



All stakeholders

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Dear colleague,

Conclusions document on Ofgem's consultation on Derogation requests to facilitate earlier connection of generation and proposed amendments to Ofgem's Guidance on derogation requests – reference number 03/09

On 21 October 2008, Ofgem issued a consultation¹ ("the October 2008 consultation") seeking views on proposals on the information that Ofgem will require to inform an assessment of requests from transmission licensees for derogation against GB Security and Quality of Supply Standards ('GB SQSS'). We noted that in certain circumstances, such derogations could facilitate the earlier connection of some generation. The October 2008 consultation also sought views on Ofgem's proposed revised derogation guidance to all electricity licensees.

This letter summarises responses to the October 2008 consultation, sets out Ofgem's views on the issues raised by respondents and our conclusions.

We have set out in appendix 1 to this letter updated guidance to transmission licensees that reflects our conclusions about the information we require to inform our assessment of a derogation request to facilitate earlier connection of generation. In addition, we have also now issued our updated Guidance, which is available on our website².

The October 2008 consultation

The October 2008 consultation set out the technical codes and standards which electricity licensees are required to comply with. It noted that there may be occasions when a licensee assesses that it is not in a position to comply with a particular obligation in a technical code or standard, or that the requirements placed upon it by a particular obligation in a technical 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 the Authority³ for a derogation from the licence requirements to comply with that obligation.

The October 2008 consultation referred to Ofgem's final report on the Transmission Access Review ('TAR')⁴. The TAR final report noted that before the enduring access regime is put

¹ http://www.ofgem.gov.uk/Licensing/Work/Documents1/081021_Derogations_letter.pdf

² <http://www.ofgem.gov.uk/Networks/Tech/TechStandds/Derogtns/Documents1/090119DerogationsGuidance.pdf>

³ The Office of Gas and Electricity Markets is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

⁴ http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/080626_TAR%20Final%20Report_FI_NAL.pdf

in place transmission licensees could identify opportunities to use derogations from minimum standards in the GB SQSS in order to achieve earlier connection of some generation. To assist transmission licensees in taking forward such derogation requests, and to ensure that Ofgem is provided with sufficient information to inform our assessment, the October 2008 consultation set out and sought views on the type of information we would expect to be provided in the context of requests for derogations to facilitate earlier connection of new generation.

The October 2008 consultation also sought views on our proposed revisions to Ofgem's Guidance on licence derogation requests. We explained that we consider it is appropriate to update the guidance to take forward a number of housekeeping changes and recent developments. One particular change proposed was to clarify that, in reaching its decision on a derogation request, the Authority will take into account, amongst other things, its obligations in respect of sustainable development and where appropriate will consider the potential impact of a derogation on carbon emissions.

In addition, we noted that on 5 March 2007 we issued a direction to distribution network operators ('DNOs') which allows them to "self-certify" derogations from Engineering Recommendation P2/6 ("P2/6") for load groups less than 60MW. We sought views on whether it would be appropriate to allow for self-certification under a wider range of circumstances and require DNOs to produce an annual compliance report against P2/6.

We received ten responses to the October 2008 consultation. These are available in full on our website⁵. Responses are summarised below, together with Ofgem's views on the issues raised.

Request for derogations to facilitate earlier connection of generation

Respondents' views

Five respondents commented on the use of GB SQSS derogations for earlier connection and on the information Ofgem expects to be provided in requests from transmission licensees. Respondents were broadly in support of our proposed approach.

One respondent commented that derogation could be used to facilitate earlier connection, but only if objectively justified, with a clear process and transparency in respect of applications.

Respondents broadly agreed that it was appropriate to take account of carbon costs in assessing derogation requests, although one commented that it should be recognised that the level of renewable activity and the impact on local and boundary systems (ie the additional strain on the local and wider network of connecting this additional generation) may result in a complex arrangement of interdependent derogation applications. One respondent commented that the scenario based approach we have proposed is appropriate, and considered that in practice transmission licensees will seek derogation without referring to potential generation users. This respondent considered that capacity realised through a successful derogation request would then be allocated to users best able to utilise it.

Two respondents commented on the interaction between transmission owners and the system operator in taking forward GB SQSS derogation requests for connections in Scotland. One noted that it would be incumbent on the transmission owners to provide information on system capability, and for the system operator to do the analysis on constraints costs. The other commented that the System Operator - Transmission Owner Code ('SO-TO Code' or 'STC') should be amended to ensure an appropriate data exchange procedure for derogation requests.

⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=140&refer=Licensing/Work>

One respondent raised concerns with regard to the interim nature of derogations to facilitate earlier connection of generation, in particular if any access rights generators achieve through derogation are removed through subsequent changes such as the proposals under TAR to auction existing access rights. This respondent also considered that Ofgem's sustainable development objectives are not fulfilled by a narrow focus on the purely quantifiable economic costs and benefits of a proposal for derogation and considered that in this area a quantitative assessment was not necessarily any more authoritative than qualitative arguments. The respondent considered there was a lack of clarity over costs and benefits to be assessed and whether embedded generators could benefit from transmission system derogations.

Ofgem's views

We welcome the support for our proposed approach. We agree that derogations to facilitate earlier connection are appropriate only where the licensee's request is objectively justified. We provided guidance in the October 2008 consultation to assist transmission licensees in submitting their request to Ofgem in order that we can assess whether a request is objectively justified, taking into account appropriate costs and benefits.

We recognise that there may be related and interdependent derogations resulting from this process, but as set out in the October consultation, we expect the transmission licensees to submit coherent and coordinated requests to minimise complexity. We also note that one respondent does not consider requests should refer to potential generators that would be able to utilise any capacity released. We note that cost benefit analysis could potentially be less robust if requests are not linked to specific generation projects. For example it may be difficult to quantify, on a generic basis, the volume of expected reductions in carbon emissions based on the type of plant connecting, its thermal efficiency, load factor and intended output, and the likely impact on generation patterns of other plant. However, should transmission licensees consider this to be the most appropriate approach, we would consider as part of our assessment of any derogation request whether the cost benefit analysis provided is sufficient.

We also recognise that there will be interactions between the transmission owner and system operator in taking forward derogation requests. To the extent that the transmission licensees consider changes are required to the STC to facilitate this interaction, we would expect them to raise an appropriate amendment proposal. However, we consider that there is scope within the existing framework for the transmission licensees to work together to progress derogations requests, as they do today, and would not expect potential STC amendment proposals to delay transmission licensees from taking forward derogation requests to facilitate earlier connection.

We note that one respondent raised a concern about the interim nature of potential derogations, which it noted could be superseded by proposals under TAR. We made it clear in the TAR final report that using derogations to facilitate earlier connection was one of several short term measures designed to facilitate connection in advance of more enduring reformed access arrangements being put in place. We continue to consider that this is an appropriate, interim measure, where requests are supported by cost benefit analysis that justifies earlier connection. We recognise that the introduction of enduring reformed access arrangements could have wide ranging impacts on existing industry arrangements, including any derogations granted to facilitate earlier connection.

We note this respondent did not consider that Ofgem's sustainable development role is fulfilled by focusing on purely quantifiable costs and benefits and that, in this area, a quantitative assessment was necessarily any more authoritative than qualitative arguments. We recognise that any quantitative assessment will depend on the assumptions underlying the inputs. As we set out in the October 2008 consultation, we expect the transmission licensees' quantitative assessment to be undertaken with appropriate account of sensitivities of input assumptions, such as using a number of scenarios, clearly identifying the assumptions taken into account, in order to identify the

likely range of costs and benefits. We acknowledge the important role that qualitative considerations may play in decisions of this nature. Where appropriate, we will take into account qualitative analysis when reaching our decision.

We note this respondent considered it was also unclear whether embedded generators could benefit from derogations. To the extent that an embedded generator is seeking to connect in advance of system reinforcement otherwise required to connect them, we would anticipate that they could benefit from derogation to the same extent as transmission connected generators. We consider that this is important to ensure that embedded generators are treated in the same way as transmission-connected generators.

Proposed revised Guidance on Licence derogation requests

Respondents' views

Of those that commented, there was broad support for our proposed revised Guidance on Licence derogation requests, including the clarification in respect of our sustainable development duties. Three respondents commented on and supported the change to include the STC as one of the codes to which the guidance applies. One respondent commented that the criteria for Ofgem's assessment of derogation requests (chapter 3 of the guidance) should explicitly take into account factors outside of a licensee's control – for example delays in consents process.

Seven of the ten respondents commented on the potential for greater self-certification for P2/6. Of those that commented, four respondents supported an increase from 60MW to a 100MW threshold. Two did not support an increase in the self-certification threshold, one on the basis that the existing threshold works well, with the other commenting that above 60MW, non-compliance was likely to have greater impact on customers and as such the Authority should continue to have a role. One respondent considered that the self-certification approach should apply more widely to the Distribution Code, and not just P2/6.

Five respondents commented on the proposed annual compliance report for P2/6. Three did not agree that this report was appropriate, and two noted that Ofgem should bear in mind information already provided through other regulatory reports.

Some respondents considered guidance should be developed both for the proposed annual compliance report for P2/6 and for self-certification more generally, in particular in respect of security of supply and one respondent was of the view that the Distribution Code Review Panel ("DCRP") DCRP, reporting to Ofgem, is the appropriate body to develop such guidance.

Ofgem's views

We welcome the support for our proposal to update the derogations guidance to clarify that the Authority will take into account Ofgem's obligations in respect of sustainable development and where appropriate will consider the potential impact of a derogation on carbon emissions. We consider this is particularly useful clarification in light of the relevant provisions of the Energy Act 2008⁶ which, once commenced will modify the general duties of the Authority in carrying out its functions under the Gas Act 1986 and the Electricity Act 1989. In particular these 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. The Energy Act 2008 received Royal Assent on 26 November 2008. We

⁶ The Energy Act 2008 received Royal Assent on 26 November 2008. The provisions referred to in this document do not yet have legal force.

do not yet have a commencement date for the relevant provisions but it is likely to be early in 2009.

We note that one respondent considers that Ofgem's criteria for assessment should explicitly factor in matters outside the licensee's control, such as obtaining consents. We consider that our assessment criteria are sufficiently broad to ensure that the Authority can take all relevant matters into account. The criteria in chapter 3 of the guidance document make clear that the Authority may consider a derogation is justified amongst other things where "The applicant has produced any other supporting information that is relevant to a specific request". We do not therefore consider it is necessary to make specific reference to matters outside licensees' control as all applications will be considered on a case by case basis.

We note the views expressed in respect of the potential to increase the P2/6 self-certification threshold and on the proposed P2/6 annual compliance report. We are considering the issues related to P2/6 compliance in the context of the distribution price control review ('DPCR5'). We note that the direction enabling self-certification up to 60MW expires in February 2010. The aim of that direction was to provide a two year trial period, with the intention to consider at the end of that period whether and/or how to extend the P2/6 self certification arrangements. We will take the views submitted in response to the October 2008 consultation into account in that context of our work on DPCR5 and we will give consideration as to whether or not it may be appropriate to consult on extending the time period for the existing direction and/or increasing the threshold.

Conclusions

We consider we have appropriately identified the type of information that we would expect to be provided in requests for derogations to facilitate earlier connection of generation. We therefore expect that, where the transmission licensees have identified opportunities to use derogations to facilitate earlier connection, they will submit requests containing the information we have identified in appendix 1 to this letter.

We do not consider that we have received any responses that would require us to make further significant changes to the proposed revised guidance on licence derogation requests we issued in October. The revised guidance replaces the version of the Guidance issued in 2003⁷.

We do not intend to make any further changes in respect of the P2/6 self certification arrangements at this stage. Should we identify changes as being required as a result of our ongoing consideration of this issue, we will consult accordingly where necessary.

Yours sincerely



Stuart Cook
Director, Transmission

⁷http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/4888_Derogation_Guidance_Note_21oct03.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/assetriskmanagement

Appendix 1 – Requests for derogations to facilitate earlier connection of generation

1.1. Ofgem expects requests for derogation to be raised after a thorough assessment of the relevant impacts. We also expect that derogation requests will be presented in a coherent and coordinated manner. For example, licensees may consider submitting a single request for a derogation relating to the connection of a number of generation projects.

1.2. When requesting derogation, we expect NGET to take into account Ofgem's Guidance on Derogation requests which sets out in more detail the information we expect to be provided in requests for derogation, the procedure Ofgem will follow and the criteria against which Ofgem will assess requests. For requests to facilitate the earlier of connection of generation, we consider that, as well as any other relevant information, the request should include:

- i. **a clear description of the non-compliance**, setting out
 - a. the specific obligations in the GB SQSS that the licensee would not comply with
 - b. the performance required by the specific obligation
 - c. the existing capability of the system
- ii. **a comprehensive, and wherever possible, quantitative assessment** of the impacts of the derogation, including the impact on carbon emissions. We would expect this assessment to identify the likely **range of costs and benefits**, for example by using a scenario-based approach. The request should **clearly identify the assumptions the licensee has taken into account** and identify:
 - a. the profile of connected capacity with and without the derogation
 - b. the volume of expected reductions in carbon emissions based on the type of plant connecting if a derogation is granted, its thermal efficiency, load factor and intended output, and taking account of the likely impact on the generation patterns of other plant
 - c. the value of carbon savings, applying DEFRA's Shadow Price of carbon and/or forecast EU ETS carbon prices
 - d. the incidence, volume and associated cost of transmission constraints arising in the period for which the derogation is requested
 - e. the impact on consumers
 - f. the impact on security of supply
 - g. the impact on competition

- h. the impact on other parties such as operational restrictions on other generators and the ability of NGET to operate the GB transmission system
 - i. the impact on health and safety
- iii. Requested **duration** of the derogation
- iv. Details of **actions to mitigate** risks to customers or other authorised electricity operators while the non-compliance exists
- v. A description of the **proposal for restoring compliance** where appropriate (including timetable of works)
- vi. A description of the **alternative actions** that have been considered

1.3. Ofgem may grant a derogation which is subject to certain conditions being satisfied, either by the licensee to which the derogation applies, by a specific user of the GB transmission system or in respect of the wider system.