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By Email Only

**Flexibility First Forum's response to Ofgem's consultation on *Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control***

**Overview**

The Flexibility First Forum (FFF) is an affiliation of organisations created to accelerate Britain's transition to a zero carbon, smart and flexible energy system. Our organisations span the energy flexibility services supply chain, forming the intelligence and technology behind a decarbonised, cost-effective energy grid. From energy retailers to generators, manufacturers and trade associations, we have come together to champion the potential of consumers to drive decarbonisation, and to call on Ofgem to provide the support we need to realise it.

The FFF welcomes Ofgem's engagement with stakeholders on its minded-to position on the regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control. To ensure that a competitive, flexible energy system becomes a reality and Distribution Network Operators (DNOs) neutrally procure and facilitate operational flexibility services and markets, it is crucial that permitted DNO activities and their regulatory treatment are clearly defined.

However, we are concerned about the impact of the regulatory treatment of CLASS as a balancing service on nascent flexibility markets. While we are supportive of DNOs looking to increase the efficiency of the system, and pass savings on to consumers, we are concerned about the impact of the treatment of consumers as a captive audience who bear the downside risk of this competitive service without their consent. The use of such a command-and-control tool undermines the delivery of a neutral, competitive flexibility market, and should be used as a last resort only.

We are also concerned with the omission of an impact assessment and a strong baselining methodology from the consultation, and the potential for Ofgem's minded-to decision to set a precedent for the rollout of CLASS across other networks and its use in wider markets.

We have set out our views on Ofgem's minded-to decision below, as well as the key points we believe must be addressed to deliver a competitive, distributed energy system that puts empowered customers at the centre of the energy system's transition and the creation of a zero carbon grid.

### Undermining Flexibility

The FFF is concerned that the regulatory treatment of CLASS as a balancing service will undermine effective competition in flexibility markets and set a precedent for DNOs to deliver flexibility services through command and control rather than competitive flexibility services.

For another flexibility provider (for example, an aggregator of storage) to offer the same "turn down" service to ESO, the provider needs to consider the following: (1) they would need to obtain the consent of their customers, (2) provide an incentive (sometimes delivered as a "profit share") with the customer to deliver the flexibility, and (3) manage the downside risk that this service was not successful in flexibility markets. In offering CLASS, the network is able to completely avoid part (1) of this process, and is able to share downside risk with customers who have not consented to share this risk. Avoiding these costs of delivery is only achievable through the network's monopoly position, and we are therefore concerned that allowing networks to operate in this way undermines the development of a competitive market for flexibility services.

While ENWL have argued that a flexibility provider may offer a profit-share mechanism that includes downside risk, our experience is that the risk must be asymmetrical in order to acquire customers - i.e. a "no lose" scenario for the customer. As such, ensuring symmetry in ENWL's risk profile in order to deliver CLASS directly undermines the principle of distorting competition and exploits their position as a regulated monopoly.

We therefore urge Ofgem to consider measures for protection against dominance of this asset in competitive balancing markets. We highlight the 2016 Baringa report that suggests that if CLASS is adopted more widely across DNO regions, it could represent up to 2GW of capacity. This is much larger than the current FFR market. In addition, we note there are existing DNO innovation projects, including Project Phoenix and ESO

pathfinder projects, that are pursuing the demonstration of similar network-provided balancing services.

The scale of this potential growth, combined with DNOs' own recognition of the provision of ancillary services as a key commercial opportunity, threatens to directly undermine the facilitation of a level playing field between network and non-network services and contradicts the Flexibility Market Principles of the Electricity Networks Association's Open Networks Project.

If Ofgem sets the precedent that the proliferation of this technology is supported through its currently minded-to decision, it is very likely that investment in valuable flexibility technologies such as DSR/storage/on-site generation will be materially or wholly curtailed, with implications for the UK's net zero ambitions. We call on Ofgem to provide the industry with transparency over when CLASS is in effect and to introduce a 10% cap on the dominance of CLASS in ancillary and Balancing Markets. We note that it is Ofgem's view that CLASS would not saturate the balancing services markets and therefore would not expect this cap to have a material impact on the efficient provision of CLASS services. In addition, it is important that as part of its decision Ofgem makes clear what boundaries will be set around the contestable services DNOs are allowed to compete in beyond CLASS. More widely, we call for clarity on the definition of DNO and DSO activities, and on how this decision on CLASS fits into the wider DSO transition.

### Baselining

The FFF urges Ofgem to consider how CLASS will be effectively baselined, especially in the context of alternative DSO markets and flexibility providers within the region over the RIIO-ED2 timescale, before it is allowed to be continued to be used. We would suggest that Ofgem seek to use the work ongoing under BSC modification P376 and Project TERRE to enable wider balancing markets and consider the requirements of baselining in order to ensure volume is effectively settled. Such arrangements should not preclude the use of other flexibility services, and be sufficiently transparent. We note that, while NGESO is incentivised to procure balancing services efficiently and safely, we have seen anomalies in skip rates from aggregated assets elsewhere, and do not consider this a sufficient basis to suggest a strong baselining methodology would not be required.

Introducing a more considered baselining approach for CLASS is particularly important with regards to preventing baseline manipulation and energy waste. CLASS could potentially incentivise DNOs to hold voltage at a level above where it needs to be in order to secure customer supplies, with the intent of subsequently dropping the voltage in order to provide a commercial service. If DNOs raised their revenues through baseline manipulation within CLASS, this could only be corrected in the long term through residual DUoS charges. Therefore, there is a risk of a double payment in the short term which will lead to an incentive for DNOs to waste energy.

Furthermore, we note Industrial and Commercial sites may be actively managing their supply voltage. Routine reduction in voltage as a result of widespread CLASS usage could result in corresponding adjustments on these sites which increase losses, wasting energy and increasing customers' costs. There is insufficient evidence that CLASS has considered this effect, and indeed it would not be visible to the DNO or ESO as customers seek to manage operational problems on their own sites arising from periodic CLASS-driven voltage reductions .

### Scale

Ofgem have suggested this is a small-scale asset, with limited prevalence. However, the FFF would like to further understand the plans for wider rollout both within ENWL and across other networks. We note that historic appetite for this is not an indicator of future appetite, because of the uncertainty about the treatment in RIIO going forward discouraging networks from pursuing this. In addition, we would highlight that the minded-to decision about the treatment of CLASS under RIIO does not restrict its use to the specific use-cases it has been used for so far. As such, the minded-to decision risks setting a precedent across markets, regions and use-cases that were not intended as part of this decision. Therefore, we would look for clarity on the exclusion of the use of CLASS in wider markets, such as the Balancing Mechanism.

### Decision Making Process

The omission of an impact assessment from the consultation process means that flexibility service providers currently have no sight of the evidence that has been used to inform Ofgem's minded-to decision. The industry is unclear on the overarching expected impact of CLASS on the system, and specifically the level of consumer benefit that it will bring and the marginal cost of its delivery. The FFF urges Ofgem to provide

better visibility of its decision-making process through the publication of an impact assessment. Furthermore, the Flexibility industry has been hit hard by a range of other regulatory changes, notably the TCR decision and does not yet have confidence in Ofgem and BEIS's support of flexibility as we await the outcome of the Access and Forward Looking TCR, and the ongoing DSO and whole markets workstreams. It is therefore difficult to demonstrate the negative impact of the use of CLASS on investment to date, or pinpoint this going forward. It is therefore important that Ofgem considers the principles and precedence this decision sets.

## Conclusion

We very much support Ofgem's work to ensure that DNOs procure and facilitate operational flexibility services and markets neutrally. Flexible energy at a residential level will be critical to reducing the cost of decarbonisation in the UK and putting customers who are in control of their energy demand at the centre of the energy transition. This is why it is so important that DNO activities do not undermine customer control or the overall competitiveness of a distributed energy system. We look forward to the regulator's continued work in this field and would be keen to discuss practical solutions to the above problems in more detail.

This submission has been sent on behalf of the Flexibility First Forum and has the support of the following organisations:

