

By email: dale.winch@ofgem.gov.uk

Your ref

Our Ref

Date

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Contact / Extension

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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

This response is from SP Energy Networks (SPEN). SPEN owns and operates the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution plc) which serves two million customers, and Merseyside and North Wales (SP Manweb plc) which serves one and a half million customers. We also own and maintain the electricity transmission network in Central and South Scotland (SP Transmission plc).

Section 9 of the Electricity Act 1989 (EA '89) and the terms of SPEN's transmission and distribution licence obligations require us to develop and maintain an efficient, coordinated and economical onshore electricity system. Furthermore, our parent company, Iberdrola, invests significantly in the UK regulatory regime for electricity networks every year. Iberdrola are proposing to spend over £4.5bn between the UK Transmission and Distribution networks, based on the business plan of projects we put forward to Ofgem as part of the RIIO-2 settlement. Therefore, as an incumbent Transmission Owner (TO) and Distribution Network Operator (DNO), we are a material stakeholder in relation to the above proposal.

We have fundamental concerns with the Pathfinders process generally and urge Ofgem to consider whether it delivers value for consumers. We believe that, without these concerns being addressed, it is premature to decide on what regulatory regime is appropriate. The high-voltage Mersey Reactive Pathfinder 2022-2031 tender outcome compared a 10-year market solution against the 40-year TO asset. The ESO subsequently opted for a 10-year market solution at a cost of £8.81m, compared to the TO's 40-year asset at a cost of £13.1m¹. The cost of the market solution has subsequently increased to £9.87m². **Therefore, for an additional £3.2m to consumers, the TO asset would have remained operational for a further 30-year period.** The approach taken fundamentally fails to protect the long-

¹ <https://www.nationalgrideso.com/future-energy/projects/pathfinders/high-voltage/Mersey>
Mersey Reactive 2022-31 Mersey Reactive 2022-31 Final Results Table

² <https://www.nationalgrideso.com/document/185236/download> Updated Tender Results for Mersey Voltage Pathfinder 2022 Tender

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term interests of consumers should the asset ultimately be required for a period beyond the initial 10-year contract term.

Notwithstanding our concerns with the Pathfinders process, we believe that this minded-to position requires further due diligence before awarding a transmission licence. We would be grateful if Ofgem can confirm how it has satisfied itself that granting MPRL a transmission licence is consistent with the intentions of the EA'89. It has been clear since the Stability Pathfinder process was launched that the question of whether this ought to be a licenceable activity requires to be addressed – something the ESO were advised of, and in their engagement with the ESO, Ofgem should have been consulting on directly. The impacts of awarding a “lite” less comprehensive licence, and thereby allowing for a reduction of standards and compliance have not, as far as we are aware, been properly assessed by Ofgem, and further risk undermining the wider regulatory regime which has been carefully designed over an extensive period of time. At a time when investment and large-scale access to capital in global and competing international markets is challenging, the introduction of such uncertainty into the regulatory regime simply destabilises further the appeal of investing in GB networks.

A transmission licence is not something which should be granted simply to cure an issue that was foreseeable and has not been resolved by proper and timely consultation. Indeed, given the significant consequences a transmission related event could have on GBs consumers and the wider economy, as witnessed in August 2019, it is imperative that the obligations and standards required of such a public interest activity remain of a high standard and are not diluted. **We therefore question whether the intent of the EA '89 allows for what is essentially a new category of Transmission licence that is inherently less detailed than what was granted for the present Transmission Owners (and therefore introduce risk to the UK consumer) to be issued in the manner that Ofgem are proceeding with.**

Furthermore, the granting of a transmission licence may not be the most appropriate means of regulating this type of asset. This may also vary on a case by case basis. For example, if the asset is connected to a point of connection on the transmission network, it should be considered as ‘a user’ of the transmission network and therefore not require a transmission licence. Whereas, if the asset is embedded within the transmission network, a licence should be required. However, this may require a new form of licence potentially called a ‘system service licence,’ as new licence conditions may be required to ensure the effective operation of such assets. In the case of a shunt reactor, similar obligations to those placed on generators within their generation licences will be required to ensure the availability of the assets.

Ofgem's proposed approach to grant MRPL a transmission “lite” licence considerably reduces the regulatory compliance obligations placed on the new transmission licensee as compared to existing transmission licensees, whilst at the same time proposing important terms relating to the operation of a part of a transmission system are contained only in private contracts. This represents a significant departure from the status quo. Furthermore, Ofgem is issuing a new kind of transmission licence without having properly assessed and consulted on how this will fit within the wider regulatory arrangements or whether this is aligned to the intent of the EA '89. As with the process carried out to create the OFTO licencing regime, **we believe a wider review of the appropriate approach must be undertaken and properly consulted on prior to any new licences being granted.** This review is imperative in light of the emerging issues we now face within the retail market as a result of a lenient issuance of licences.

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In the interim, we recommend that Ofgem utilises the Mersey Reactive Power pathfinder as a case study, and promote and ensure that the ESO seek and agree stringent commercial terms and conditions to ensure that Peak Gen Top Co Limited is held accountable for its actions and deliver its relevant outputs, whilst ensuring the required availability of the assets.

Given the above, SPEN fundamentally disagree with Ofgem's minded-to decision to grant a transmission licence. We also wish to offer detailed feedback on our specific concerns with Ofgem's minded-to approach. Should Ofgem decide to grant a transmission licence, it is essential that these concerns are addressed. These are set out as follows:

1. Ofgem must carry out detailed due diligence on any potential licence holder given this will be connected to the MITS, and in some cases, Critical National Infrastructure.

In the present case, Ofgem has not been involved in the competition, therefore we do not believe it will have been able to assess whether MRPL can undertake the necessary functions to be awarded an electricity transmission licence. Ofgem has also not provided any guidance on how it intends to assess whether the current applicant, or any other competitively appointed party, is "fit and proper" to be awarded a new transmission licence. It is not clear to us why Ofgem has departed from the process for future grants of competitively appointed transmission licences that it has said it would follow.³ This assessment is even more pertinent as Ofgem was not the tender body for the Mersey Reactive Power Pathfinder competition. Clarification from Ofgem on how they have determined MPRL fit to hold a transmission licence, prior to their final decision being published should they decide to grant a transmission licence, is necessary.

Ofgem must also learn the lessons from the ongoing issues playing out in the energy retail market, where failings to adequately assess new entrants has led to significant disruption. The cost of absorbing those customers whose supplier has collapsed already stands at over £2bn⁴, which will be socialised through energy bills. Although not directly comparable, this situation has proved the necessity for rigorous assessment of any new licensee. We note, for example, that a licence condition for financeability has not been included within the proposed transmission lite licence. Why such an important condition has not been included serves to highlight the dilution of standards required of organisations who may be specifically set up for Pathfinder competitions. The corporates chosen to provide the Pathfinder services may lack the strength of covenant to meet the enduring requirements that existing TOs face in the maintenance and operation of the network – the absence of this licence condition provides no security that these organisations can do the same.

From a national security perspective, ensuring the required due diligence is carried out in advance of granting a licence is imperative. In any case, we would also expect any licensee to be subject to the NIS regulations and standards.

³ See section 8.8 of the Ofgem guidance on 'Applying for a gas or electricity licence'

⁴ <https://www.bloomberg.com/news/articles/2021-10-16/u-k-pays-price-for-energy-market-that-anyone-could-join> U.K. Pays Price for Energy Market That Anyone Could Join – Bloomberg, 16 Oct 21

2. New 'lite' licence requires statutory modification procedure to amend current Transmission Licence.

In Ofgem's licence application guidance⁵, it is stated that an applicant who wishes to act as a TO will have sections A, B, D in their licence. However, Ofgem is only proposing to include some of sections A and B in the 'lite licence' as currently proposed. In our view, this decision is leading to Ofgem creating a new category of transmission licence, as the current application guidance only envisages either a SO licence (only one of which can be granted) or a TO licence.

We are aware that the idea of a 'lite' licence is a term used in the electricity supply licence, whereby a licensee can apply under SLC11.3 of the supply licence to relieve it of certain obligations (in whole or part) to comply with specified industry codes. However, Ofgem will only grant a Licence Lite direction if the new supplier has made a commercial arrangement with a third-party licensed supplier to carry out compliance for those parts of a supply licence that are more challenging for a new supplier.⁶

The lite transmission licence does not propose any comparable third-party assistance to help with compliance, rather the obligations are greatly reduced with no apparent consideration or impact assessment as to what the wider implications of this new category of transmission licence will be.

If Ofgem decides to grant a transmission licence, we would expect, at a minimum, for Ofgem to give effect to this substantial change to the industry arrangements by way of statutory modification of the Transmission Standard Licence Conditions, in order to (i) introduce the concept of a lite licence; and (ii) provide the option to apply for a lite licence on similar terms to the supply licence requirements (i.e. to ensure another TO is responsible for compliance with wider obligations).

3. Use of private contracts for transmission licensee obligations is at odds with the regulatory principle of transparency

Section 3A of the Electricity Act 1989 (the **1989 Act**) states that, when conducting regulatory activities, Ofgem must have regard to the principles of being transparent and accountable.

We have concerns that the present proposals may place Ofgem in conflict with those core principles. Ofgem's view is that the commercial arrangements that have been made between MRPL and the ESO will include appropriate service standards, access requirements and network requirements and that they will offer sufficient safeguards that protect consumers' interests and avoids the need for certain SLCs.

Ofgem will presumably not be involved in those commercial discussions, so it is not clear how Ofgem has this comfort that the arrangements will include those standards and that they will be sufficient.

⁵ [applying for a gas or electricity licence - 2019 guidance document 1.0 0.pdf \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/482_an_introduction_to_licence_lite_factsheet_web_0.pdf)

⁶

https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/482_an_introduction_to_licence_lite_factsheet_web_0.pdf

If Ofgem decides to proceed with granting a transmission licence, we consider the principles of transparency and accountability require that important terms relating to the operation of a part of a transmission system, including for example any service standards and network requirements, should instead be set out in MRPL's licence so that they are subject to the same regulatory scrutiny and held to similar standards and potential enforcement as any other transmission licensee. Any new transmission licensee must be subject to the same strict enforcement action and regulatory oversight as other transmission licensees. Further still, the principle of transparency means that the public should also have sight over those standards MRPL is being held to, in the same way as other licence holders. In any case, we would expect any provider to be subject to the STC to ensure an appropriate degree of safety coordination between them and the adjacent TO and any TO/TO liabilities or data sharing requirements are appropriately covered.

4. Alignment with unbundling requirements

Peak Gen Top Co Limited was the successful bidder under NGESO's procurement, however it is MRPL that have 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.

Another key concern we have is 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. They all share an ultimate shareholder (Dione Holdings Ltd). There also appears to be common management of these entities with the same two directors appointed to entities in the corporate group with generating licences that are also appointed to Mersey Reactive Power Limited. This arrangement appears to be entirely inconsistent with the unbundling requirements. In any case, Peak Gen would be required to have Ultimate Controller duties within its licence if granted.

As Ofgem will be aware, section 10(A)(1) of the Electricity Act 1989⁷ requires electricity transmission licensees to be certified. It is not clear from Ofgem's minded to decision whether MRPL has applied for certification yet. We consider that it is essential that Ofgem also considers the certification requirements before making its decision as to whether to grant a transmission licence to MRPL. Further clarification from Ofgem on this is welcomed.

Please do not hesitate to contact us should you wish to discuss any of the points raised in the above response.

Yours sincerely



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⁷ <https://www.legislation.gov.uk/ukpga/1989/29/section/10>