

Dale Winch

Sent by email: dale.winch@ofgem.gov.uk

23 November 2021

Dear Dale,

Consultation on minded-to decision for an application for an Electricity Transmission Licence for Mersey Reactive Power Limited (MRPL) for the operation of a shunt reactor

Please find enclosed a response from Scottish Hydro Electric Transmission plc ('SSEN Transmission') to Ofgem's consultation, dated 22 October 2021, on a minded-to proposal to grant an onshore transmission licence to MRPL for the operation of a shunt reactor. Please also see the attached annex for our response to the specific questions posed by Ofgem.

SSEN Transmission has serious concerns with the sequence of events that has led to Ofgem's minded-to position. We have fundamental concerns with the Pathfinder process generally and urge Ofgem to consider whether it delivers value for consumers. We also question whether the intent of the Electricity Act 1989 (EA89) is for onshore transmission licences to be issued in such a disjointed manner.

This is potentially the first new onshore transmission owner licence granted since privatisation. We note that new types of licences for new entrants have been granted in other sectors of the industry (IGT, IDNO), but only after considered and thorough examination of the benefits to consumers and institution of proper protections. Even then, there have been unintended consequences that have required subsequent regulatory intervention. It is deeply concerning that a 'loophole' in consumer protections has been pursued as a result of a 'learning by doing' process not subject to the rigours of the regulatory framework or the general duty on transmission licensees. We urge Ofgem, as a matter of urgency, to examine the approach by which transmission licences can be granted rather than, as is implied here, treating this as a precedent on which others might seek these rights (but without associated responsibilities).

Our response to Ofgem's notice of application for an electricity transmission licence¹ considered whether the Authority has legislative power to approve an application for an onshore transmission licence on the basis of a competitive tendering exercise. We note Ofgem has failed to provide a view. The Energy Acts of 2004 and 2008 amended the EA89 to enable the Authority to grant an offshore transmission licence via a competitive tender process, in accordance with the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015. However, no such similar legislation or enabling powers for the Authority exists in the context of onshore transmission. The OFTO regime required amendments to primary legislation as a prerequisite for granting offshore transmission licences following an Ofgem led competition. We would therefore anticipate similar legislative arrangements also being required to appoint an onshore transmission licensee following a NGENSO (or any other party) competitive tendering exercise. In this regard we further note that the pathfinder project is

¹ <https://www.ofgem.gov.uk/publications/mersey-reactive-power-limited-notice-application-electricity-transmission-licence>
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described as “learning by doing”, hence the process and framework that lead to the pathfinder contract award is under development and uncoded.

We also note Ofgem’s view that the granting of this transmission licence is a *‘potentially short-term solution, designed to enable flexibility and compatibility with a future licensing regime’*. Ofgem’s decision to facilitate transmission licence ‘lite’ applications, prior to a full review of the regulatory framework for ancillary services, will have further consequences for consumers which Ofgem’s assessment has failed to consider. Ofgem’s proposed approach in this instance will reduce the obligations placed on a new transmission licensee, whilst simultaneously proposing important terms relating to the operation of a part of a transmission system are contained only in commercial contracts. This is a significant departure from the current approach and could pose further risks to consumers.

A comparable approach was taken by Ofgem in the retail energy market, which was designed to encourage competition by helping new suppliers enter the electricity supply market. Ofgem must learn from recent failings in the retail market, which act as a timely and stark reminder of the need to carefully consider the applicability and consequences of a ‘two-tier’ transmission licencing regime. In the retail market, smaller retailers were given exemptions from certain obligations to stimulate competition and encourage participation in the market. This focus on lowering barriers to market entry has led to major failures, due to inadequate regulatory assurance of properly managed price risk and hedging (i.e. financial resilience), resulting in significant increase to consumer costs², and ironically, a reduction in competition with only larger suppliers able to bear the cost of these failures whilst the market stabilises. If similar failures materialised in electricity transmission, unlike in the retail energy market, there would be no safety net to protect the network, connected customers or the GB energy consumer from the significant cost of failure of critical national infrastructure.

Linked to the above, NGESO, as directed by Ofgem, is currently expanding Pathfinders as a pre-legislative form of competition³. We are therefore likely to see applications of a similar nature in the future despite these processes being proposed on the premise they were for non-network solutions and that transmission licences would not be required. Ofgem itself has concluded it does not have the power to award a transmission licence pursuant to a competitive process without amendment to primary legislation⁴. We urge Ofgem, as a matter of urgency, to examine the approach by which transmission licences can be granted rather than, as is implied here, treating this as a precedent on which others might seek these rights (but without associated responsibilities).

Failing a wider review, we would welcome details of Ofgem’s risk assessment and further information detailing the ‘tipping point’ in terms of when it considers certain conditions are met such that it becomes appropriate to issue a full TO licence (for example, when a concentration of reactive services become critical to the safe operation of the network or an entity holds a number of transmission lite licences) and how it would intend to retrospectively apply those to transmission licensees granted a form of ‘lite’ licence.

We continue to be concerned about the absence of such fundamental evaluation by Ofgem in addressing these very real issues resulting from network fragmentation. It is not clear how network need will be addressed should a third-party solution fail, or a tender exercise be unsuccessful or challenged legally, or a third party fails financially, as we have seen recently in the electricity retail market. We welcome further information from Ofgem as to how it has assessed the possible proliferation of transmission licensees held to a lower standard and how it

² <https://www.bloomberg.com/news/articles/2021-10-26/u-k-energy-market-failures-will-cost-every-single-household>

³ https://www.ofgem.gov.uk/sites/default/files/docs/2021/05/early_competition_update_2021_0.pdf

⁴ Page 7, https://www.ofgem.gov.uk/sites/default/files/2021-08/Early_comp_August_2021_Final.pdf

intends to protect consumers and maintain the high standard of quality throughout the GB electricity transmission system.

We would welcome Ofgem's view on the points raised within this letter and are available to discuss at the earliest opportunity.

Yours sincerely

Steven Findlay
Senior Regulation Manager
SSEN Transmission

Annex

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

Ofgem has highlighted that this is a *novel application* as it relates to a single component of the system and a very specific geographical limit and... “[a]t the time the legislation was drafted prohibiting transmission participation without a licence, it was envisaged that a transmission owner would own a substantial part of the network. However, the electricity sector is quickly evolving. It is important that we make timely regulatory decisions using the tools currently available to support the transitional nature of this sector. At the same time, we also recognise that any decisions will need to adapt for the future including the facilitation of competition within the sector. Our minded to position for this application should therefore be considered a potentially short-term solution, designed to enable flexibility and compatibility with a future licensing regime”.

On account of this, the grant of such a licence is, in our view, contrary to the intended purpose of the Electricity Act 1989 (EA89) as drafted, as well as the existing regulatory practices (discussed further below) and Ofgem’s statutory obligations. We appreciate the need to adapt for the future but the decision in this case appears sweeping and to sidestep the existing legal framework and established industry practices, which is a concern for SSEN Transmission.

The grant of a transmission licence in this way conflicts with the newly established regulatory practices in introducing other forms of competition in the industry for the OFTO and CATO regimes, which have (or will be) underpinned by primary legislation, and NGESO’s previous position that the pathfinder process was never intended to result in the granting of transmission licences. The intention behind the pathfinder process was to consider “non-network” options to meet transmission voltage needs beyond the use of traditional reactive assets, typically owned by TOs such as shunt reactors, capacitors, and compensators⁵. Pathfinder was never intended to involve the granting of a transmission licence, as stated in NGESO’s Early Competition Plan: “...pathfinders use competition to identify whether non-network solutions, or distribution network solutions, could provide more efficient alternatives to the solution proposed by the incumbent TO.”

In being minded to grant a transmission licence under the EA89, Ofgem is required to state its reasons under section 6B(3) of the EA 1989. We feel that this notice falls short in providing more detailed reasoning for its minded to decision in these particular circumstances. In any case, we urge Ofgem, as a matter of urgency, to examine the approach by which transmission licences can be granted rather than, as is implied here, treating this as a precedent on which others might seek these rights (but without associated responsibilities). Whilst we appreciate Ofgem has cited that this is a novel application, it is unclear how we and other interested parties are expected to reconcile this against what has gone before in the competition sphere and also the intention of the EA89. We do not agree that the grant of a transmission licence should be treated in the same way the NGESO approaches pathfinders as “learning by doing”. This decision merits detailed assessment and evaluation particularly as it appears that it is intended to set a precedent for further entrants into the transmission market which is completely unprecedented particularly given the circumstances within which this licence appears to have been applied for (i.e. in the very late stages of a pathfinder project intended for non-network solutions) and not by the party who actually bid.

We note Peak Gen Top Co Limited was the successful bidder under NGESO’s procurement. However, it is Mersey Reactive Power Limited that has applied to Ofgem for a transmission licence. We are interested in understanding why it is now a different entity that the contract, and potentially transmission licence, is being awarded to and how that is consistent with the terms of NGESO’s procurement and the Utilities Contracts Regulations 2016. We would

⁵ <https://www.nationalgrideso.com/document/140821/download>

also welcome further detail in relation to how Ofgem's proposals align with the ownership unbundling requirements. MRPL is part of the same corporate group as nine other companies which hold generation licences. In any case, Peak Gen would be required to have Ultimate Controller duties within its licence if granted. We also note that MRPL will require certification under section 10(a)(1) of the EA89 and would welcome further detail from as to whether Ofgem will consider these requirements prior to deciding as to whether to grant this onshore transmission licence.

Lastly, we are also mindful that reforms to the EA89 (enacted by the Energy Act 2004) and specifically section 6(1)(b) (being the provision we assume Ofgem would seek to rely on to grant a transmission licence lite in question) was not, in our view, to invite new entrants into the transmission sphere but rather to accommodate both TO and SO as transmission licence holders in the same area. This is supported by a statement made by Ofgem and the Government in consultation report: *The Development of British Electricity Trading and Transmission Arrangements (BETTA) Report on consultation and next steps May 2002* which stated:

*"Under the current framework set out in the Electricity Act it would not be possible to licence the GB system operator as it is not possible to grant the system operator an authorised area that overlaps with the authorised area of the existing transmission licensees. Therefore, Ofgem/DTI anticipate that an amendment to the Electricity Act will be sought so that the GB system operator and regional transmission owners can co-exist under the licensing regime (i.e. that the area for which the GB system operator is licensed can overlap with the area for which any particular transmission owner is licensed)" (emphasis added)*⁶.

Accordingly, the intention of the EA89 is not to allow for the grant of an onshore transmission licence to any party looking to undertake a transmission activity but rather to accommodate a new system structure following the allocation of powers to the System Operator and delivery of the British Electricity Trading and Transmission Arrangements (BETTA).

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

As noted above, new entrants must be subject to the same rules, responsibilities, and accountabilities of incumbent electricity Transmission Owners (TOs), particularly where these relates to the continued levels of service and security of the network. It is difficult for SSEN Transmission to properly assess the SLCs Ofgem propose to include in the licence. This assessment would require consideration alongside the NGESO/MRPL service specification and obligations which are to be detailed in the contract. We note NGESO has published proforma contracts however it is not clear which would be used, and they are not yet populated with the specific details of the service to be provided.

Regardless, we are concerned Ofgem is not proposing to include standard licence condition B7 requiring the licensee to ensure it has necessary resources to undertake its transmission business properly and efficiently. Regardless of the contractual terms agreed with NGESO, we believe it to be in consumers best interests that all TOs ensure the safe and timely operation of assets. Relinquishing control of this assessment to NGESO (who does not own or operate transmission infrastructure) via a commercial contract introduces additional risk for consumers.

⁶ Ofgem/DTI, Regulatory framework for transmission licensees under BETTA – Volume 2: Electricity transmission licences under BETTA, December 2002 88/02 Vol 2, paragraph 2.5. <https://www.ofgem.gov.uk/sites/default/files/docs/2002/05/427-20may02.pdf>

Ofgem's assessment has also failed to consider the impact of not applying standard conditions B9 and 10 which are required to ensure MRPL's licenced activities are financially resilient. It is not immediately clear from the consultation why Ofgem does not believe this to be proportionate or relevant, particularly given recent failures in the retail market? Ofgem refers to '*a limited financial risk to the wider network*'. We are unclear what this means in practice.

What are your views on the geographical and time limitations we have proposed to include in the licence? Do you have any views on any additional limitations that should apply?

Ofgem is proposing to '*introduce a minimum applicability date, where the licence will be valid for at least the duration of the commercial agreement between ESO and MRPL specified at the grant of the contract.*' It is our view that the licence must be limited to the length of the commercial agreement between NGESO and MRPL. It is not immediately clear to us how NGESO will determine the network need at the end of the commercial contract. There is a real risk that consumers could end up being exposed to further costs for a fully depreciated asset if say, for example, NGESO intends to undertake a similar pathfinder in the area and the same entity were successful as a result of having assets in situ.

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

The nature of the question suggests Ofgem is anticipating future applications of a similar nature. As noted above, NGESO, as directed by Ofgem, is currently expanding pathfinders as a pre-legislative form of competition. As Ofgem has set a precedent via the proposed licence for MRPL, this could lead to several 'licensees' participating in the transmission of electricity. This brings the points raised above into sharp focus and Ofgem must learn from recent events in the retail energy market. In particular, whether it is appropriate or proportionate not to activate any of the standard licence conditions (B9 and B10) which are required to ensure MRPL's licence activities are financially resilient.

Based on the information provided to date, we question whether Ofgem has complied with its statutory obligations under Sections 3A(2)(b) and 3A(5)(a) to secure that licence holders are able to finance activities and promote the efficiency and economy on part of persons authorised by licences or exemptions to participate in the transmission of electricity.

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?

As noted above, we urge Ofgem, as a matter of urgency, to examine the approach by which transmission licences can be granted rather than, as is implied here, treating this as a precedent on which others might seek these rights (but without associated responsibilities). Ofgem has recognised the potential for future similar cases and this application should be assessed not on its individual merits, but whether a group of licensees of this nature is in the interests of the consumer.