authority has carefully considered the information before it, including the responses to the recent consultation and all other relevant information.

The Authority considers that, following years of uncertainty, it is essential that ownership and maintenance responsibility for each Sub-Deduct Arrangement be clarified. The Authority therefore declares its understanding of the correct legal and factual position in respect of ownership and maintenance responsibility for Sub-Deduct Arrangements to be as follows:

i. BG had a statutory monopoly on both the installation of gas pipes and the supply of gas during the period when Sub-Deduct Arrangements were built. We consider it likely that Sub-Deduct Arrangements were designed, installed, tested, commissioned and operated by BG. We, therefore, consider that Sub-Deduct Arrangements were initially owned by BG.
ii. We have not seen any evidence that transfers the ownership of or responsibility for Sub-Deduct Arrangement assets installed by BG to a third party. We, therefore, consider that NGG has ownership of and responsibility for Sub-Deduct Arrangements as a legacy obligation taken over from BG;
iii. We do not consider that responsibility for Sub-Deduct Arrangements was passed to IDNs at DN Sales because there was no evidence presented to support this. Since NGG has stated it does not consider it inherited any responsibility for Sub-Deduct Arrangements, it would have been unlikely to have sought to transfer any such responsibility to IDNs at DN Sales.
iv. We consider that a site owner or operator should have made a specific choice to convey gas through a Sub-Deduct Arrangement under the Order or as a GT. **Other than in these circumstances, we consider that NGG is the default owner/operator of each UNC Sub-Deduct Arrangement in GB.**

In view of the GDNs' responses, their prior funding and re-engineering conditions for adoption, the financial implications and the likelihood that some Sub-Deduct Arrangements may never be adopted due to engineering difficulties or excess cost, we do not consider it appropriate to pursue a voluntary adoption scheme with the GDNs.

Reasons for the Authority's declaration

We consider that in the absence of conclusive evidence that BG owned Sub-Deduct Arrangements it is reasonable in the light of all of the relevant information before the Authority including the relevant statutory provisions, industry codes and practice, caselaw and consultation responses that BG owned the Sub-Deduct Arrangements at the time when they were laid because:

a. BG had a statutory monopoly on the installation of gas pipes and the supply of gas during the period when the existing Sub-Deduct Arrangements were built. We consider that Sub-Deduct Arrangements were designed, installed, tested, commissioned and operated by BG. We consider that the provisions in UNC Section G para 1.18.1 to 1.18.3, which refer to "System" Sub-Deduct Arrangements for conveyance by the Transporter supports our view.

b. Sub-Deduct Arrangements were initially operated by BG and for the benefit of BG (because BG could use less pipework than it would have had to use to service the same number of customers under a conventional connection arrangement); and

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c. The relevant statutory arrangements in place at the time when the Sub-Deduct Arrangement pipes were laid necessarily excluded the application of the fixtures rule to Sub-Deduct Arrangements.

Further discussion on the issues that lead to our declaration can be found in **Appendix 1.**

Implications of our declaration

In light of our clarification of existing ownership and maintenance responsibility, from the date of this letter we consider NGG to be responsible for all Sub-Deduct Arrangements in GB except where they can provide evidence that the site owner accepts this responsibility. We therefore expect NGG to commence a programme to identify each site owner/operator who may have taken or wishes to take responsibility for specific Sub-Deduct Arrangements and put in place suitable, enduring administrative arrangements to clearly define the acceptance of that responsibility.

For the remainder of Sub-Deduct Arrangements in GB, we would expect NGG as network operator to commence a suitable and efficient risk assessment and mitigation programme and put in place a suitable asset management system.

We note the System Operator Managed Services Agreement ("SOMSA") and the Front Office Managed Services Agreement ("FOMSA") that were put in place to facilitate DN Sales. In order to manage the logistics of discharging its duties and responsibilities for Sub-Deduct Arrangements throughout GB, we consider that NGG could seek similar agreements with other third parties to manage these responsibilities.

Subject to necessary bi-lateral agreements and risk mitigation measures, in the interests of efficient asset management, NGG could consider the eventual transfer of the assets of relevant Sub-Deduct Arrangements to IDNs. We would support this approach and would expect co-operation from IDNs to achieve that goal.

If NGG consider it is necessary to invest material levels of expenditure ahead of 2013 to address risks on the Sub-Deduct Arrangements for which they are responsible, we will consider their applications for adjustments to allowed revenues under the current Gas Distribution Price Control ("GDPCR1"). These costs would be "logged up", assessed and if appropriate funded separately or through the RIIO-GD1 price control. In either case we would only look to make adjustments to reflect efficient risk mitigation measures.

We hope that this declaration will bring clarity to this area.

Queries relating to the content of this letter should be sent to the above address for the attention of Steve Brown or emailed to steve.brown@ofgem.gov.uk.

Yours faithfully,

Rachel Fletcher
Acting Senior Partner, Distribution
For and on behalf of the Authority

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Appendix 1

Further discussion on the issues that lead to our declaration:

The relevant statutory arrangements in place at the time when the Sub-Deduct pipes were laid excluded the fixtures rule by necessary implication.

Two respondents made reference to the case of *Melluish (H.M. Insp. Of Taxes) v BMI* to support the view that Sub-Deduct Arrangement pipework is a fixture that has become part of the land to which it is affixed and has therefore passed into the ownership of the relevant landowner; such that maintenance responsibility has always fallen upon the private landowner rather than upon BG and its statutory successors.

We have carefully considered these arguments.

We do not consider that the fixtures rule applied to Sub-Deduct Arrangements because its application was impliedly excluded by the statutory regimes in the Gas Act 1948, Gas Act 1972 and the Gas Act 1986. Under these Acts the Area Boards[6], BG and later (under the 1986 Act) a GT had the right to enter upon private land for the purpose of altering or repairing any pipe lawfully placed there, as long as 7 days notice was given to the owner or occupier.[7] We are of the view that the grant of a statutory power which gives GTs the right of entry to private land for the purpose of altering, replacing, or maintaining pipe lawfully laid on that land carries the strong implication that the ownership of the pipe and maintenance responsibility for the pipe remained with the GT who has laid the pipe (otherwise there would be no good reason for the right of entry). In the case of all Sub-Deduct Arrangements, BG was the person that lawfully laid the relevant pipe.

We consider that Sub-Deduct Arrangement pipes that were lawfully laid on private land by BG whilst undertaking its statutory duties at the time did not cede to the land but remained the property of BG unless transferred to a third party at a later date.

In support of our analysis above, we note the following case law where the common law fixtures rule was found to have been excluded by statute:

In *North Shore Gas Co Ltd v Commissioner of Stamp Duties*[8] it was held that gas mains and service pipes laid by a gas company under publicly-owned land were fixtures to the underlying land such that stamp duty was payable upon their sale. In this case, notwithstanding that the mains and services pipes were fixtures, the Court nevertheless stated that the mains and pipes were owned by the gas company that had laid them rather than by the owner of the underlying land because the mains and pipes had been placed further to a Private Act of Parliament, such that the Act effectively excluded the application of the common law fixtures rule to the pipes laid by the gas company.

We note that the case of *Newcastle-upon-Lyme Corp v Wolstanton*[9] supports the principle that the common law rule that ownership of fixtures vests in the owner of the underlying land can be displaced by a contrary provision of statute.

Network or installation pipework?

One respondent considered that BG never owned Sub-Deduct Arrangements and disagreed with the suggestion that installation pipework and fittings installed by BG since 1948 is

[6] Predecessors of British Gas Corporation
[7] See paragraph 1(3)(b), Schedule 4, Gas Act 1972 and paragraph 27(1), Schedule B, Gas Act 1986.
[8] [1940] 63 CLR 5
[9] [1947] Ch 427

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owned by NGG simply because BG installed them and there is no record of ownership transfer. We consider that such an approach does not take into account that most installation pipework and fittings normally installed by BG for customers would thereafter be owned by and operated by those customers under the Gas Safety (Installation and Use) Regulations 1998.

It appears more reasonable to conclude that during the monopoly period, BG themselves operated the Sub-Deduct Arrangement pipes they had installed to convey gas under the Gas Act to the secondary meters that BG was supplying

The HSE has confirmed that it considers that Sub-Deduct Arrangement pipework (whether operated by a GT or a relevant person under the Order) would normally be classified as network rather than installation pipework and hence be subject to the GSMR. This would therefore require an HSE accepted safety case unless an exemption had been granted from the HSE.

Two respondents expressed the view that Sub-Deduct Arrangements are installation pipes and therefore not part of a network. Neither of these respondents commented on or gave reasons for their apparent variance from the HSE's views that were set out in the March consultation regarding the extent of the network and the safety management of Sub-Deduct Arrangements.

The HSE view appears to be supported by the Institution of Gas Engineers and Managers (IGEM). Figure 38 on page 40 of the IGEM publication 'Defining the end of the Network, a meter installation and installation pipework'[10] shows a legacy arrangement where pipework between primary and secondary meters may be defined as network rather than installation pipe.

Other relevant considerations

Security of supply

One respondent considered that the person in control of the primary meter has the absolute right to remove the meter or dictate the manner in which gas flows through it and that the rights of the parties downstream depend on private arrangements between individuals.

We do not consider that Sub-Deduct Arrangement secondary meters should have less protection of their security of supply than other competitive supply meters.

Secondary meters downstream of the primary meter are fully open to competition and supplied by licensed gas suppliers. Under the Order, a relevant person must refrain from any action calculated to impede the choice of gas supplier to subsequent premises.

We anticipate that although this provision may provide some security of supply protection to customers downstream of the primary meter, customers would be more fully protected if gas in Sub-Deduct Arrangements were conveyed by a GT under full third party access arrangements governed by industry codes.

Therefore, whilst our declaration of ownership is based on what we understand to be the correct legal and factual position, we note that our declaration is also consistent with maintaining security of supply to customers within Sub-Deduct Arrangements.

[10] IGEM/G/1 3rd Impression Communication 1733

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UNC

UNC Section G para 1.18.1 to 1.18.3 makes specific provision for the existence of both System (GT conveyance) and Non-System (Order exempted conveyance) Sub-Deduct Arrangements that were installed before 1 March 1996. Further, para 1.18.6 allows for the re-engineering of System Sub-Deduct Arrangements at the cost of the GT if it is necessary to do so.

A System UNC Sub-Deduct Arrangement provides extensive title, risk and security of supply protection to both registered users and consumers downstream of the primary meter. If no System Sub-Deduct Arrangements existed on 1 March 1996,[11] all Sub-Deduct Arrangements would necessarily be Non-System and hence the responsibility of the site occupier or owner.

If that were the case, it would not have been necessary to include any provision in the UNC for System Sub-Deduct Arrangements. Thus, the existence of provision for System Sub-Deduct Arrangements in the UNC is consistent with our understanding of ownership of these arrangements set out above.

Ofgem's previous statements

Ofgem expressed the opinion at a presentation to the UNC Distribution Workstream in 2006 that 'none of BG successor entities holds responsibility for the pipelines beyond the emergency control valve'.

The statement was made to reflect our understanding of the position in 2006. It was not a statement of Ofgem's proposed exercise of its discretion or policy.

Metering competition/smart metering/revenue protection

One respondent highlighted the indirect impact that Sub-Deduct Arrangements may have on competition in metering services and smart metering.

We do not consider that our declaration will have any adverse impact on metering competition or smart metering developments. We consider that providing certainty over who is responsible for Sub-Deduct Arrangements is likely to make it easier to resolve the revenue protection issues that were identified by one respondent.

[11] Date of the introduction of Network Code, the predecessor to UNC

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