

Guidance on licence derogation requests

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Target Audience: Electricity generation, transmission, distribution and supply licensees and interested parties

Overview:

This document sets out Ofgem's guidance on the process for requesting a derogation from a licence obligation to comply with technical codes and standards within electricity generation, transmission, distribution and supply licences. It also sets out the criteria Ofgem will take into account when considering such requests.

This guidance replaces the Guidance Note: Derogation From Codes And Standards In Electricity Generation, Supply, Distribution And Transmission Licences we issued in October 2003. It updates the previous guidance in light of recent developments, including the revised guidance on impact assessments, guidance to industry on environmental issues and code objectives and, most recently, issues arising in the context of the Transmission Access Review. The guidance sets out that Ofgem's assessment of derogation requests will take into account the Authority's statutory duties and consider costs and benefits, including amongst other things the potential benefits of reduced carbon emissions.

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Context

This document sets out the process for electricity generation, transmission, distribution and supply licensees to apply for a derogation from a licence obligation to comply with relevant technical codes and standards, Ofgem's assessment of such requests and criteria of assessment. This guidance replaces the guidance we issued in 2003.

The previous guidance has been updated to reflect recent developments, in particular in relation to sustainable development. In March 2008, Ofgem issued revised guidance on impact assessments to take account of best practice as it has developed, for example in relation to sustainability issues. In June 2008, Ofgem issued guidance to industry on the treatment of carbon costs within the existing code governance framework. In parallel, we are undertaking a broader code governance review which will consider, amongst other things, whether it is appropriate to amend the code framework to align it more closely with the Authority's statutory objectives in relation to the environment.

Also in June 2008, Ofgem published its final report following the Transmission Access Review (TAR). Under TAR, Ofgem identified a number of measures which may facilitate faster connection of some generation and establish enduring access arrangements that will facilitate the achievement of the government's 2020 targets for renewable energy. The final TAR report noted that transmission licensees would be working to identify opportunities to use derogations from minimum standards in the GB SQSS to facilitate faster connection. It also noted that Ofgem's assessment of derogation requests would take into account the Authority's statutory duties and will consider appropriate costs and benefits including, amongst other things, the potential benefits of reduced carbon emissions.

We consider it is appropriate that the guidance on derogations reflects these developments in relation to sustainable development, in particular to clarify the type of information we expect to be included in a request for a derogation, including where appropriate a quantitative assessment of the impacts of the potential derogation on, amongst other things, carbon emissions.

We have also updated the guidance to include a number of housekeeping changes, for example to refer to correct standard licence conditions as these have changed since the document was first produced and to include the System Operator Transmission Owner Code ('SO-TO Code' or 'STC') as a code to which the guidance applies.

Associated Documents

- Guidance Note: Derogation from Codes and Standards In Electricity Generation, Supply, Distribution And Transmission Licences. October 2003
http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Documents1/4956-Derogation_Guidance_Note_21oct03.pdf
- Transmission Access Review - Final Proposals. June 2008
http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/080626_TAR%20Final%20Report_FINAL.pdf
- Guidance on Impact Assessments. March 2008
<http://www.ofgem.gov.uk/About%20us/BetterReg/IA/Documents1/GUIDANCE%20ON%20IMPACT%20ASSESSMENTS.pdf>
- Ofgem Guidance - Environmental issues and code objectives. June 2008
<http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Open%20letter%20response-%20final%20version%20of%20letter%2030%20June.pdf>

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Summary

Guidance on derogation requests

What a derogation is and when it may be appropriate

Electricity generation, transmission, distribution and supply licensees are obliged to comply with certain technical codes and standards. Compliance with technical codes and standards is in the interests of electricity consumers as a failure to comply can have a direct and adverse impact on the security and quality of electricity supplied, and may have health and safety implications.

However, there may be occasions when a licensee assesses that it is not in a position to comply with a particular code or standard, or that the requirements placed upon it by a code or standard may result in an inefficient outcome either in the short or longer term. In these circumstances, a licensee may submit a request to Ofgem for a derogation from the licence requirement to comply with a particular obligation in a code or standard.

This document sets out the information Ofgem requires in order to assess a request for a derogation, and outlines the factors Ofgem takes into account in its assessment.

Information required and Ofgem's assessment

A request for a derogation should be submitted in writing to Ofgem and should include sufficient information to enable the Authority to make a decision, including a comprehensive, and where possible, quantitative assessment, of the impact of the non-compliance on:

- Consumers
- Competition
- Sustainable development
- Health and safety and the associated risk management measures
- Other parties affected by the non-compliance, including the ability of the relevant system operator to operate its system

Each derogation request is assessed by Ofgem individually on its merits in terms of the likely effect on consumers and on the ability of other authorised electricity operators to comply with their statutory obligations and licence conditions.

In its assessment the Authority, having regard to its principal objective and its statutory duties, including our duties in respect of sustainable development, will consider amongst other things the impacts set out above.

If Ofgem is satisfied that the information received meets the minimum requirements and considers that the derogation request is justified then the Authority will issue a direction to the licensee granting the necessary relief from the relevant obligations

for a time period specified in the direction. A copy will also be placed on Ofgem's public register.

1. Introduction and background

Chapter Summary

This chapter explains what a derogation is, the circumstances in which a derogation may be appropriate, and the different types of derogation Ofgem may grant.

Background

1.1. Electricity generation, transmission, distribution and supply licensees are obliged to comply with certain technical codes and standards. Compliance with technical codes and standards is in the interests of electricity consumers as failure to comply can have a direct and adverse impact on the security and quality of electricity supplied and may have health and safety implications.

1.2. Unless the Authority directs otherwise, electricity generation, transmission¹, distribution and supply licensees are required to comply with the Distribution Code and the Grid Code. In addition, Distribution Licensees must comply with the Engineering Recommendation P2/6 and Transmission Licensees with GB SQSS when planning their respective systems. Further, transmission licensees are required to comply with the System Owner - Transmission Owner Code ('SO-TO Code' or 'STC').

1.3. A licensee may submit a request to Ofgem for a derogation from the licence requirement to comply with a particular obligation in a code or standard. This document summarises the process for requesting a derogation from a technical code or standard within electricity generation, transmission and distribution licences. It also sets out the criteria Ofgem will take into account when considering a derogation request, and the process we will follow.

1.4. A list of the technical codes and standards to which this guidance applies, together with the associated licence and licence condition number is provided in Appendix 1 to this guidance.

1.5. This document will be updated as required from time to time to reflect changes in licences, the technical codes and standards referenced, primary and secondary legislation and Ofgem's processes.

What is meant by derogation?

1.6. A derogation is a direction from the Gas and Electricity Markets Authority ('the Authority') relieving a licensee from its obligation to comply with a technical standard

¹ This applies only to a transmission licensee with section C (System operator conditions) in force in its licence. In practice therefore this applies only to one of the electricity transmission licensees, National Grid Electricity Transmission plc (NGET).

or code in its licence in specified circumstances and to a specified extent. The derogation will normally have an expiry date so that the need for it can be systematically reviewed and performance towards compliance can be monitored. The derogation will not apply to a period before the date the direction is issued. Every derogation will be entered on Ofgem's public register after it has been granted.

1.7. A derogation is granted to an individual licensee and cannot be transferred. Thus if a non-compliant system or plant item is sold, the new licensee will need to apply for a new derogation.

1.8. If a licensee would gain a competitive advantage from a derogation, then a direction would not be issued without Ofgem assessing what measures might be appropriate to offset that advantage. Such measures may also include requirements to monitor the impact of the derogation on the licensee making the application and other parties who may be affected.

When would a derogation be required?

1.9. Continued compliance with technical codes and standards is a licence obligation and is the responsibility of each relevant licensee. Failure to comply, unless permitted by a derogation, is a contravention of the licence for which Ofgem may take enforcement action and consequently issue an order and/or impose a financial penalty². However, as noted above, Ofgem recognises there may be occasions when a licensee assesses that it is not in a position to comply with a particular code or standard, or that the requirements placed upon it by a code or standard may result in an inefficient outcome either in the short or longer term. There are a number of circumstances in which a derogation may be required, for example:

- To prevent a breach of a licensee's obligations while a system or plant item is restored to compliance with a code or standard. Such a derogation is likely to be limited to a timescale in which the compliance could reasonably be expected to be restored.
- To prevent a breach of a licensee's obligations while changes to a code, standard or licence condition are made. Such a derogation is likely to be limited to a timescale in which the compliance could reasonably be expected to be restored.
- To permit a system or plant item to operate out of compliance with the standard or code either indefinitely or for the lifetime of the system or plant item.

1.10. In general, where a licensee has failed to comply with their obligations, but has remedied the matter before an application for a derogation could reasonably be made, a derogation would not be issued by the Authority retrospectively. In such circumstances, Ofgem will consider the extent to which the situation warrants enforcement action being taken in respect of the breach based on the nature of that breach, its consequences and any remedial action taken by the licensee. Ofgem will

² Section 27A of the Electricity Act 1989 (as amended) gives the Authority power to impose financial penalties where there has been a contravention of a licence condition.

however expect to be notified by licensees of any such situations as soon as possible. If no remedial action has been taken there is an increased likelihood of enforcement action by Ofgem.

Types of derogation

1.11. There are three main categories of derogation that arise. These are:

Definite	-	Continues for a period of time specified in the Authority's direction
Lifetime	- - - -	Specific to a system or plant item and continues for the lifetime of the equipment forming that system or plant item Would cease should the equipment or plant item be replaced or a further derogation is made or the derogation is revoked Would only be granted when there are strong grounds for not taking action to restore compliance May be made where all parties materially affected by the non-compliance agree in writing to accept the consequences or are protected from the effects of the non-compliance
Indefinite	- - - -	Continues until a further derogation is made or the derogation is revoked. Would only be granted if there are strong grounds for omitting an expiry date May be made where all parties materially affected by the non-compliance agree in writing to accept the consequences or are not affected by the derogation To the extent that it does not set out the actions that would be required to restore compliance, this will need to be justified against the Authority's principal objective and statutory duties and the licence obligations of the applicant

1.12. It should be noted that a lifetime or indefinite derogation would only be issued in very limited circumstances. It is usual practice for derogations to be limited for a period of time that is specified in the direction. The Authority may issue further directions that can vary or withdraw previous derogations. This would be done following consultation with the affected licensee (and more widely if required) and may be initiated by a request from a licensee or by the Authority.

2. Information required in a derogation request

Chapter Summary

This chapter sets out the information required to be provided by the licensee to enable Ofgem to consider a derogation application.

Applying for a derogation

Submitting a request

2.1. Where a relevant licensee has identified that it does not, or will not in the future be in a position to comply with relevant obligations in a technical code or standard, the licensee should make a written request to the relevant Ofgem Director for a derogation from the licence requirement to comply with such obligations.

2.2. Requests in respect of compliance with the Grid Code and the GB SQSS should be made to Ofgem's Director of Transmission. Requests in respect of compliance with the Distribution Code and engineering standard P2/6 should be made to Ofgem's Director of Distribution.

Minimum requirements of the request

2.3. The request should include as a minimum:

- **Details of the applicant** (typically the Company Secretary), including the full name and address of the licensee concerned;
- **A clear description of the non-compliance** including
 - Type of licence and relevant licence condition number and technical code or standard
 - The required performance
 - The existing capability of the system or plant;
- A clear description of the **reasons why the non-compliance has occurred or is expected to occur**;
- A comprehensive and, wherever possible, quantitative assessment, of the **impact of the non-compliance on**:
 - **Consumers**
 - **Security of supply**
 - **Competition**
 - **Sustainable development**
 - **Health and safety** and the associated risk management measures
 - **Other parties affected** by the non-compliance, including the ability of the relevant system operator to operate its system;

- Details of **actions to mitigate** risks to consumers or other authorised electricity operators while the non-compliance exists;
- A description of the **proposal for restoring compliance** (where applicable) including timetable of works;
- A description of the **alternative actions** that have been considered; and
- The proposed **duration of the derogation** requested

Additional information

2.4. The licensee is required to justify the derogation request in terms of both the specific circumstances and the expected duration. Licensees are advised to give as much notice as possible when making derogation requests since a derogation will not be granted unless the Authority is satisfied that the request is justified.

2.5. Where relevant, in assessing the likely costs and benefits in terms of carbon savings, we expect the licensee to identify the volume of the change in carbon emissions associated with a particular request, and to apply the Shadow Price of carbon and/or forecast EU ETS carbon prices in order to quantify a value for this change.

2.6. All technical terms should be fully explained, and the request should be presented in as clear a manner as possible to avoid unnecessary delays in Ofgem's assessment of the request.

2.7. A request cannot be made for a retrospective derogation however if non-compliance has occurred detail of any remedial action taken by the licensee will be taken into consideration for enforcement purposes.

3. Ofgem's assessment of derogation applications

Chapter Summary

This chapter sets out the procedure Ofgem will follow in considering a request for a derogation from an electricity generation, transmission, distribution or supply licensee and the criteria against which the request will be assessed.

Ofgem's role

Our assessment

3.1. Each derogation request is assessed by Ofgem individually on its merits in terms of meeting the minimum requirements set out at paragraph 2.3 and the likely effect on consumers and on the ability of other authorised electricity operators to comply with their licence conditions and statutory obligations.

3.2. In its assessment the Authority, having regard to its principal objective and its general duties including environmental guidance issued by the government, will consider amongst other things the impact on:

- **Consumers:** we will consider the extent to which the non-compliance impacts on consumers, for example through increased costs.
- **Competition:** for example, any competitive advantage that may arise from granting the derogation.
- **Sustainable development:** Where relevant and possible, we would expect to assess the costs associated with granting a derogation (for example increased operational costs), compared to potential environmental benefits such as a reduction in carbon emissions.
- **Health and safety:** If health and safety implications have been identified by the applicant, Ofgem may seek expert advice from the relevant government bodies and other organisations, for example, the Health & Safety Executive (HSE)
- **Other parties affected:** where relevant, we will seek the views of affected parties before making a decision. We will also take into account the impact on the relevant system operator to operate its system if a derogation were granted.

3.3. Our assessment will also take into account:

- The nature of derogations already granted by Ofgem
- The likelihood of similar derogation requests in the future

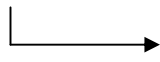
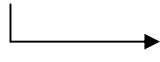
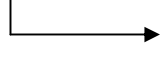
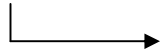
- The effect of the decision on future derogation requests
- Allowances that have been made in current and previous price controls (where relevant)
- Any other relevant information

3.4. We have set out below Ofgem's procedure for considering an application for derogation and the criteria that Ofgem proposes to apply when considering a derogation request.

Procedure

3.5. Ofgem may consult with the licensee making the request initially to clarify points relating to the derogation request and satisfy itself that there is a need for a derogation.

3.6. As part of its consideration of the request, Ofgem will consult with other parties as required in accordance with the following checklist:

Is broader industry consultation (eg an impact assessment) required to inform the Authority's decision?		
	 YES	<p>Ofgem will consider the appropriate manner in which to consult with industry and affected parties.</p> <p>Should Ofgem consider an impact assessment is required, this will consider the matters set out in our Impact Assessment Guidance³.</p>
Have directly affected authorised electricity operators been identified?		
	 NO	Discuss with the licensee making the request
	 YES	Consult with those who are materially affected (this includes those parties who Ofgem considers would be affected technically and/or commercially)
Are there safety implications?		
	 	Consult with relevant organisations, eg the Health

³<http://www.ofgem.gov.uk/About%20us/BetterReg/IA/Documents1/GUIDANCE%20ON%20IMPACT%20ASSESSMENTS.pdf>

	YES	and Safety Executive
Does it affect a nuclear powered generating station?		
	YES	Consult with the Nuclear Installations Inspectorate
Is a monitoring mechanism required?		
	YES	Consult with licensee and materially affected parties (or more publicly where necessary) about suitable mechanism
Are there other relevant factors?		
	YES	Seek independent external advice if required.

Criteria

3.7. Ofgem is likely to consider that a derogation request is justified if:-

- An assessment has been provided by the applicant that demonstrates that there are NO:-
 - Significant risks associated with the non-compliance to the licensee, other relevant licensees or connected customers (who may or may not be a licensed party).
 - Avoidable adverse impacts (immediately or in the longer term) on the licensee, other relevant licensees or connected customers.
 - Additional measures that could be taken to further mitigate the impact of the non-compliance on the licensee, other relevant licensees or connected customers for its duration.
 - Outstanding objections from other parties who are materially affected by the non-compliance.
 - Competitive advantages to the licensee arising from the derogation that cannot be addressed that are not offset by a suitable mechanism.
 - Other reasonable options to address the non-compliance that have not been considered.
- The applicant has presented a robust, economic case that supports the action that it considers necessary to address the non-compliance. (Ofgem notes that there may be cases where the impact of the non-compliance may not justify the expenditure required to restore compliance but would expect any applicant to make a strong economic case for any decision not to restore compliance.)
- The applicant has presented a realistic and comprehensive implementation plan that defines, at the very least:

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- The works required to restore compliance.
 - The timetable for those works that show a deadline that is reasonable and is achievable (subject to highlighting any factors that may be outside the applicant's control, for example, third party consents).
 - Any measures to mitigate the risks to other parties that will be (or have been) taken until the non-compliance is restored.
- The applicant has produced any other supporting information that is relevant to a specific request, including on the materiality of the issue.

3.8. Where an applicant is unable to satisfy all the above criteria, Ofgem will assess how far the applicant's ability to satisfy the criteria is sufficient to justify the granting of a derogation. It is noted that a justified derogation request would not necessarily need to meet all of the listed criteria. Ofgem would use its judgement in assessing any derogation requests and would advise any applicant of additional information requirements that were not included in the original request.

3.9. If Ofgem considers that the derogation request is justified then the Authority will issue a direction to the licensee granting the necessary relief from the relevant obligations for a time period specified in the direction. A copy will also be placed on Ofgem's public register.

3.10. Ofgem may reserve the right to revoke a derogation and may grant a derogation which is subject to certain conditions being satisfied, either by the licensee to which the derogation applies or in respect of the wider system.

3.11. If Ofgem considers that the derogation request has not been sufficiently justified then the Authority may:

- Issue a direction granting the derogation for a short duration to allow the licensee time for further investigation of solutions to the non-compliance, or
- Refuse the derogation request.

3.12. Where Ofgem refuses a derogation request where there is non-compliance with the licence obligation, Ofgem will consider the extent to which the situation warrants enforcement action being taken in respect of the breach based on the nature of that breach, its consequences and any remedial actions taken by the licensee.

3.13. Ofgem will maintain a record of derogations that have been granted and is likely to incorporate a derogation monitoring activity for fixed duration derogations in its asset risk management work area.

Appendices

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Appendix 1 - Technical codes and standards to which this guidance applies

Technical Code or Standard	Electricity Licensee	Relevant Licence condition
Grid Code	Transmission* Generation Distribution Supply	C14 5 20 11
Distribution Code	Transmission* Generation Distribution Supply	C15 6 20 11
SO-TO Code (STC)	Transmission	B12
Engineering Recommendation P2/6	Distribution	24
GB Security and Quality of Supply Standard (GB SQSS)	Transmission	C17 and D3

* Applies only to National Grid Electricity Transmission plc as system operator, and not the other transmission licensees

Appendix 2 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.⁴

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly⁵.

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them⁶; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.⁷

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

⁴ entitled "Gas Supply" and "Electricity Supply" respectively.

⁵ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

⁶ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

⁷ The Authority may have regard to other descriptions of consumers.

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- Promote efficiency and economy on the part of those licensed⁸ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
 - Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
 - Contribute to the achievement of sustainable development; and
 - Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation⁹ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

1.9. The Energy Act 2008 contains provisions which, once commenced, will modify the general duties of the Authority in carrying out its functions under the Gas Act and the Electricity Act. In particular, those changes will mean that, when carrying out its functions in the manner which it considers is best calculated to further its principal objective, the Authority must do so by having regard to the need to contribute to the achievement of sustainable development equally with the need to have regard to the need to secure that all reasonable demands for electricity and gas are met and that licensees are able to finance their regulated activities.

1.10. It has also been highlighted within the text of the principal objective that the Authority's consideration of the interests of consumers includes both future as well as existing consumers.

⁸ or persons authorised by exemptions to carry on any activity.

⁹ Council Regulation (EC) 1/2003

1.11. The Energy Act 2008 received Royal Assent on 26 November 2008 but these provisions do not have legal force until they are commenced. We do not yet have a commencement date for the new provisions but it is likely to be early in 2009.

1.12. During the period between the Energy Act 2008 having received Royal Assent and commencement of the provisions which affect its duties, the Authority must continue to apply the principal objective and its statutory duties in accordance with the Gas Act and the Electricity Act as they currently stand (i.e. prior to the Energy Act 2008 amendments taking effect), although it will be mindful of the changes that are forthcoming. The Authority already takes account of sustainable development in its decisions but with the change in duties the weight that is attached to such considerations will be increased.