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11th May 2022 Sent by email to:

[flexibility@ofgem.gov.uk](mailto:flexibility@ofgem.gov.uk)

Dear Mike,

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

Thank you for the opportunity to respond to your consultation on the regulatory treatment of CLASS for RIIO-ED2.

Electricity North West is an innovative leader as is demonstrated by the development of CLASS which has been providing balancing services to the ESO for a number of years, delivering cost savings to all Great Britain’s customers in a low carbon manner.

We welcome your review and fully support your minded-to position which takes a whole system approach to solving system challenges as the electricity system is decarbonised by making best use of assets that have already been installed and funded by electricity customers. We are aware that some parties believe that this decision is inconsistent with other decisions which prevent DNOs to act as commercial aggregators or storage providers. We do not believe this to be the case, other parties can easily provide storage or aggregation and there is no need for DNOs to compete against them directly being an aggregator or storage provider: CLASS can only be provided by DNOs and hence it is appropriate for DNOs to provide this valuable service to benefit consumers.

DRS8 is clearly the most effective approach to incentivise DNOs to make discretionary investments in network assets that can provide real benefits to both their own customers and more widely to GB customers. The mechanism allows for future revenues to be shared with customers and DNOs are incentivised to make decisions in the best interests of both their customers and their shareholders. It is important, however, that if this mechanism is to be retained, future forecast ED2 revenues in relation to CLASS are not discounted in the ED2 settlement. DRS8 inherently allows for cost, revenue and risk sharing hence discounting would be a double count, as such forecasts would clearly be speculative and uncertain. Additionally, the ED2 framework is not yet decided and so we anticipate what sharing factor[[1]](#footnote-1) is set to be a key determinant of how much further CLASS is rolled out, along potentially with as yet unknown elements of the regulatory package for ED2[[2]](#footnote-2).

The technical capabilities of CLASS make it well suited to provide a subset of the NGESO balancing requirements. The NGESO has other needs and evolving requirements which CLASS would be unable to provide.

We are aware that NGESO are planning to review the operation of the reserve market, but this needs to be progressed as a matter of urgency. If the whole Fast Reserve market were opened to competition, CLASS would still only provide a relatively small proportion of the total requirement which is expected to increase as more flexibility is needed to manage the system.

Ofgem’s impact assessment basically shows that the more CLASS is deployed, the greater the consumer benefit. Whilst at this stage the mandated within price control approach is not preferred, should the risks to DNO’s and their customers of recovering their investments in CLASS be perceived as high[[3]](#footnote-3), Ofgem may wish to review a decision to use DRS8, moving over to treating CLASS within the price control in order that consumers benefit through more CLASS capability being rolled out.

In summary, we are supportive of Ofgem’s minded-to position, and agree that this is reflective of best interests of customers, and in alignment with Ofgem’s strategic objectives We assume other DNO’s will have incentives to rollout CLASS in ED2 under this minded position. We have provided answers to the specific questions raised in the consultation in the following appendix.

I hope these comments are helpful however please do not hesitate to contact either Paul Auckland or myself if you would like to follow up on any particularly aspect of our response.

Yours sincerely,

“By email”

# Paul Bircham

# Regulation and Communication Director

**RESPONSE TO 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?**

The approach taken in the Impact Assessment is fair and reasonable. It is proportionate, indeed in our view is thorough, and allows for the trade-offs between the expected impacts of CLASS and the costs we assume have been incurred and could be incurred for doing further analysis. The requirements for services like those of CLASS provides, are dependent on the need of NGESO and will therefore fluctuate throughout the year but will in general grow substantially as net zero progresses. Since the CLASS consultation has been published the Government has produced the Energy Security Strategy which is also reaffirming how a faster move to renewables to achieve net zero is a key part of achieving energy security. CLASS becomes even more valuable in our view in this policy environment where we think more balancing services, especially low carbon ones like CLASS are even more pivotal.

**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?**

The sensitivity analysis captures the relevant range of uncertainty over likely costs and benefits of deploying CLASS and the NERA sensitivity analysis has taken into account a number of relevant factors including direct costs, asset health costs and carbon cost to name but a few.

We think the deployment scenarios which have been assessed are all realistic options. DRS8 is the minded to position and in our opinion is the best way forward for CLASS, we will be able to price in a competitive, low cost manner which benefits consumers. DRS9 isnt an acceptable option for CLASS as there are limitations to the pricing and these may not be beneficial to the market or consumers. We would support option 2 which requires the DNO’s to provide CLASS as a mandated service however, if multiple DNO’s were to enter the market quickly this could result in a reduction in market prices and therefore could itself act as a disincentive to develop CLASS more widely due to the risk of lower revenues as utilisation prices are likely to continue to fall. There is a risk that prices drop so low the investments are unrecoverable.

In any event Ofgem concludes and we agree …” The results of the CBA indicate that the economic net benefit of CLASS is expected to be strongly positive across all regulatory options and deployment scenarios. There is very little variation in the Net Present Value (NPV) under each regulatory option – CLASS is a competitively priced technology (and therefore procured) irrespective of the assumed bidding strategy. However, there is considerably more variation in the estimated economic net benefit under different deployment scenarios, and this is summarised in the below figure. Whilst the total NPV is increasing with the scale of CLASS deployment, the average net benefit per unit of CLASS capacity decreases as the marginal unit increasingly displaces less costly alternative providers.”

“We also recognise that CLASS is a new technology and there is some uncertainty over its likely costs and benefits. For these reasons, we asked NERA to prepare alternative assumptions that could account for some of the key uncertainties in its estimates. The downside and upside scenarios are set out in detail in the IA in paragraphs 3.14 to 3.17, but the results are summarised in the below figure. They suggest that the CBA findings are robust and CLASS might be expected to return a positive NPV under a range of different scenarios.”

Conservatively though we have not seen a material impact, Ofgem has included some Asset health impact costs. Additionally Ofgem has taken into account that CLASS operates in a competitive market so therefore CLASS will not always be picked if the pricing is higher than alternative options in the market. Our experience is that price isn’t just the determining factor in the selection of a fast reserve dispatch, the size and length of time the unit can run for seems to be considered by the ESO and their assessment of their needs.

**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?**

The analysis completed in the impact assessment demonstrates the immaterially low impact (0.01%) to the total energy imbalance cashflow. The impact CLASS has on the settlement cashflows is extremely limited and therefore, it isn’t necessary to develop a solution to adjust supplier imbalance.

**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 agree with this assessment, NGESO now provide the dispatch data for the Fast Reserve market alongside much data transparency of other markets and the services in those. Due to CLASS adding to the options available to the ESO it is self-evident CLASS assists competition. We have seen no actual evidence that CLASS has either distorted or impeded competition though as the only current DNO providing CLASS we are aware of vocal concerns by some existing market players. There is and has been no actual evidence though of any detrimental impacts. On the contrary CLASS has lowered costs for consumers and will deliver substantial NPV benefits if rolled out as this Ofgem consultation shows.

**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?**

The safeguards which are in place are sufficient to deal with any perceived or indeed potential real opportunity for DNO’s taking advantage of their role within the balancing markets. We provide CLASS and understand fully that penalties would be substantial. A critical concern for DNO businesses is our legitimacy in the eyes of stakeholders and reputational impacts which are driving factors. There is a strong compliance track record, plus transparency of our actions sitting alongside oversight from Ofgem which is proportionate.

We have shared with Ofgem that we have internal procedures in place put in place from a CLASS perspective and it should be expected that other DNO’s would introduce business separation within their business to ensure information which could be available wasn’t used in an anti-competitive manner. The current licence obligations also allow Ofgem to intervene with enforcement powers if there was a breach. REMIT also provides a level of safeguarding as any long-term unavailability would need to be reported. It is a requirement for parties to register under REMIT when providing balancing services.

**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?**

We think the existing measures are adequate. We believe our ED2 business plan is robust when it comes to the DSO separation measures. The DNO will provide the services whilst the DSO will/would make the decision to utilise services if required.

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

The minded to position option 1A which is a continuation of the current regulatory treatment is the most efficient incentive for CLASS in balancing services however, we would support option 2 which requires the DNO’s to provide CLASS as a mandated service however, if multiple DNO’s were to enter the market quickly this could initially result in a reduction in prices and therefore could itself act as a disincentive to develop CLASS more widely due to the risk of lower revenues as utilisation prices are likely to continue to fall. There is a risk that prices drop so low the investments are unrecoverable. GB consumers would benefit from unsustainably low service prices whilst regional DNO customers would lose out as they wouldn’t be recovering their costs. This could lead to a value transfer from potentially more fuel poor areas of the country. The technology is low carbon and provides value for money to the consumers. The more DNO’s which were involved would expand the consumer benefits.

CLASS is limited to the markets in which it can participate, whilst other providers can provide multiple services to NGESO. The current markets which are utilised by NGESO are covered in the table below. CLASS cannot participate in the STOR market due to the duration the response is required for. The spend in the Fast Reserve market is £130M and CLASS provided £6.5M of response during financial year 21/22. We continue to monitor the markets to ensure we participate in the best fitting market to ensure best value for NGESO and consumers.

Fast Reserve Market reform splits the Fast Reserve market down again into slow and fast response and therefore this could potentially open the market for other providers as per current draft guidelines CLASS will be unable to provide services in the slow response but will be best placed to provide cost effective services in the fast response market.



**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?**

No, we do think there is a workable option to treat CLASS within the price control, especially when we consider that in certain scenarios (e.g. high scale of rollout, significant price competition) the minded option 1A position might involve too much risk and too low rewards to encourage DNO’s to provide the clear consumer benefits identified. Ofgem’s analysis shows that the more CLASS that is provided the greater the consumer benefit (albeit as less marginal service providers are replaced the marginal benefit reduces).

**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.**

We don’t believe any additional reporting is required in the RIIO-ED2 period, the data that NGESO now releases daily (whenever there is a dispatch) provides transparent information on number of activations, providers, utilisation price and size of the unit. This is released into the public domain for all to see and therefore checks can be made to see the impact of CLASS on the market. Ofgem’s own market analysis is a useful contribution to showing how CLASS is positively benefitting consumers and it could be worthwhile for this sort of analysis to be undertaken by the ESO/FSO in future, not just in respect of CLASS but in respect of all balancing services markets to demonstrate how these markets are working effectively. Generally, we find ESO transparency is effective though we would like to see more data on availability pricing in the fast reserve market being published.

1. The Totex Incentive Mechanism (TIM) sharing factor. Because this won’t be set primarily concerned with appropriately stimulating CLASS rollout for consumers we consider Ofgem should think carefully about the relevant sharing percentage used for the DRS8 treatment. [↑](#footnote-ref-1)
2. For example, the existence of, calibration of and current and forecast view of any Return Adjustment Mechanism impacts could impact decisions if CLASS might be taken forward or not. [↑](#footnote-ref-2)
3. For example should a risk of multiple DNO’s entering a market of limited size due to how the ESO defines markets result in too low prices, there could be a chance no DNO’s rollout CLASS. [↑](#footnote-ref-3)