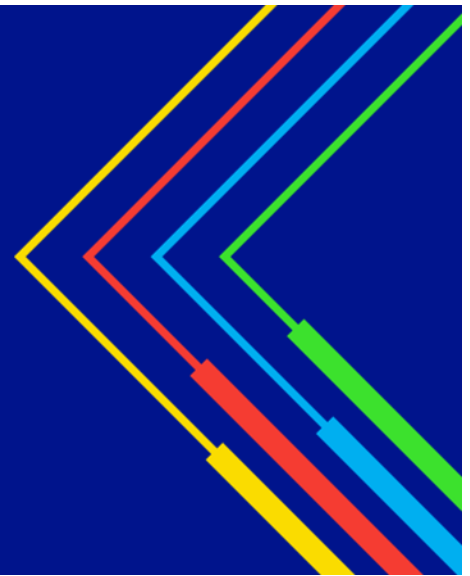


National Grid response to consultation for an Electricity Transmission Licence for Mersey Reactive Power Limited for the operation of a shunt reactor



National Grid sits at the heart of the energy system – our electricity network transmits electricity safely, reliably, and efficiently to supply millions of customers and communities across the UK. Stability of our network is critically important to the achievement of national objectives for a net zero future and central to the operation and growth of the nation's housing, businesses, and public services.

We recognise the need for the UK's energy regulatory framework to keep pace with changing markets. We support the introduction of competitive delivery of onshore transmission networks where benefits for existing and future consumers can be realised through the introduction of primary legislation.

We welcome the opportunity to respond to the Ofgem consultation on a minded-to decision for an application for an Electricity Transmission Licence for Mersey Reactive Power Limited (MPRL) for the operation of a shunt reactor.

This consultation response is on behalf of National Grid Electricity Transmission plc (NGET), the transmission owner in England and Wales.

As well as responding to the questions in the consultation, we have also set out our position in detail below which can be summarised as:

- We are seeking further detailed clarification from Ofgem on the need for MRPL to hold a transmission licence.
- Should Ofgem proceed with its minded-to position set out here we believe the current proposed SLC are not sufficient to protect consumers and have suggested additions in this response.
- This issue highlights how quickly the energy industry is changing. We are committed to working with Ofgem and BEIS to ensure that end consumers are fully protected as we all transition to meet our common goal of Net Zero.

The need for a transmission licence

As it is an offence for a person to participate in the transmission of electricity for the purposes of giving a supply unless authorised to do so by licence (s4(1)(b) Electricity Act 1989 (EA89), and participation includes making available for use any parts of the transmission system (s4(3A)(b) EA89), we understand why MRPL wishes to apply for a transmission licence if it is participating in transmission. However, given the obligations associated with holding a transmission licence (including the requirements under s10D EA89 to be certified as independent of relevant producer or supplier interests) it is important that a transmission licence is only granted where the actual activity necessitates one. It would not be in the interests of consumers or other transmission users if granting a transmission licence were to establish a precedent such that prospective future service providers might also need to meet such additional requirements, without careful consideration of their particular circumstances.

The MRPL application raises such an issue about the interpretation of the EA89 which could risk setting some unhelpful precedents for future electricity system development. It is not clear whether MRPL's

intended activity constitutes “participation in transmission” as defined in EA89 or, alternatively, the provision of a reactive power service from a User System (using the Grid Code term which denotes any system owned or operated by a User comprising generating modules or units, the lines from them, distribution systems, non-embedded customer equipment and remote transmission assets – none of which are considered to be part of the transmission system). In respect of the definition of transmission and the associated definition of a transmission system in s4(4) EA89, we understand that MRPL will use high voltage electrical equipment but not high voltage lines and will only contribute indirectly (by providing a reactive power service at the location) to conveying electricity from a generating station to a substation, from one generating station to another or from one substation to another. Careful consideration therefore needs to be given as to whether, in these circumstances, the applicant will, in fact, be participating in the transmission of electricity.

In the consultation Ofgem states that MRPL will be participating in the transmission of electricity because the shunt reactor will be constructed solely to provide a reactive power absorption service that is necessary for the correct operation of the transmission system and so concludes that the activity requires a transmission licence. However, Ofgem does not explain how the proposed shunt reactor and the associated activity undertaken by MRPL is deemed to be “participating in transmission” under section 4 of the EA89 and specifically how this amounts to participation in transmission by means of a transmission system as those terms are defined in that section. We would respectfully request that Ofgem clearly explains this reasoning to stakeholders before making any final decision in respect of granting a transmission licence to MRPL.

Licence conditions

Should the minded-to position remain, then the conditions attached to MRPL’s transmission licence must be sufficiently robust and targeted such that there is full regulatory accountability for the asset operated by MRPL and consumers are properly protected. It appears that the licence conditions that are proposed by Ofgem would leave it with very little regulatory oversight over the operation of the assets owned and operated by MRPL. If this were to remain the case then it would seem that the proposed transmission licence is a licence in name only.

As transmission ownership widens via onshore and offshore competitive processes, the existing transmission licensing arrangements remain relevant. This is because they provide the necessary safeguards (through Ofgem’s licensing and enforcement powers) beyond those which would result from enforcement of contract terms by the System Operator or other contracting party. Ofgem is not party to such contractual arrangements and therefore has no ability to take enforcement action from a contractual perspective. The transmission licence itself must therefore have sufficient obligations to give Ofgem appropriate regulatory oversight and enforcement powers. As you will see in our response to Q2, the current proposed Standard Licence Conditions (SLC) within this consultation exclude D2 (Obligation to provide transmission services). The proposed absence of D2 would appear to support the view that MRPL is not, in fact, participating in transmission as it is not under any obligation to make transmission services available to the System Operator. Without the application of D2 the need for a transmission licence must be questioned if ultimately any breach by MRPL is intended to be dealt with solely via the balancing services contractual relationship between MRPL and the System Operator rather than regulatory oversight to ensure consumer protections and safeguards are in place.

Consultation Question responses

Scope of the licence

- Q1. Do you agree with our minded-to position to grant the ET Licence in this case?

We agree that the grant of a transmission licence is appropriate where the activity involved constitutes participation in transmission. However, based on the current information available to us we cannot agree with the minded-to position to grant MRPL a transmission licence unless and until Ofgem fully explains, as

requested above, how the proposed shunt reactor and the associated activity undertaken by MRPL is deemed to be “participating in transmission” under section 4 of the EA89. As stated in this response we cannot see how the development of a shunt reactor and the associated operational activity amounts to “participating in transmission”.

Ahead of Ofgem taking its final decision, National Grid would like Ofgem to fully set out its reasoning which justify the grounds on which MRPL will be participating in transmission as set out in section 4 of the EA89.

We note the line in the consultation that the minded-to decision should be considered a “potentially short-term solution, designed to enable flexibility and compatibility with a future licensing regime.” However, whilst we acknowledge that the current licensing regime was not designed for circumstances such as these, we consider that a transmission licence should only be granted where there is participation in transmission and, if a transmission licence is awarded, it must have appropriate conditions attached to it so as to ensure Ofgem has full powers of enforcement to protect consumers.

Q2. Do you have any views on the SLCs we propose to include in the licence?

Notwithstanding our current view (in the absence of further justification) that a transmission licence is not required, should Ofgem progress its minded-to position we agree with the principle of a transmission “lite” licence but we cannot support only the proposed standard licence conditions (SLC) A1-A6, B4-6, B8 and B20-21 being applied.

Should a transmission licence be granted, sufficient obligations must be included to ensure Ofgem have the necessary future independent regulatory powers to enforce against MRPL.

We set out specific comments below on the proposed terms and SLC for any MRPL transmission licence:

- In paragraph 1 of Part I of the Terms of the licence the words “treated as” should be deleted. If granted the licence will be granted under section 6(1)(b). The “treated as” formulation does not apply as the grant has not been subject to a scheme of arrangement.
- In relation to Part II of the Terms of the licence we note that all of section B has effect in the licence unless the provisions are disapplied via a section B direction given under SLC A5. We assume therefor that if any of section B is to be disapplied then Ofgem will issue a suitable Section B direction alongside any licence grant.
- In relation to Part II of the Terms of the licence we note that Section D does not have effect in the licence unless the provisions are applied via a section D direction given under SLC A3. We assume therefor that if any of section D is to be applied then Ofgem will issue a suitable Section D direction alongside any licence grant.
- In relation to Part II of the Terms of the licence we note that several conditions listed in the table at paragraph 2 do not exist as SLC and could therefore be removed.
- Amended Standard Condition A1: the definition of “transmission area” should perhaps refer to the area specified in Schedule 1 rather than the licence terms.
- Amended Standard Condition A1: the definition of “transmission business” refers to the shunt reactor that is part of the “transmission system”. “Transmission system” is not defined in SLC A1 and should refer to “national electricity transmission system.”
- Schedule 2 (Revocation). As SLC A4 will be included in the proposed MRPL licence it is unclear why paragraph 1(b) (amounts payable under SLC A4) is “not used”. It is accepted that SLC A4 will not directly apply to MRPL as it would not be subject to a Section C direction, but we see reason to exclude the provision to allow for future flexibility.
- SLCB B1: It is not clear why the licensee would not be obliged to prepare regulatory accounts given that it is also not proposed that SLC B15 (RIGs) will not apply. Payment and performance obligations in the contract with the System Operator are not a substitute.
- SLC B3: It is not clear why this condition would not apply. Ofgem’s rationale for the exclusion would suggest that payment and performance obligations in the contract with the System Operator is

sufficient. This would imply that MRPL would be able to dispose of the shunt reactor and so breach its contractual obligations with the System Operator but that Ofgem would not have / want to have any oversight over such an action.

- SLC B7: It is not clear why MRPL would not be subject to obligations which require it to confirm to Ofgem that it has sufficient resources to conduct its transmission business. We believe that this should apply alongside SLC B6 (which Ofgem is proposing to apply) to provide necessary assurance to Ofgem. Payment and performance obligations in the contract with the System Operator are not a substitute.
- SLC B8: It is not clear why this condition would not apply (alongside SLC B4) to give assurance that the ultimate controllers of MRPL would not place it in breach of the proposed transmission licence. This is a powerful provision, and would, for instance, help ensure that MRPL remains compliant with its unbundling certification requirements through such ultimate controllers not taking action which would breach those provisions.
- SLC B9: It is not clear why the standard indebtedness provisions of the financial ring fence would not apply to MRPL. These requires indebtedness to be on an arm's length basis, on normal commercial terms and for a permitted purpose. It also prevents the creation of a cross default obligation. It is not clear why such a provision would not apply to a licensee simply because its transmission area is geographically limited.
- SLC B12: Payment and performance obligations in the contract with the System Operator are not a substitute for compliance with the STC. If there is to be no obligation on MRPL, as a TO, to comply with the STC then we would again question the need for a transmission licence in this instance.
- SLC B15: See comment above in relation to SLC B1.
- SLC B21: Should a transmission licence be granted to MRPL in this instance we agree that SLC B21 should be applied in order to ensure that MRPL (as a transmission licence holder) remains certified as suitably unbundled from relevant production and supply interests as required by s10D EA89. The certification of MRPL would be a separate but related issue to the grant of a transmission licence but we assume that MRPL is able to be so certified and look forward to having sight of Ofgem's decision on such certification should it proceed with the grant of a licence.
- SLC B22: We have no particularly strong objection to SLC B22 not being applied but we would note that payment and performance obligations in the contract with the System Operator are not a substitute for the requirement to have sufficiently independent directors appointed which seems to be Ofgem's rationale for such an approach.
- SLC D2: We refer to our comments above in relation to the proposed exclusion of this condition. It seems to us that this condition is a fundamental obligation of the transmission licence and, in the absence of such, we would question the need for a transmission licence to be granted. The proposed absence of D2 would appear to support the view that MRPL is not, in fact, participating in transmission as it is not under any obligation to make transmission services available to the System Operator. Without the application of D2 the need for a transmission licence must be questioned if ultimately any breach by MRPL is intended to be dealt with solely via the balancing services contractual relationship between MRPL and the System Operator rather than regulatory oversight to ensure consumer protections and safeguards are in place.
- SLC D3: This condition is not restricted to the making of connection offers as would appear to be the case from Ofgem's rationale for its proposed exclusion. SLC D3 imposes obligations on the licensee in terms of how it should plan and develop its transmission system and the standards (whether in STC, SQSS or otherwise approved by Ofgem) that apply to such. It is not clear why such standards would not apply to MRPL and why Ofgem would not have oversight over compliance with such.
- SLC D6: we agree that the prohibition on selling electricity should apply in any licence granted to MRPL. We note that the prohibition is subject to an exception where such sale or other disposition to third parties is for the purpose of providing transmission services. As the exclusion of SLC D2 would

imply that MRPL would not be providing transmission services we would query how the provision of a reactive power service would be compliant with this obligation.

- We note that Ofgem is not proposing any special conditions in any transmission licence that may be granted to MRPL. For the reasons stated above we believe that Ofgem should have regulatory oversight and enforcement rights in respect of all relevant transmission activities conducted by MRPL. Payment and performance obligations in the contract with the System Operator are not a substitute for such oversight which can be afforded to Ofgem by the inclusion of a suitable relevant special condition that governed the services to be provided by MRPL. In the absence of such an obligation or an obligation to provide transmission services (SLC D2) it seems that MRPL will be providing a balancing service only without the need for a transmission licence.

Should Ofgem proceed with the grant of a transmission licence to MRPL it is important that the Terms and licence conditions that are applied are unique to this asset and do not become a blueprint for future pathfinders ahead of regulatory reform.

- **Q3. What are your views on the geographical and time limitations we have proposed to include in the licence?**

Notwithstanding our current view (in the absence of further justification) that a transmission licence is not required, we support the geographic constraints and time limitations proposed in this consultation for inclusion in any MRPL transmission licence. We note that the Terms of the licence would authorise MRPL only to participate in transmission (if this is demonstrated to be the case) in the defined area shown and described in Schedule 1 for the 9 year period described in paragraph 3 of the Terms of the licence. In the absence of any Special Condition which has the effect of restricting a licensee's activities outside of its transmission area (akin to Special Condition 9.9 of the NGET transmission licence) we would like to understand how Ofgem will ensure and enforce that no transmission activity is carried on outside of the defined boundary set out in Schedule 1 to the Terms and also that the activity within this area is restricted to the operation of a shunt reactor.

- **Q4. Do you have any views on any additional limitations that should apply?**

Should the minded-to decision proceed as is, the proposed grant of a licence s would include SLC B21 and we note that Schedule 2 (revocation) would apply if MRPL was not certified/ did not remain certified. Should a transmission licence be granted to MRPL in this instance MRPL (as a transmission licence holder) must be and remain certified as suitably unbundled from relevant production and supply interests as required by s10D EA89. The certification of MRPL would be a separate but related issue to the grant of a transmission licence but we assume that MRPL is able to be so certified and look forward to having sight of Ofgem's decision on such certification should it proceed with the grant of a licence recognising, as part of wider future competition and regulatory reforms, we may see an evolution of unbundling requirements.

The current unbundling legislation prevents network licence owners from operating in storage. As part of competition reforms, we believe there are efficiencies and innovation gains that could come from incentivising network licence owners to include non-wire alternatives in their bids and that this could be captured in regulatory price controls.

Impact on customers

- **Q5. What impacts on existing and future consumers, if any, do you anticipate from granting a restricted ET Licence in this and similar instances?**

We believe that early competition mechanisms should not be introduced in the absence of supporting primary legislation.

Specific legislation is required to address the complex interaction and interfaces between licensees which will arise from the introduction of competition to onshore electricity transmission, and to amend statutory

obligations imposed by the EA89 to reflect those issues, in order to ensure that consumers remain appropriately protected.

We acknowledge that Ofgem has a general power to grant new licences for electricity transmission activities, but those powers can only be exercised in appropriate circumstances, and without the full reasoning being provided by Ofgem, we cannot agree that is the case here.

In this instance we remain concerned there are unintended risks to consumers of granting a 'lite' transmission licence. In this minded-to decision Ofgem are unable to ensure that transmission services are being provided to the System Operator. The only protection would be afforded via the contractual obligations with NGESO. This begs the question as to why a transmission licence is required at all if MRPL is not obliged to provide any transmission services to the System Operator where such an obligation is one which Ofgem would enforce.

We are not able to provide a comprehensive view on potential future scenarios as it will depend on the nature of the assets/solutions in question.

We recognise the challenge that exists between Pathfinders, early competition and the current licensing regime and acknowledge there are no neat "on the shelf" solutions. However, as a principle we do not believe that Pathfinders should be expanded to introduce early competition in transmission prior to the introduction of required and appropriate legislation. The impact of this could be a loss of accountability and public acceptability should numerous "lite" transmission licences being issued.

The Pathfinders scheme operates in a substantially different context and is concerned with providing non-network solutions and services to transmission system needs. We are of the view that any procedures regulating the grant of early competition transmission licences must be carefully considered and put on a statutory footing to ensure consistency with the broader system of electricity transmission applications.

- Q6. Do you agree that granting an ET Licence in the proposed manner for the case of MRPL (and potential future similar cases) is unlikely to result in any significant risk to consumers' interests?

We do not believe such a grant causes a significant risk to consumer interests if this minded-to decision is treated as a unique case (as it is time and geographically bound) provided that all suitable licence conditions (SLC and, where relevant, special conditions) are included.

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