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Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control

Dear Edwin,

Thank you for the opportunity to respond to the consultation on the 'Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control'. This is the response of Scottish Hydro Electric Power Distribution Plc and Southern Electric Power Distribution Plc.

We believe there are several important principles that should underpin developments:

- CLASS is in consumers' interests, with potential for efficiencies and savings;
- Provision of CLASS fits with the principle of whole system solutions;
- We recognise arrangements must ensure a level playing field between network licenses and market participants in providing services

With that in mind, we do not support Ofgem's initial view to allow DNOs to offer to provide CLASS as a balancing service and be directly remunerated by the ESO. We believe funding is best facilitated through the price control to provide the level of scrutiny and transparency required by third parties.

The provision of network services to the ESO is not new. Network companies have been funded through their price controls to install inter-trips, Active Network Management, frequency tripping and reactors to support the ESO balancing the system.

We believe CLASS should follow consistent revenue treatment. As noted in the consultation, results of ENWL's work show *"changes in voltage were shown to be unperceivable to consumers"*. We believe there is no requirement for operating revenues from the ESO as there are no direct customers costs. The costs of CLASS are the asset installations which are best facilitated through the price control with a strong TotEx Incentive Mechanism and a robust process to optimise placement. The ESO pathfinder projects are a useful template.

Appendix A contains our response to the individual consultation questions. I am more than happy to discuss these further with you.

Yours faithfully,

Chris Harris
Regulation Manager – Scottish and Southern Electricity Networks

Appendix A

1. Are there other options we should have considered? Please provide reasons.

The range of options considered within the consultation was comprehensive. It would though be beneficial to understand lessons from the cross-border interconnector cap and floor regime. Ancillary services are offered by the interconnector owners, participating in the balancing, frequency and capacity markets to the ESO. Whilst the regulatory regime is fundamentally different from RIIO it would be useful to understand whether cap and floor provides any lessons or templates for other network companies who could be offering system services with increasing frequency in context of whole system planning.

2. Do you agree that market based mechanisms can provide the most efficient incentive for CLASS participation in balancing services?

No. As noted in our covering letter we believe funding of assets to deliver CLASS is best facilitated through the price control. The Ofgem consultation notes the results of ENWL's work show *"changes in voltage were shown to be unperceivable to consumers"*. We therefore believe there is no requirement for operating revenues from the ESO as there are no direct customers costs. The costs of CLASS are the asset installations which are better facilitated through the price control with a strong TotEx Incentive Mechanism and a robust process to optimise placement with efficient price discovery. The ESO pathfinder projects provide a useful template for this. This will ensure consistent treatment of revenues with other system services network companies provide to the ESO such as installation of inter-trips, Active Network Management, frequency tripping and reactors.

3. What is your view on DNOs' sharing profits with consumers, even if this means consumers are also exposed to DNOs' losses (including how this might affect DNOs' competitive behaviour noting this is different to other providers of balancing services)?

Benefit sharing is not new and exists in the RIIO price control framework through the TotEx Incentive Mechanism. This is shown to work well for consumers in RIIO-ED1, driving strong performance and returning significant revenue to consumers where efficiency savings have been achieved. Funding CLASS through the price control can leverage the benefit of this mechanism for consumers.

4. How might limits on charges to the ESO in DRS9 affect investment and utilisation signals for CLASS?

As noted previously we believe CLASS is best facilitated through the price control. Through the price control an efficient ex-ante allowance and where necessary, an uncertainty mechanism can be agreed with the regulator for CLASS assets ensuring consumers pay a fair and efficient price. Other mechanisms also exist e.g. review at closeout to ensure DNO's "do the right thing" and deliver efficient solutions and value for money to relevant consumers. The price control framework should be capable of considering whole system solutions across network licensees.

5. Do you agree that requiring CLASS in the price control would not promote efficient investment signals in CLASS and could distort competitive outcomes?

No. We believe that with a strong process for need case identification, such as an ESO pathfinder, optimal investment signals can be provided. The pathfinder will allow the ESO to consider network and market-based solutions to provide the services. We believe that this allows the efficient prices for services to be uncovered, through the ESO's market modelling. It is important to understand there is a fundamental difference between revealing cost of services and cost recovery mechanisms; we believe DNOs can reveal costs directly to the ESO to facilitate service assessment while recovering costs through the price control framework. Furthermore, an ESO pathfinder takes a longer-term scenario-based view ensuring network companies and market participants can deliver timely locational based solutions.

6. Do you have evidence CLASS could affect the likelihood of system reliability issues?

SSEN has not, to date, delivered any CLASS solutions. However, it should be noted that the ability of a network to provide CLASS favours those networks that have significant headroom in their networks either through legacy design standards, demand erosion or slow growth e.g. from embedded generation. For DNOs with lots of exporting GSPs, each requires good network modelling to ensure that in offering these services against a variable generation output background it would not compromise network operability or stability.

7. Do you have evidence competition is currently being distorted or impeded by the participation of CLASS? Do you agree with our assessment that it is unlikely DNOs have or would have market power in future, and the reasons we have provided in Appendix 2?

SSEN has not, to date, delivered any CLASS solutions and is not aware of such evidence. We do not believe DNOs would have market power that would enable them to distort the market. We also note there is a robust legal and regulatory framework that provides protection against such outcomes.

8. What information could the DNO have privileged access to that that could offer it an unfair advantage in balancing services provision? How might this change in future if the DNO and ESO increasingly coordinate?

We do not believe the DNO has any information which offer it an unfair advantage. We believe the use of ESO pathfinders will ensure clear, transparent, and timely market signals are provided. This will ensure efficient prices are discovered.

9. What measures would you consider effective and proportionate to ensure that privileged information the DNO has access to is not used inappropriately to benefit the commercial performance of CLASS?

Existing measures through the network company licences, industry codes and the Electricity Act ensure network companies do not abuse their monopoly position or act anti-competitively. DNOs take these obligations extremely seriously.

10. In what other ways do you think DNOs could take advantage of their DNO role in the context of providing balancing services with CLASS?

We are committed to acting in a fair, transparent and efficient manner. We take our obligations under our licences, industry codes and the Electricity Act seriously. This is embedded across the organisation. With this in mind, we recognise the benefits of a whole system approach and the move to further facilitate such an approach across networks under RII0-2 and with the introduction of the whole system licence condition later this year. We believe DNOs providing CLASS as a balancing service is another important step in this direction.

11. How far do you think existing safeguards (including licence obligations and competition law) against DNOs taking advantage of their DNO role in the context of participating in the balancing markets with CLASS are sufficient?

As set out above, we believe existing safeguards are robust and provide suitable protection

12. What additional measures would be effective and proportionate to address actual or perceived risks of DNOs taking advantage of their DNO role?

No additional measures are required. In addition to strong obligations, we note that Ofgem also has strong investigative powers should there be any concerns.

13. Are there other specific effects to competition that are relevant to our decision? What effects would these have on consumers?

No.