



Office of Utility Regulation

Investigation of Guernsey Electricity's Supply Connection Charges

Finding

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Contents

1. Introduction.....	2
1.1. Background	2
1.2. Background	2
1.3. Investigation Process	3
2. Structure of the Paper	4
3. Issue under Investigation	5
3.1. Favourable Connection Charges	5
3.2. Licence Condition 17	5
3.3. Licence Condition 19	5
3.4. Licence Condition 20	6
3.5. Licence Condition 31	6
4. GE Response & DG's Position.....	7
4.1. Collection of Evidence.....	7
4.2. Statement of Connection Charges (Condition 31)	7
4.3. Mechanism for Estimating Electricity Supply Connection Charges	7
5. Proposed Finding and Responses	10
5.1. Summary of Proposed Finding	10
5.2. Summary of Responses.....	10
5.3. DG's Position.....	11
6. DG's Decision	12

1. Introduction

1.1. Background

The functions of the Director General of Utility Regulation (“**DG**”) are set out in The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 (as amended) (the “**Utilities Law**”) which includes, amongst others, the function to:

“to receive and to conduct inquiries and investigations (which may include inspections of any part of a utility network) and to hear complaints by any person regarding utility activities.”¹

Under Section 5 of the Utilities Law, the DG has to power to do anything that appears to him to be necessary or expedient for the purpose of exercising his functions and powers, including without limitation, the power to impose any direction, requirement or sanction under the Utilities Law or any Sector Law.

Under section 29 of the Electricity (Guernsey) Law, 2001 (the “**Electricity Law**”) the DG has the power to give directions to licensees in the event that the DG is satisfied that a licensee is or has been in contravention of any condition of a licence or any provision under the Utilities Law or the Electricity Law².

An important aspect of hearing complaints and determining disputes involves ascertaining whether there is or has been a contravention of any licence condition or a contravention of the applicable law. The DG has issued guidelines on the procedures which his office (“**OUR**”) will apply to the handling of complaints and disputes (including disputes between licensees that have not been resolved bilaterally between the parties)³ (“**DRG**”).

1.2. Background

Guernsey Gas (“**GG**”) made a submission in December 2006 to the OUR alleging, inter alia, that Guernsey Electricity (“**GE**”) was offering more favourable connection terms to developers who agreed to install electricity for off-peak heating. GG believed that such practices could raise concerns regarding GE’s compliance with certain of its electricity licence (the “**Licence**”) conditions, namely, Conditions 17, 19, 20 and 31. GG subsequently confirmed that it wished the matter to be considered as a formal dispute. The OUR determined at that stage that there was insufficient evidence to merit an investigation upon which it could act.

However following further correspondence and a subsequent meeting with GG on 26 June 2007, the OUR decided in July 2007 that there were sufficient grounds to warrant further investigation of the issues raised by GG.

¹ The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 Section 4 (1)(e)

² The Electricity (Guernsey) Law 2001 Section 29 (1)

³ Dispute Resolution Guidelines Document number OUR 02/32

1.3. Investigation Process

On the 30th July 2007 the OUR wrote to GE regarding the allegation that GE might not be in compliance with its charging policy published under Condition 31 of the Licence (i.e. its Connection Charging Statement). In order to consider the complaint further the OUR asked, in the first instance, for specific information from GE relating to new connections over the period 1 March 2002 to 31 December 2006 (“**the Investigation**”).

GEL responded promptly to this information request on 3rd August 2007 informing the OUR that there had been no new connections to the 11,000 volt or higher voltage systems (the conveyance system) during the period stated by the OUR. GE’s Connection Charging Statement applies only to the conveyance system. Accordingly GE was not in breach of its Connection Charging Statement of Condition 31 of the Licence.

The OUR responded on 17th August 2007 confirming that, as there had been no new connections to the 11,000 volt or higher voltage system GE could not have been in breach of its Connection Charging Statement or its obligations under Condition 31 of its licence. However GE is subject to a number of other licence conditions as a dominant operator in the electricity supply market, inter alia, Conditions 17 (Unfair cross-subsidies), 19 (Linked Sales) and 20 (New Prices).⁴ The OUR requested a listing of all electrical connections to GEL’s lower voltage system (i.e. the supply system) over the period 1 March 2002 to 31 December 2006 in order to assist it to consider whether GE was also in compliance with these Conditions.

GE responded to this request on 6th September 2007 providing the information sought by the OUR. The OUR sought some additional clarification by letter on 12th September 2007 which was provided by GE on 26th September 2007. GE and OUR then met on 9th October 2007 to discuss the information provided by GE.

The considered all of the information provided by GG and GE in the correspondence and meetings referred to above and distributed a draft finding to both parties for comment by 30th November 2007. This document sets out the DG’s finding based on his consideration of the information provided by the GG and GE in response to that draft finding.

⁴ See Section 3 for a summary of these Conditions.

2. Structure of the Paper

The rest of this paper is structured as follows:

- Section 3:** presents the issues under investigation as raised by GG;
- Section 4:** summarises GE's response to the allegations and sets out the DG's proposed position on the issues raised; and
- Section 5:** summarises the DG's proposed finding and the responses to that draft finding from GG and GE; and
- Section 6:** sets out the DG's finding on the matter under consideration.

3. Issue under Investigation

3.1. Favourable Connection Charges

During GE's price control review in 2006, GG outlined to the DG its concerns with a number of practices adopted by GE and in December 2006, GG submitted details of certain matter in respect of which it believed GE might not be in compliance with certain of its Licence conditions. Following further correspondence and meetings GG expressed the view that GE's connection charging policy (i.e. of offering favourable connection charges to certain new customers) was not or might not be in compliance with a number of specific Licence Conditions.

GG believed that alleged practice by GE of offering favourable connection charges could involve an infringement of four of its Licence conditions, namely:

- Condition 17 (unfair cross-subsidies);
- Condition 19 (Linked Sales);
- Condition 20 (New Prices and discounts); and
- Condition 31 (Connection Charges).

A summary of GG's concerns in respect of each Licence condition is set out below.

3.2. Licence Condition 17

GG believed that GE might be in breach of Licence Condition 17 which states, inter alia, that:

- 17.1 *The licensee shall not unfairly cross subsidise or unfairly subsidise the generation, conveyance or supply of electricity.*
- 17.2 *To enable the Director General to evaluate where any unfair cross-subsidisation or unfair subsidisation is taking place, the Licensee shall record at full cost in its accounting records any material transfer of assets, funds, rights or liabilities between a part and any other part of its business, and between it and any Associated Company, and shall comply with any directions issued by the Director General for this purpose.*

From GG's perspective any discount for connecting customers who agreed to use electricity for heating might involve an unfair cross-subsidy or subsidy whereby other customers would be subsidising the new heating customers.

3.3. Licence Condition 19

GG also had concerns relating to GE's compliance with Condition 19 of its Licence. Condition 19 states that:

- 19.1 *The Licensee shall not make it a condition of supplying electricity that a person or Electricity Undertaking should acquire from the Licensee, or any person specified by the Licensee, any electrical appliance, meter or service other than the one that is specifically required by the person concerned, unless the Licensee has notified the Director General of its intention to do so and has satisfied her that there are technical reasons why such a bundling should occur, or that there is a sufficient economic benefit to customers to justify the bundling.*
- 19.2 *The provisions of Condition 19.1 shall not prevent the Licensee from offering discounts in accordance with any discount scheme which complies with Condition 20.*

It appeared to GG that, if GE was requiring a developer to install electricity heating as a condition of providing a lower cost connection, this could constitute a “linked sale.”

3.4. Licence Condition 20

Condition 20 includes a number of provisions including the following requirement which is pertinent to the Investigation:

- 20.3 *All published prices, discount schemes and special offers of or introduced by the Licensee shall be transparent and non-discriminatory; all discount schemes shall be cost-justified and all special offers shall be objectively justifiable.*

GG maintained that GE’s discounts for certain connections were not cost justified and that GE was therefore likely to be in breach of this licence condition.

3.5. Licence Condition 31

GG had concerns about GE’s compliance with Condition 31 of GE’s licence which includes, inter alia the following provision:

- 31.1 *The Licensee shall, as soon as practicable and, in any event, within three months after this licence has come into force, prepare a statement in a form approved by the Director General setting out the basis upon which the charges for connection to and use of the Conveyance System in respect of generation and supply will be made.*

GG believed that GE was offering different connection charges for customers using off-peak electricity for heating and that this policy should be highlighted in the company’s connection policy statement.

4. GE Response & DG's Position

4.1. *Collection of Evidence*

Following commencement of the Investigation, the OUR requested information from GE to enable the OUR to carry out its Investigation. GE responded to the requests for information with letters dated 3rd August, 6th and 26th September 2007. GE also attended a meeting with the OUR on 9th October 2007 to help clarify GE's responses.

4.2. *Statement of Connection Charges (Condition 31)*

GE Response

GE informed the OUR that it had made no new connections to its conveyance network (i.e. 11,000 volt or higher voltage systems) between 1 March 2002 and 31 December 2006. Since, the Statement of Connection Charging is concerned only with those system users who may wish to connect directly to GE's conveyance network GE could not be in breach of Condition 31 of its Licence.

DG's Proposed Position

The DG accepted in light of the evidence provided that GE has complied with Condition 31 of its Licence. The DG also notes that the Connection Charging Statement is publicly available on GE's website.

4.3. *Mechanism for Estimating Electricity Supply Connection Charges*

In estimating connection charges for new electricity connections GE apportion the total budgeted costs between three types of contributions:

- A **technical** contribution - representing the company's estimate of the value of the network development to all electricity supply customers;
- A **commercial** contribution – representing the contribution GE makes where the new load has a major off-peak element which improves the GEL's generation and network asset utilisation; and
- A **customer** contribution – which is the residual value which the customer (typically a property developer) has to pay.

GE demonstrated to the OUR the internal process that is followed to assess each application for a new connection. At the meeting on 9th October 2007 GE explained the customer contributions that were estimated for three projects. These projects were selected by the OUR as samples from the population of all new connections from 1 March 2002 to 31 December 2006.

GE argued that the commercial contribution was justified on two grounds:

- Customers contributing significant off-peak demand do not contribute substantially to maximum demand and hence the need for additional investment in capacity, but do generate additional revenue; and

- Providing discounts for new connections was common practice for all companies in the Island's energy market.

GE maintained that its use of a commercial contribution was fully in accordance with the law, its Licence and was in customers' best interests in the local energy market.

DG's Proposed Position

Condition 17 – Unfair Cross-subsidy

The DG accepted the arguments put forward by GE for the use of a commercial and technical contribution towards new connections to its supply business. There is no evidence that the subsidy or cross-subsidy offered by GE to new customers is unfair and therefore the DG does not consider that GE is in breach of this Licence condition.

Condition 19 – Linked Sales

The DG did not consider the use of commercial and technical contributions to determine connection charges to comprise a form a "linked sale." GE's customer in this instance is not obliged to take a particular product from GE. Therefore the DG does not consider that GE's use of commercial contributions for new connections means that the company is in breach of condition 19 of its Licence.

Condition 20 – New Prices and Discounts

The current system did not provide customers or the market with sufficient transparency on how charges for connection to the supply system are derived. This is in stark contrast with the visibility provided by the Statement of Connection Charges for the company's conveyance business. The DG was of the view that producing a schedule of charges for connections to GE's supply system would not be appropriate or possible due to the unique characteristics of each individual connection (i.e. each charge will depend on the requirements for each connection). However, it should be possible to provide transparency on GE's connection charging policy for such connections.

Accordingly while the DG did not believe that GE should be considered to have breached Condition 20, he considered that it would be appropriate for GE to provide greater transparency, as required by Condition 20, in respect of its policy for charging for connection to the supply system.

On the basis of the evidence provided to him the DG was satisfied that GE's charges for connection to its supply system are not in breach of its Licence conditions and that such charges are consistent with its regulatory obligations. On the basis of the rationale and justification provided by GE, the use of discounts for connections to the supply business are economically justified and do not represent unfair subsidies or cross subsidies of new customers by existing customers. Further the DG did not consider that the provision of discounts could be considered as a form of "linked sale" as suggested by GG. However the DG did believe that there should be greater transparency regarding GE's policy in respect of connection charges.

Condition 31 (requiring the Connection Charging Statement in relation to the conveyance network) does not apply to connections to GE's supply system. That statement applies only to the conveyance system (i.e. 11,000 volt or higher voltage systems) and GE has pointed out that it has had no new connections to that system

between 1 March 2002 and 31 December 2006. In contrast over this same period there have been 115 projects where GE has determined connection charges for customers connecting to its supply system. There is, however, at the current time no transparency provided to customers or the market as to how the charges for such connections are determined.

Condition 20 of GE's licence requires that all of GE's published prices, discount schemes and special offers should be transparent and non-discriminatory and that all discount schemes should be cost-justified and all special offers should be objectively justifiable. Clearly it is not feasible for GE to publish a schedule of tariffs for new connections to its Supply Business as each new connection will have a different cost depending upon the nature of the engineering work required. However the DG believed that customers and the market would benefit from greater transparency as to how the connection charges are derived.

The DG also considered that the use of a discount in the capital cost of new connections (i.e. GE's commercial contribution to certain projects) may have implications for additions to GE's Regulatory Asset Base ("RAB") for future price controls. This issue will be considered during the next price control.

5. Proposed Finding and Responses

5.1. Summary of Proposed Finding

The DG proposed not to find GE's charges for connection to its supply system to be in breach of its Licence obligations (17, 19, 20 & 31).

However, in order to provide greater transparency to consumers and the market, the DG proposed to require GE to publish a Statement of Connection Charging Policy in respect of its supply system outlining the basis for the commercial and technical contributions for new connections to the supply system in order to achieve the transparency required by Condition 20 of its Licence.

5.2. Summary of Responses

GE agreed with the OUR's finding that its charges for connections were not in breach of the company's licence conditions. It also accepted the OUR's proposal that GE could provide further information publicly on its policy for connection charges to its supply system – in the form of a Statement of Connection Charging Policy.

GG accepted the DG's proposed finding that GE complied with Licence Condition 31 of its licence. It expressed the view however that it would be helpful if GEL could make it clear that its published connection policy only applies to connections made from its 11,000 volt system or higher⁵.

GG remained unconvinced that there is no unfair cross-subsidy for its supply connection charges (i.e. Condition 17 – Unfair Cross-subsidy) and requested that the DG publish examples of GEL's calculations or other numerical analysis (whilst respecting confidentiality constraints) to support his conclusions. In particular, GG believed it would be helpful if OUR would give consideration to publishing the following:

- summary information of new connections made by GEL over the period 1 March 2002 to 31 December 2006;
- details of the three connection examples that OUR examined with confidential information removed; and
- an explanation of how the OUR will treat GEL's contributions from a regulatory perspective.

GG believed that the connection charges comprised linked sales as the type of service offered by the company was not requested by the customer. To support its argument GG referred to the Monopolies and Mergers Commission (Cm500) case in 1988 which found that British Gas plc was acting uncompetitively by, amongst other things, making supply conditional upon the purpose for which the gas was to be used.

⁵ Although the opening sentence of the fifth paragraph of the Introduction to the document states that *"This statement is concerned only with the conveyance system, that is, the electricity distribution system operating at 11,000 volts and above."*

However, GG accept that the MMC was considering the question in context of the prevailing UK competition law and not as a breach of a licence obligation.

GG welcomed the DG's proposal that that GEL should publish a connection charging policy for its Supply Business (Condition 20 –New Prices and Discounts). GG agreed that where it can be justified economically, a utility should be able to make a contribution towards the cost of a new connection. GG itself adopts this approach to promote and encourage new gas sales. However GG believes that GE does not appear to apply this consistently and seeks a consistent application of a cost justified common connection policy across all of GEL's customers.

5.3. *DG's Position*

The DG welcomes GE's support of the proposal for the company to prepare a Statement of Connection Charging Policy for its Supply Business. The DG remains of the view that such a document should greatly enhance the transparency of GE's charges and contribute towards demonstrating that charges are derived on a consistent basis. The DG therefore will request that GE prepares a draft Statement for consultation prior to finalising a published version.

The DG believes that GE's Statement of Connection Charging Policy for its Conveyance business is sufficiently clear that it applies only to the electricity distribution system operating at 11,000 volts and above and that no further clarification is necessary.

The DG does not consider it appropriate to disclose any of GE's confidential information as he has found no evidence of the use of unfair cross-subsidies within the business. The DG does not believe that the specific information requested by GG would assist GG in assessing the DG's decision. In the DG's view the publication of GE's Statement of Connection Charges for its Supply business should address GG's concerns going forward.

6. DG's Decision

The DG therefore requests GE to produce a draft Statement of Connection Charges for its Supply business by Monday 25th February 2008. This document should be made available on GE's website. Interested parties will then be free to provide comments by Monday 17th March 2008. All comments should be copied to the OUR at Suites B1 & B2, Hirzel Court, St Peter Port, Guernsey, GY1 2NH. GE will then review all comments received with the OUR and finalise the document by Monday 7th April 2008.