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Octopus Energy's response to Ofgem's consultation on the Regulatory Treatment of Customer Load Active System Services (CLASS) as a balancing service in the RIIO-ED2 price control

Thank you for the opportunity to respond to this consultation on the regulatory treatment of CLASS for RIIO-ED2. We are thankful that a thorough Impact Assessment (IA) has been completed in light of the stakeholder feedback when this consultation was first launched in 2020.

Flexibility will play a hugely important role in enabling a secure, affordable and net-zero electricity system to operate efficiently. A diverse mix of flexible resources is needed to ensure system security and Octopus is supportive of exploring the use of new tools to provide additional flexibility where it is possible to do so. Given the scale of the decarbonisation challenge ahead, we believe that all tools that can be utilised to provide much-needed system flexibility should be incentivised, especially when these are assets that already exist and therefore this reduces the need for additional investment. We are concerned by the absolute level of market share that CLASS has been forecast to achieve in reserve and response markets if the fast rollout scenario in the IA is realised, as this has the potential to crowd out alternative providers of flexibility; eg. that provided by retailers and aggregators. Nonetheless, our view is that, with the right level of monitoring and protection in place, CLASS should continue to be permitted in balancing services. Regular monitoring of market share and the number of participants in balancing markets should be implemented, with mechanisms in place to limit the market share CLASS can achieve if there is evidence that competition is being distorted.

Whichever regulatory treatment of CLASS that Ofgem decides to move forward with it is important that there is regular monitoring of the impact this is having on new investment in flexible assets. There is an evident need for significant new flexible capacity to meet the target to operate a fully decarbonised electricity system by 2035. Therefore it should be the overarching objective that the final regulatory decision on CLASS does not create new barriers for alternative providers of flexibility, and there must be tools in place to quickly review market rules if there is any evidence that investment in flexible assets is being stalled.

Consultation Questions

Question 1: Do you agree that the approach taken in our Impact Assessment is proportionate and balances the trade-offs between the scale of expected impacts and the cost of doing further analysis relative to the benefits such analysis may yield?

Whilst we appreciate the positive consumer savings that could be realised from permitting CLASS to participate in balancing services, which is especially important given the current affordability crisis, we do not believe that the Impact Assessment fully accounts for the range of potential competition impacts and follow on costs that could be incurred if CLASS is permitted to compete in balancing markets without any protections in place. We have concerns that the Monetised Cost-Benefit Analysis has weighed more greatly into influencing Ofgem's minded-to decision than analysis of hard to monetise costs, benefits and competitive impacts, where we believe there are greater gaps in the IA. That being said, we are not proposing CLASS be precluded from participating in balancing services, but instead that there must be sufficient monitoring in place to ensure the inclusion of CLASS in balancing markets does not crowd out other providers of flexibility.

Question 2: Do you agree that our sensitivity analysis captures a reasonable range of uncertainty over the likely costs and benefits of deploying CLASS as a balancing service?

We do not have the expertise to comment on the accuracy of cost assumptions in the downside sensitivity. Given many DNOs are yet to deploy CLASS it is difficult to assess whether the sensitivities capture the full range of expected impacts.

Question 3: Do you agree that it would not be proportionate for Elexon to work with industry to develop a solution to adjusting supplier imbalance positions via the Modification process in response to CLASS activations at this stage?

We agree that there isn't an urgent need to adjust supplier imbalance positions given only one DNO is using CLASS technology, but once the impact of CLASS on settlement cash flows becomes significant then Elexon should work with industry to develop a solution. Ofgem should work with Elexon to determine the threshold at which impact is deemed significant and therefore adjustments must be made to supplier imbalance positions.

Question 4: Do you agree with our assessment that there is no evidence that competition is currently being distorted or impeded by the participation of CLASS?

We do not believe it is sufficient to assess market impacts of ENWL's participation in Static Secondary FFR, Firm FR and Optional FR to conclude that there will not be significant market distortions in balancing services in the future. The impact assessment highlights that

CLASS is technically eligible to participate in several other balancing services, many of which are more lucrative than those that ENWL has participated in thus far. Whilst there may not be evidence that competition has been distorted yet when only one DNO has participated in a select few balancing services, this is not sufficient evidence to extrapolate that there will not be impacts on competition in the future. If the high rollout scenario is realised and CLASS does capture 43% of reserve and response markets, this would undeniably have significant impacts on competition.

To ensure competition is not impeded in the future there must be regular monitoring of the number of market participants and share of the market procured by the type of provider.

Question 5: 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?

It is important that DNOs take licence obligations and competition law responsibilities seriously, however, these safeguards are extremely broad and there is a risk that these safeguards alone are not sufficient instruments to ensure DNOs do not take advantage of the information available to them as monopoly providers of CLASS.

Question 6: What additional measures do you think would be effective and proportionate to address actual or perceived conflicts of interest with respect to CLASS?

There is ongoing work through the ENA's Open Network Project on defining and implementing primacy rules for the ESO and DSOs to manage conflicts of interest. CLASS must be considered in this project so that additional safeguards can be created if deemed necessary to address any potential conflicts of interest. The ENA must engage with participants in balancing services outside of their membership, to ensure DNOs are not the only voice able to define how primacy rules should work. Ofgem should ensure a wide range of participants are consulted regarding final primacy rule decisions.

Alongside our request for monitoring of balancing markets to ensure distortive impacts on competition do not emerge, Ofgem should set out clearly what would indicate that a DNO has taken advantage of their role in the context of participating in balancing markets. The risks of CLASS' participation in balancing markets should be set out upfront to ensure the impacts are established and can be monitored effectively.

Question 7: Do you agree that our minded-to position provides the most efficient incentive for CLASS's participation in balancing services?

Out of the options considered in the Impact Assessment, we agree that Option 1A provides the most efficient incentive for CLASS's participation in balancing services, with the lowest

risk of complete saturation of balancing markets. This option, compared to 1B and 2, ensures that markets will remain diversified and competitive - which is a crucial objective of the ESOs and will provide sufficient security of supply. Regulatory treatment of CLASS through DRS8 will ensure other providers of flexibility can compete with CLASS in balancing markets, and therefore has the lowest risk of weakening the business case for alternative providers of flexibility. It is right that DNOs share profits with consumers, who have funded the network assets in use, and this will provide the best incentive for DNOs to maximise the value to customers connected to their networks. We suggest that consideration is given to developing a new service category in the licence where customers see a greater proportion of the profits but are not exposed to any downside risk. This will bring the incentives more in line with those achievable by other flexibility providers, such as storage aggregators, who operate in many of the same markets.

Question 8: Do you agree that requiring CLASS in the price control would not promote efficient investment signals in CLASS and could distort competitive outcomes?

We agree that this option has the greatest chance of distorting competition in balancing markets, however, we note that this option also results in by far the greatest saving in BSUoS charges. Whilst we recognise that procuring CLASS at lower prices will result in the greatest system benefits, the lower the payments the less incentive there is for alternative providers to participate or gain market share in balancing markets - which could stall progress on connecting new flexible resources, and eventually result in even greater balancing costs. As stated previously, liquidity must remain in these markets so that there is still a business case for alternative providers of balancing services. Therefore we agree that Option 1A provides the best balance between these two competing factors, as long as there is regular monitoring in place to measure the impact of this regulatory decision on competition.

Question 9: What additional reporting or monitoring in RIIO-ED2 could be valuable to assess the ongoing impact of CLASS? Please explain how Ofgem, the DNOs or any other party would be required to support the proposed measure.

On the assumption that CLASS specific costs incurred are relatively minor compared to the revenue that can be earned through the use of CLASS in balancing services, we agree that this relatively low-cost source of flexibility that is almost readily available should be deployed if it can truly reduce balancing costs borne by consumers. However, there is little visibility of CLASS costs at present. We, therefore, suggest that reporting under DRS8 is amended to provide greater clarity of costs and revenue earned from the use of CLASS by providers to give the industry reassurance that this remains a low-cost source of flexibility and that its use remains in the best interests of consumers.