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Contact / Extension

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Dear colleagues,

Call for Evidence on the correct regulatory treatment of assets dedicated to provision of ancillary services

SP Energy Networks (SPEN) represents the transmission licensee of SP Transmission plc, as well as the distribution licensees of SP Distribution plc and SP Manweb plc. SP Transmission owns, develops and maintains the onshore electricity transmission network in the south of Scotland. SPEN also own and operate the electricity distribution networks in the south of Scotland (SP Distribution) which serves two million customers, and Merseyside and North Wales (SP Manweb) which serves one and a half million customers.

We welcome the opportunity to provide comments on this Call for Evidence on the correct regulatory treatment of assets dedicated to provision of ancillary services. Our main representations are:

- (i) **We agree with the objective of this review to ensure that the policy and regulatory treatment of dedicated ancillary service provision**, whilst promoting competition and innovation, ensures security of supply for consumers.
- (ii) **A new type of licence could be created for currently unlicensed licenced activities i.e. a *Network Services Licence***, which would include robust provisions to ensure licence holder financeability as well as network resilience. This will ensure protection and transparency for consumers for the delivery of this service.
- (iii) Relying on bilateral commercial contracts to deliver and regulate these services lacks transparency. Therefore, following this review of ancillary services, **it is fundamental that a licence is complemented by a suitable well-established regulatory reporting regime**, similar to that which Transmission and Distribution Network Operators have to operate within. The regulatory regime should ensure the financial resilience of the companies providing important network services. This should be considered as part of this review.
- (iv) To achieve legislative Net Zero targets, **it is crucial that there is more clarity around the ESO's intentions for using the the market to deliver dedicated ancillary services**, and the timescales involved. This will enable the most optimal planning and implementation of projects for RII0-T3 and onwards.

- (v) Any licensing regime must also consider provisions for an “Ancillary Services of Last Resort” regime, in the event of market participant failure, to ensure ongoing network resilience.
- (vi) Any regime must ensure long term value for the consumer. The increased focus on services to be provided by market participants is largely driven by delivery of perceived consumer value over the short-term, however it is difficult to monetise the long-term consumer value delivered by the projects so far. Ofgem should ensure that there is a clear and transparent assessment of the costs and implications when the market bids are assessed.

Answers to the questions issued in the Call for Evidence on the correct regulatory treatment of assets dedicated to provision of ancillary services can be found in **Appendix 1**.

Yours faithfully,



Stephanie Anderson
Head of Regulation

Appendix 1 - Call for Evidence Questions

1. Do you agree with the objective and scope of our review? Are there any other relevant issues we should consider?

Yes, we agree with the objective of this review to ensure that the policy and regulatory treatment of dedicated ancillary services, whilst promoting competition and innovation, ensures security of supply for consumers.

We are of the view that assets dedicated to ancillary services should be licensed in order to ensure the necessary protections for existing and future consumers are in place. Should the outcome of the review result in granting dedicated ancillary service providers a type of licence, it is fundamental that a licence is complemented by a suitable regulatory reporting regime, similar to that which TOs and DNOs are required to operate within. This should be considered as part of this review.

2. Table 1 summarises the key dedicated ancillary service technologies and the ancillary services that they provide. Do you consider other technologies as capable of providing dedicated ancillary services? If so, please indicate what services they can provide.

Synchronous Compensators and Grid Forming Batteries are currently covered by Generation licences and we do not suggest changing the licence arrangements for these assets. However, it may be appropriate to give further consideration to the threshold of when a Generation licence is required. For example, Grid Forming Batteries of less than 50MW do not require a Generation licence.

MSCDNs, STATCOMs and SVCs may also be considered as assets providing ancillary services, as they have a capability to provide voltage control/reactive compensation which is currently used within the system alongside shunt reactors.

Table 1: Ancillary service technologies matrix

	Synchronous condenser (including modified generator equipment)	Shunt reactor	Other
System stability	C	N	
Voltage management	C	C	
Other			

*C – capable of service provision; N – not capable of service provision

3. What are the barriers to commercial dedicated provision of ancillary services?

a. Are there specific barriers for dedicated stability service providers? If so, what are they?

We believe market participants are better placed to answer this question.

b. Are there specific barriers for dedicated voltage service providers? If so, what are they?

We believe market participants are better placed to answer this question.

c. Are there specific barriers for other types of assets dedicated to providing ancillary services? If so, what are they?

We believe market participants are better placed to answer this question.

4. Should assets dedicated to providing ancillary services receive regulatory funding, be commercially provided, or should there be a combination of the two?

We believe that the key goal is for ancillary services to operate within a regulatory framework, which should be supported by transparent licence obligations, regardless of which type of funding is chosen for the provision of ancillary services.

Relying on bilateral commercial contracts to deliver and regulate these services lacks transparency. Therefore, following the review of ancillary services, it is fundamental that any new licence arrangements are complemented by a suitable well-established regulatory reporting regime, similar to that which TOs and DNOs have to operate within.

5. On an enduring basis, should electricity consumed solely to provide an ancillary service be exposed to the costs, charges and levies that consumption of electricity in general (such as final demand) is exposed to? Please provide details to support your position, such as the magnitude of the impact to your business, and the impacts on competition and energy consumers more widely.

Other parties are better placed to answer this question.

6. Are there any other changes to the licensing and charging regime needed which could better enable competition that drives down prices for the dedicated provision of ancillary services and why?

Network security and the development of a coordinated, economic and efficient system of electricity transmission in the interests of consumers should be the central consideration when reviewing the most optimal regulatory regime for ancillary services. Following the ancillary services review, should the outcome of the review result in granting these service providers a licence, it is essential that it is complemented by a suitable regulatory reporting regime similar to that which TOs and DNOs have to operate within. The requirements of a regulatory reporting regime should be considered as part of the ancillary service review.

TOs and DNOs have a well-established regulatory reporting regime with Ofgem, hence Ofgem should consider a similar, robust regulatory reporting regime for ancillary service providers. For example, when the successful bidder Mersey Reactive Power Limited (MRPL) for the NOA Mersey Voltage Pathfinder was granted an amended Transmission licence, there were substantial exclusions of regulatory reporting requirements, which other Transmission Licence holders are obliged to report on an annual basis. Some of the excluded conditions from the Transmission licence granted to MRPL included the following¹:

- (i) SLC B1 Regulatory Accounts: this condition requires the licence holder to provide regulatory accounts on an annual basis in order to ensure transparency;
- (ii) SLC B3 Disposal of relevant assets and restriction on charges over receivables: inclusion of this condition would prevent the removal of the asset should the licence holder fail;
- (iii) SLC B7 Availability of Resources: this condition sets the obligation on a licence holder to ensure sufficient resources;
- (iv) SLC B9 Indebtedness: this condition prevents the creation of cross default obligations.

Ofgem considered that the exemptions from regulatory reporting were justified by limited risk to the national electricity transmission system (NETS), due to the nature of MRPL's operations being a single shunt reactor within a limited operating area. However, we believe that Ofgem must consider future

¹ This is not a full list of the exclusions, for the full list of exclusions please refer to <https://www.ofgem.gov.uk/publications/consultation-proposed-modifications-electricity-transmission-licence-we-are-minded-grant-mersey-reactive-power-limited>

developments in this area, in particular market participants potentially building a portfolio of similar assets, following further Pathfinder tenders and potential Early Competition tenders, which collectively may change the overall risk profile of the operator and the system.

The battery market is already fairly saturated and revenue by battery providers is made by the provision of services to the Balancing Mechanism, in order to enable the ESO to match demand and supply in real time. Should there be limitations to revenue stacking², a consideration should be made within the regulatory regime in order to protect the consumer in case of provider failure.

Following the recent collapse of many suppliers in the energy retail market, Ofgem should ensure that market participants have an obligation to comply with robust financial regulation requirements. Oxera reviewed Ofgem's regulation of the energy supply market³, and have made a number of recommendations which could be considered as part of the review.

In order to protect the security of the NETS and consumer interest, we believe that a robust regulatory reporting regime is required for network service providers to ensure the continued reliability and performance of the electricity transmission system.

7. Are there any other existing disadvantages between different providers of ancillary services that need to be addressed and why?

We believe market participants are better placed to answer this question.

8. Should the dedicated provision of ancillary services be a licensed activity?

Yes, we believe that the dedicated provision of ancillary services should be a licensed activity. In our view, licensing the dedicated provision of ancillary services will provide the right level of transparency and monitoring, which the current regulatory regime can provide.

We are of the view that a new type of licence for the dedicated provision of ancillary services should be considered, to ensure that there are no gaps or omissions of the necessary obligations for these services.

Ancillary service providers, currently operating under a Generation licence, should continue to be regulated under a Generation licence. Additions to the Generation licence may be required to allow for suitable regulation of the provision of ancillary services. It may also be appropriate to give further consideration to the threshold of when a Generation licence is required, as for example, currently Grid Forming Batteries <50MW do not require a Generation licence.

Where the provider is not covered by an existing licence, an abbreviated Transmission licence is not appropriate. A new type of licence should instead be created *i.e. a Network Services Licence*, which would include robust provisions to ensure the licence holder's financeability as well as ensuring network resilience. In light of the current energy retail market crisis, more rigorous regulatory oversight around the financeability and resources that market participants have to carry out their functions is required. An estimate of at least £1.8bn in claims will be passed onto domestic consumers as a result of collapsed retailers within the energy sector. We therefore strongly believe that to prevent similar issues, detailed due diligence is essential for the decision to grant any type of licence for the dedicated provision of the ancillary services, coupled with a robust ongoing regulatory reporting framework, as explained above.

² <https://www.energy-storage.news/uk-battery-storage-will-be-allowed-to-stack-revenues-in-key-grid-balancing-markets/>

³ <https://www.ofgem.gov.uk/publications/review-of-gems-regulation-energy-supply-market>

a. What are the benefits and risks for consumers and other stakeholders of assets dedicated to providing ancillary services being provided solely through Transmission Owner (TO) ownership?

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. Totex Efficiency Incentives give network companies an incentive to seek the most cost-effective solution and encourages them to contract for services with third parties that can drive down project costs, resulting in a win-win-win scenario for the utility, third parties and consumers. SPT already supports a significant amount of competition on our network, with c. 96% of our regulated transmission activities being delivered by the market⁴. TOs currently make investment decisions to meet several complex, moving needs on the network, which are taken in the best interests of consumers on a long-term basis. This is only possible with a holistic and long-term view of the network.

If assets dedicated to providing ancillary services are provided solely through TOs, this would enable the delivery of these assets within the scope of a wider programme of works within the same location/network area, i.e. integration with load and non-load related reinforcement work programmes and system access plans, which enable a number of efficiencies.

System stability and voltage needs are currently being procured by the ESO, via the recently introduced Pathfinder tendering process. This process was introduced in order to expand the market for non-network solutions while seeking to deliver consumer value and to potentially uncover innovative solutions.

The existence of the Pathfinders 'potentially' being considered by the ESO as a solution to addressing well-identified network needs is already resulting in uncertainty in relation to network planning and will continue to do so as TOs commence their RIIO-T3 planning.

b. What are the benefits and risks for consumers and other stakeholders of assets dedicated to providing ancillary services being provided only through commercial ownership?

A regulatory regime for ancillary services and resilience which relies solely on commercial agreements, is concerning given the lack of transparency of such agreements. We believe the key risk here is not the actual ownership of the asset, but how the ancillary services are provided to the network and how it is regulated going forward, to ensure a secure network and value for consumers. For example, in the NOA Merseyside Voltage Pathfinder case the Transmission licence granted to MRPL excludes condition B3: Disposal of relevant assets and restrictions on charges over receivables. This condition ensures that the licensee does not dispose of any relevant asset, with the exemption of listed circumstances, in order to maintain the security of the network and manage any potential disruptions. Whilst exclusion of the condition B3 in the Merseyside case may not materially impact the security of the wider network (although it may have more significant impacts locally), as it would only affect one shunt reactor, consideration should be given to the scenario where there may be portfolios of similar assets owned by a number of market participants, which may represent an increased level of network risk particularly as they may not have the same extent of licence obligations as TOs.

The increased interest in services to be provided by market participants is largely driven by delivery of perceived consumer value in the short-term, however it is difficult to monetise the real consumer value delivered by the projects so far. In particular, this is because the solutions provided by market participants to date, have been shorter term (approximately 10-14 years) as per the competition requirements, whereas TO solutions consider a 40-year asset life cycle. Ofgem should ensure that there is a clear and transparent assessment of the costs and implications, in case the services are

⁴ https://www.spenergynetworks.co.uk/userfiles/file/Annex_18_Competition_Plan.pdf

required beyond year 14, and that these costs are taken into account when the market bids are assessed against the counterfactual proposals submitted by TOs. Our experience suggests that many of the network needs on the system, currently being addressed by the provision of ancillary services, will exist on the network in the longer term.

c. Would different licensing treatment for assets dedicated to providing ancillary services present any challenges? For example, with TO-owned assets licensed under their electricity transmission licence and commercially owned assets under a different (or no) licence.

We suggest that a new type of licence (*i.e. a Network Services Licence*) is considered for dedicated ancillary services, which currently do not fall within the Generation licence, which would ensure that there are no unintended regulatory omissions. We do not believe that the amended Transmission licence (as per the NOA MRPL case) is the appropriate solution for the provision of ancillary services – our concerns regarding exemptions are included in the answers above, as well as within our response to the MRPL minded-to decision consultation⁵.

Ancillary service providers, currently operating under a Generation licence, should continue to be regulated under a Generation licence. Additions to the Generation licence may be required to allow for suitable regulation of the provision of ancillary services. It may also be appropriate to give further consideration to the threshold of when a Generation licence is required, as for example, currently Grid Forming Batteries <50MW do not require a Generation licence.

Creating a new licence type may pose some challenges in terms of the requirement to update the EA '89. Therefore, consideration must be given to the interaction with existing licences, as well as, ensuring that an adequate impact assessment is undertaken which consider all potential risks.

d. What would be the impact of each of these options on competition?

We believe that the solution provided by TOs does not limit competition and therefore has no negative impact on delivering value to consumers. For instance, we already support a significant amount of competition on our network, with c. 96% of our regulated transmission activities being delivered by the market.

9. Do you think that the dedicated provision of ancillary services should fit within an existing licence category as an enduring solution? If not, how should this activity be best categorised within the licensing framework?

As above, we are strongly of the view that a new type of licence (*i.e. a Network Services Licence*) is introduced for dedicated ancillary services provision, which currently do not fall under an existing licence category, which would include obligations relevant to the network services they provide to the network

10. Do you think there is enough clarity around existing roles and responsibilities in the provision of ancillary services?

Licensing entities helps to define the roles and responsibilities clearly, hence these should be developed once the decision is taken on what type of licensing arrangement will be applied to ancillary services.

Any licensing regime must also consider provisions for an “Ancillary Services of Last Resort” regime, in case of market participant failure, in order to ensure ongoing network resilience.

⁵ <https://www.ofgem.gov.uk/publications/consultation-proposed-modifications-electricity-transmission-licence-we-are-minded-grant-mersey-reactive-power-limited>

11. Are changes to arrangements needed to clarify responsibilities? If so, what changes are needed?

The introduction of multiple third parties for dedicated ancillary service provision, alongside existing proposals for Early Competition, will introduce significant additional complexity into the way the main transmission and distribution systems will be developed, operated and maintained. There will potentially be many additional entities involved in network activities. This is not envisaged under the current, carefully developed regulatory framework. This naturally introduces significant additional complexity and risk to economic system development and operation. Ofgem must properly consider its statutory duties under the EA '89. The proposals therefore raise very serious questions around potential impact on present and future consumers, security of supply, safety, and the continued provision of an efficient, co-ordinated and economical electricity network. It is vital that these are properly considered to ensure the continued value, stability and security of the network.