

Electricity Distribution Price Control Review

DRAFT STANDARDS OF PERFORMANCE REGULATIONS: CATEGORY 4 SEVERE WEATHER EVENTS

Joint Legal Working Group Paper

ILP/22

1. Introduction

- 1.1 This paper sets out the observations of the distributor members of the working group on the introduction of a Category 4 severe weather event into the draft standards of performance regulations.
- 1.2 The distributors have recently submitted to Ofgem proposed changes to the draft regulations which acknowledge a weather event of such extremity – a Category 4 event – that it goes beyond the normal parameters of severe weather. In such a case, the legal obligation to pay compensation to affected customers would not apply. The threshold for this event was set on the basis that at least 50% of exposed customers were affected by it. At the meeting of the working group on 12 October, Ofgem questioned the desirability of this change and we agreed to submit a further note to explain our thinking.
- 1.3 This note addresses three issues:
 - (a) the adequacy of a square-law relationship between restoration time and the number of affected customers as a protection for distributors;
 - (b) the consequences of not establishing a Category 4 event in the event that such extreme weather conditions occur; and
 - (c) the potential arbitrariness of the Category 4 threshold, particularly if the same weather event affects a number of customers in two distribution areas that was in one case just above and in the other case just below the relevant threshold.

2. Adequacy of the Square Law Approach

- 2.1 As we suggested in ILP/17, a square law approach more accurately reflects the consequences of severe weather for network restoration times than the linear relationship originally assumed by Ofgem. That is to say, the nature of the relationship tends to be exponential.
- 2.2 However, the square law as proposed in our redrafting is unable accurately to reflect the effects of extreme weather. This is because the denominator in the calculation is necessarily set at the existing Category 3 threshold number of customers, which is 35% of the exposed customer group. It would therefore require 70% of exposed customers to be affected – an almost unprecedented portion of the customer base – before the calculation became based on a figure of 2², so giving an eight-day restoration time.

- 2.3 The severe storms of October 2002 did not approach this level of extremity. The only comparable event in recent memory was the hurricane of October 1987, following which some 170,000 customers in the south-eastern areas of England were still off supply after eight days (in spite of a level of military support in the restoration effort that would be unlikely to be available today) (see the Electricity Council's formal report of December 1987 to the Secretary of State for Energy).
- 2.4 For such exceptional weather events, even the square law calculation cannot of itself adequately reflect the real impact of the event on reasonable supply restoration times.

3. Effect of Not Having a Category 4

- 3.1 If an event of this extremity took place again in the absence of a Category 4 threshold, the sums of compensation payable under the regulations would be very substantial indeed.
- 3.2 If distributors were prevented from recovering such sums from customers (see, for example, the current drafting of special condition E1), far more than the expected percentage of revenue would be exposed by the regulations.
- 3.3 On the other hand, to the extent that distributors were allowed to pass-through the costs, the effect of the regulations would almost certainly be to create a substantial cross-subsidy between urban and rural customers (something which in other contexts is generally discouraged by Ofgem). It is also highly likely that the customers who successfully claimed compensation would see a significant proportion of those payments being recovered from themselves through increased use of system charges.
- 3.4 At this point, the regulations would have effect, in practice, as a scheme in which very substantial sums of money circulate around the customer base at considerable administrative time and expense. We think that at such a point the process becomes self-defeating. It cannot be good public policy to turn a large part of the customer base into an insurer of last resort for another large part. One of the benefits of our Category 4 approach is that it is designed to avoid such circumstances arising.

4. Potential Arbitrariness of the Threshold

- 4.1 The setting of any threshold may have effects which seem arbitrary. To some extent this is unavoidable. However, we do recognise the difficulty that would be caused for Ofgem by a Category 4 threshold that gave rise to two wholly different outcomes in relation to distributors who were more or less equally affected by the same weather event.
- 4.2 This possibility arises from the arbitrary nature of distribution area borders in relation to weather events. However, we believe that it can be resolved by defining Category 4 on the basis of the following principles:

- (a) if a weather event affects only one distributor above the lower threshold (the starting point for a Category 3 event), a Category 4 event arises where 50% of that distributor's exposed customers are affected; but
 - (b) if the same weather event affects more than one distributor above the lower threshold, then a Category 4 event is deemed to arise for all such distributors if it arises for one of them under the 50% test.
- 4.3 This may not be a perfect solution, but we think it is broadly workable. We would be happy to suggest detailed redrafting in support of this change, which we strongly recommend to Ofgem. However, if Ofgem has concerns about this approach and can identify a more workable alternative, we would also be happy to discuss that with Ofgem.

**Electricity Distributors
of Great Britain
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