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value for all customers*

Electricity Distribution Licensees
and other interested parties

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Dear Colleague,

Reform of Requirement for Distribution Licensees to Seek Derogation in Respect of Compliance Issues with Standard Condition 5 of the Distribution Licence ("Distribution System Planning Standard and Quality of Service")

The distribution licence¹ requires licence holders to plan and develop their distribution systems to a standard not less than that set out in Engineering Recommendation P2/5 ("P2/5"). The distribution licence also allows the licensee to seek a derogation from the Authority if this requirement cannot be met on specified parts of its distribution system. This letter sets out Ofgem's proposal for the introduction of simplified arrangements relating to the management of compliance with P2/5 ("Simplified P2/5 Regulation Arrangements"), in particular concerning the need for distribution licensees to apply for derogations in the case of certain types of temporary non-compliance.

The main aims of the proposed Simplified P2/5 Regulation Arrangements are to:-

- Clarify the circumstances where a distribution licensee should apply for derogation.
- Specify areas of distribution systems where non-compliance with P2/5 without specific derogation is allowed.
- Reduce the regulatory burden of the derogation process in line with Better Regulation principles.

In parallel with the proposals outlined in this letter, Ofgem is considering a request from the distribution licensees for approval of the electricity network security standard Engineering Recommendation P2/6 ("P2/6") as a replacement for P2/5. This proposal applies equally to the standard condition 5 of the distribution licence should it be amended to refer to P2/6.

Background

P2/5 sets out factors that should be taken into account when designing distribution systems including:-

¹ Distribution licence condition 5 requires that the distribution system is planned and developed as a minimum in accordance with the standards sets out in Engineering Recommendation P2/5.

- The demand conditions that should be considered.
- Permissible impacts of unplanned and planned outage conditions.
- Evaluation of network capability including the treatment of demand transfer arrangements and contributions from connected generating plant.

P2/5 defines normal recommended levels of security in terms of level of demand. The scope of P2/5 is further described in Appendix 1 to this letter.

P2/5 recognises that there may be occasions where departure from the normal recommended levels of security may be acceptable. Ofgem considers that this flexibility within P2/5 allows distribution licensees to apply sound engineering judgement when developing distribution systems. This flexibility is of particular importance when a distribution licensee considers design options for parts of the distribution system which are approaching the thresholds between the defined class sizes. Ofgem would expect any departures from the normal recommended levels of security that the distribution licensee considers allowed for by P2/5 to be supported by clear evidence to a similar level of detail to that which the distribution licensee would expect to provide as justification for a derogation request. We expect that this supporting evidence could be made available to Ofgem if requested.

Ofgem expects compliance by the licensees with distribution licence condition 5. The distribution licence also provides Ofgem with powers to issue directions granting relief² from this P2/5 compliance obligation in relation to specified parts of the distribution system. The issue of such a direction does not mitigate the possible consequences to network customers of a P2/5 compliance issue. It is recognised that the requirement for a distribution licensee to apply to Ofgem for a derogation improves the visibility of P2/5 compliance. Furthermore derogation requests provide Ofgem with information about underlying issues which if not addressed might affect distribution system performance in the future.

Distribution licensees carry out regular demand monitoring and routinely prepare demand forecasts. These forecasts in many cases accurately predict the time at which distribution system reinforcement is required. For example, where there is sufficient certainty about a forecast demand change (e.g. a contractual agreement with a new customer) and sufficient notice, then Ofgem would expect that the distribution system would be reinforced before a P2/5 non-compliance actually occurred. We acknowledge that compliance with P2/5 can be difficult to maintain on all parts of the distribution system at all times as the distribution licensee does not have certainty about or control over customer actions. For example, for smaller demand groups (typically at lower voltage levels), it is not uncommon for a single customer's action (e.g. a change to a single customer's demand) to result in a compliant distribution system becoming non-compliant (or vice versa). Ofgem recognises that some demand predictions are based on general trends and there is much less certainty about when and if the forecast demand level will occur. We acknowledge that a distribution licensee needs to assess predicted demand scenarios in accordance with its wider statutory duties³ and it is recognised that a degree of certainty about future demand levels will be sought before a distribution licensee would commit expenditure to reinforcement measures. Ofgem considers that it is generally in the wider interests of customers that distribution licensees use their best commercial and engineering judgement in such situations.

² Such directions are also referred to as derogations.

³ Section 9 of the Electricity Act states "It shall be the general duty of an electricity distributor:
 (a) to develop and maintain an efficient, co-ordinated and economical system of electricity.
 (b) to facilitate competition in the supply and generation of electricity".

There are a number of possible causes for P2/5 non-compliance. These include: -

- Unexpected third party action.
- Delay to the completion of agreed reinforcement works (e.g. due to planning consents).
- Inaccurate demand forecasting.
- Failure of the distribution licensee to plan and develop the distribution system in accordance with statutory and licence obligations.

The information reported to Ofgem about distribution system performance has been significantly enhanced by the introduction of the distribution licence quality of service incentive scheme and associated reporting arrangements⁴. The incentive arrangements for distribution system are now well established. Distribution licensees provide regular reports (i.e. output measures) to Ofgem against a range of defined distribution system performance output measures (e.g. customer interruptions and customer minutes lost). Ofgem is now much better able to monitor the performance using output measures. The effects of P2/5 compliance issues for smaller demand groups (typically at lower voltage levels for which there is disaggregated reporting) are more visible in the annual distribution system performance reports as they would give rise to customer interruptions. At lower voltages in particular, there is less value from a general requirement on distribution licensees to report P2/5 compliance issues (i.e. an input measure). For larger demand groups, first circuit outage compliance issues would not necessarily give rise to customer interruptions. Therefore such compliance issues would not be visible to Ofgem in the annual distribution system performance reports.

Driver for Proposed Reform

One of the recommendations from a recent investigation⁵ was that Ofgem should strengthen the procedure to process and grant derogations. The consultants advised that Ofgem should clarify the circumstances under which a distribution licensee would be expected to apply for derogation. Also a number of distribution licensees have formally asked Ofgem to provide guidance about its process for the assessment of derogation requests.

Scope of Proposed Simplified P2/5 Regulation Arrangements

Ofgem proposes that simplified regulation arrangements relating to P2/5 compliance should be introduced for specified areas of distribution systems. Ofgem considers that Simplified P2/5 Regulation Arrangements should be limited to distribution licensees who are also obliged to comply with distribution licence condition 49. The introduction of the proposed Simplified P2/5 Regulation Arrangements is not intended to lead to any deterioration in the quality of service delivered to customers. It is noted that standard condition 49 contains incentives and reporting requirements relating to distribution system performance. The proposed Simplified P2/5 Regulation Arrangements will not require a variation to any distribution licensee's performance targets.

Ofgem proposes that a distribution licensee who is obliged to comply with standard condition 49 but who is unable to in some regard comply with standard condition 5 should not be required to apply for a specific derogation but may self regulate if the non-compliance with P2/5 meets the following criteria:

- The non-compliance does not have a significant impact on the performance of the overall system;

⁴ Distribution licence condition 49 and associated Regulatory Instructions and Guidance. Distribution licence condition 49 : Quality of Service Incentive Scheme and Associated Information. This condition is only switched on in the distribution licences held by the ex-PES companies.

⁵ Ofgem's investigation of distribution licensee compliance with P2/5, in relation to specific substation points.

- Business processes are in place to ensure timely identification of compliance issues by the licensee;
- Compliance issues are proactively assessed by the licensees and remedial actions identified and implemented within a defined timescale;
- The non-compliance and the plan for remedial action is documented and retained and is available for inspection by Ofgem (on request) for a defined time period; and
- Measures are identified to mitigate the impact of the non-compliance until necessary remedial actions are completed.

Ofgem considers that the proposed Simplified P2/5 Regulation Arrangements should not apply if the identified non-compliance:-

- Impacts on another licensee's ability to comply with its licence e.g. at the transmission/distribution interface, interfaces with other distribution systems; or
- Affects a demand group of 60MW (Class D) or more⁶; or
- Affects a customer with special security of supply requirements or sensitivities e.g. a COMAH⁷ site.

Ofgem considers that where the proposed Simplified P2/5 Regulation Arrangements do not apply, a distribution licensee is expected to request derogation in relation to any P2/5 compliance issues that it identifies on its distribution system.

This proposal is not intended to reduce the distribution licensee's obligations in relation to security of supply or distribution system performance. The proposed Simplified P2/5 Regulation Arrangements are intended to remove the need in specified circumstances for a distribution licensee to request derogation in respect of certain types of P2/5 compliance issues. These proposals are designed to provide clarity to distribution licensees about the circumstances where a derogation application is required, in light of the licensee views that this situation is currently ambiguous. This is a governance refinement that has advantages to both licensees and Ofgem and is consistent with Better Regulation principles.

Ofgem does not consider that additional routine reporting requirements are required as part of the Simplified P2/5 Regulation Arrangements. Ofgem already monitors distribution system performance and would expect to investigate distribution licensee compliance with P2/5 in cases where it has concerns for example about deterioration in distribution system performance or following a significant event on the distribution system. Ofgem considers that as part of any such compliance investigation, the distribution licensee should be able to demonstrate that it has robust processes in place to ensure continued adherence to its obligation to develop its distribution system at least to the standard set out in P2/5. The proposed Simplified P2/5 Regulation Arrangements will not preclude Ofgem from taking enforcement action if evidence indicates a serious failing by a distribution licensee.

Options for Implementation of Simplified P2/5 Regulation Arrangements

A distribution licensee is required to plan and develop its distribution at least to the standard set out in P2/5 unless relief has been granted by the Authority. We consider

⁶ P2/5 defines a higher level of security for Class D and E requiring defined proportions of supply to be maintained for both first and second circuit outage conditions. Ofgem has adopted the P2/5 breakpoint in demand group size as a rational boundary for the Simplified P2/5 Regulation Arrangements.

⁷ A site covered by the Control of Major Accident Hazards (COMAH) Regulations is referred to as a COMAH site. The COMAH regulations apply mainly to the chemical industry, but also to some storage activities, explosives and nuclear sites and other industries where the threshold quantities of dangerous substances identified in the COMAH regulations are kept or used.

that there are two options for the implementation of Simplified P2/5 Regulation Arrangements which are:-

- Grant a derogation to relevant distribution licensees that amends the P2/5 compliance obligation under distribution licence condition 5 to allow for the Simplified P2/5 Regulation Arrangements for circumstances specified within the derogation.
- Amend distribution licence condition to change the scope of the P2/5 compliance obligation to allow for the Simplified P2/5 Regulation Arrangements.

Ofgem considers that either of these options could be adopted to implement the proposed Simplified P2/5 Regulation Arrangements. An update of Ofgem's Derogation Guidance Note⁸ would also be required to reflect the Simplified P2/5 Regulation Arrangements.

Ofgem recognises that the proposed Simplified P2/5 Regulation Arrangements are a change from the previous approach to regulating P2/5 compliance. We consider that there is value in a staged implementation of the new arrangements. Ofgem proposes the following implementation plan:-

- Grant derogation from standard condition 5 to distribution licensees who are also required to comply with standard condition 49. The derogation would define conditions which must be satisfied in circumstances where a distribution licensee opted to self regulate.
- Update the Derogation Guidance Note to reflect the Simplified P2/5 Regulation Arrangements.
- Review of the impact of the new arrangements after two years.
- Consider changes to standard condition 5 of the distribution licence in light of the findings of the Ofgem review.

Distribution licensees and other interested parties are invited to provide views on the proposed Simplified P2/5 Regulation Arrangements by 11 April 2006. Ofgem would prefer to receive responses electronically by email to bridget.morgan@ofgem.gov.uk or addressed to Bridget Morgan at Technical Directorate, Ofgem, 9 Millbank, London, SW1P 3GE. Confidential responses should be clearly marked.

Please do not hesitate to contact me on the above number if you have any queries in relation to the issues raised in this letter or alternatively contact Bridget Morgan on 020 7901 7080.

Yours sincerely



John Scott

Technical Director

Appendix 1 – Scope of P2/5

The normal recommended levels of security set out in P2/5 are defined for six bands of demand. The demand thresholds are defined as absolute MW values and the bands are: -

- Class A - Up to 1MW,
- Class B - Over 1MW and up to 12MW,
- Class C - Over 12MW and up to 60MW,
- Class D - Over 60MW and up to 300MW,
- Class E - Over 300MW and up to 1500MW and
- Class F - Over 1500MW.

P2/5 defines the security requirements for five of the demand bands in terms of the minimum demand to be met within a defined timescale following first and second circuit outage conditions. P2/5 refers to a transmission system security standard for demand groups of 1500MW and above. The security requirements increase as the size of demand increases and there is a significant change in the security requirements between each of the defined bands. P2/5 does not specify required restoration times for second circuit outage conditions for Classes A, B or C and defines permissible levels of demand disconnection (in terms of total MW and duration of interruption) for first circuit outage conditions. For Classes D and E, the distribution system should be designed to maintain supplies to defined proportions of connected customers for both first and second circuit outage conditions. This higher standard for Class D and E arise from probabilistic analysis that underpins P2/5.