



3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

18 May 2022

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

Dear Ofgem,

Thank you for the opportunity to respond to this consultation.

We agree that utilising distribution network assets with Customer Load Active System Services (CLASS) capability can deliver savings for consumers during the ED2 period. We also agree that delivering through a market-based mechanism is preferable as it should lead to more efficient outcomes.

However, we believe the option proposed by Ofgem (Option 1A) is potentially the least preferable option for consumers because:

- It represents poor value for consumers with around half of benefits given away to the distribution network operators (DNOs). The Impact Assessment shows this could cost consumers over £800m¹.
- DNOs would be able to make further, and excessive, returns on assets that consumers are already paying for.
- It does not provide a regulatory mechanism that is fit-for-purpose for dealing with all types of DNO load management.

To address this, Ofgem should:

- Reduce the share the DNO receives of the profits from providing class to a level that maintains an incentive but is more proportionate to the incremental investment required to deliver CLASS (for example, to 10%)
- Set out principles for DNO load management activity in ED2 and design a Directly Remunerated Service (DRS) that can be applied to different forms of DNO load management.

¹ Scenario C, Option 1A, profits for DNOs

Patron HRH The Princess Royal Chief Executive Dame Clare Moriarty

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Charity registration number 279057. VAT number 726 0202 76. Company limited by guarantee. Registered number 1436945.

England registered office: 3rd Floor North, 200 Aldersgate Street, London EC1A 4HD.

- Reconsider Options 1B and 2 if a new DRS, with a lower DNO sharing factor, is not accepted

Reduce the DNO sharing factor

We welcome Ofgem seeking to find a market-based mechanism for CLASS. If designed effectively we would expect a market-based mechanism to provide a proportionate investment signal and incentive to DNOs about where to locate CLASS services to provide value to the energy system and therefore to consumers.

CLASS is largely making use of assets that consumers are already funding (including a return on investment). Consumers should therefore receive the vast majority of the benefits from utilising these assets to provide services to the ESO. The reward to the DNOs should relate to the incremental investment required to provide CLASS. Sharing rewards 50:50², as proposed under Option 1A, will significantly under-reward consumers and over-reward DNOs. We believe a far lower share for DNOs can still represent an attractive return on the incremental investment required and so will deliver the efficient level of deployment. In any case, due to the scale of the amount of consumer value that is given away under Option 1A, deployment would need to be affected to an extent that is not credible to make consumers worse off by reducing the DNO sharing factor.

Principles for DNO load management activity

Class represents a welcome opportunity to help consumers reduce their energy bills which have risen dramatically and caused well publicised affordability problems. However, we think a regulatory approach to realise short term cost reduction for consumers should also seek to protect the long term realisation of value for consumers from their energy flexibility, which is likely to be best served by engaged consumers in a competitive market.

To achieve this outcome it is vital that the role of distribution network operators (DNOs) in load management is clearly set out in a fit-for-purpose regulatory mechanism. While CLASS is one form of DNO load control, Northern Power Grid (NpG) have trialled an alternative called 'BEET-Box' and others may emerge in the future. To regulate these services consistently we encourage Ofgem to set out principles for DNO load management activity in ED2 and set out a Directly Remunerated Service (DRS) that can be applied to different forms of DNO load management. Without this clarity the development of flexibility markets will be unnecessarily restricted by uncertainty of regulatory treatment for similar services.

² Assuming a sharing factor of 50% under the ED2 Totex Incentive Mechanism

Alongside setting out the role of networks in active load control more clearly, there also needs to be a clearer definition of the balancing markets CLASS can participate in. We would expect this to be based on supporting evidence that CLASS benefits significantly outweigh risk to DNO or consumer assets. Without clarity on the markets impacted it restricts visibility of DNO for other flexibility market participants.

Reconsider other options

We share a number of the concerns that Ofgem has with Options 1B and 2. However, we find it difficult to see how the impact of these on consumer benefits can be of the same scale as the impact on consumer benefits from the sharing approach in Option 1A. As an example, even if Option 1B resulted in lower deployment through reduced incentives compared to Option 1A, the Impact Assessment shows it can still be expected that consumer benefits will be higher under Option 1B. The reduction in costs for consumers under Option 1B, in the *medium* deployment scenario is over £1.4bn³, whereas in the *high* deployment scenario it is around £1bn for Option 1A.

Please do get in contact if you have any queries

Kind regards

Ed Rees

Senior Policy Researcher
Citizens Advice

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?

We would like to better understand through impact assessment the consideration of the markets that CLASS would participate in and the impact on DNO assets.

We agree that the short term benefits are easier to capture than the longer term impacts on competition and consumer-led flexibility. We think there is more modelling that could be done on the role of CLASS in relation to the emergence of competing technologies and the potential advantages and barriers it may create. Ofgem should return to this to inform future decisions.

³ DUoS and BSUoS cost reductions

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 would like to see Ofgem provide further clarity on the specific flexibility markets that CLASS will play into and detail on how this will impact DNO assets and the markets themselves.

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 would expect most networks to utilise CLASS with a proportionate incentive and this will make the impact on imbalances significant and will likely justify a modification. We agree that taking a modification to the report stage at which point clear costs are known is a necessary part of the business case.

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 are not in a position to provide a view. However, we are unsure of the weight of evidence, around value for consumers, that can be taken from one DNO's approach to flexibility procurement. It will be the future impact on competition from a new scale of CLASS activity that should be relevant to Ofgem's consideration.

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?

Modelled impact of CLASS on competition should inform the safeguards Ofgem are considering.

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?

To better mitigate the longer-term risks we propose the following alterations and additions are made to the minded-to position:

- Ofgem to set out principles of DNO active load management service criteria and a tailored DRS approach for all DNO active load management
- A clear definition of the markets where CLASS activity is suited and the particular risks for assets of market participation are well understood

- A sharing factor that creates an incentive in line with returns from other DNO regulated activity

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

We do not agree that the minded-to position provides the most efficient incentive for CLASS participation in balancing services.

We welcome Ofgem seeking to find a market-based mechanism for CLASS. If designed effectively we would expect a market-based mechanism to provide a proportionate investment signal and incentive to DNOs about where to locate CLASS services to provide value to the energy system and therefore to consumers.

CLASS is largely making use of assets that consumers are already funding (including a return on investment). Consumers should therefore receive the vast majority of the benefits from utilising these assets to provide services to the ESO. The reward to the DNOs should relate to the incremental investment required to provide CLASS. Sharing rewards 50:50, as proposed under Option 1A, will significantly under-reward consumers and over-reward DNOs. We believe a far lower share for DNOs can still represent an attractive return on the incremental investment required and so will deliver an efficient level of deployment. In any case, due to the scale of the amount of consumer value that is given away under Option 1A, deployment would need to be affected to an extent that is not credible to make consumers worse off by reducing the DNO sharing factor.

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?

Yes we agree this is a risk and we think that more needs to be done to assess the risk and attempt to mitigate it as outlined in previous questions.

We share a number of the concerns that Ofgem has with Options 1B and 2. However, we find it difficult to see how the impact of these on consumer benefits can be of the same scale as the impact on consumer benefits from the sharing approach in Option 1A. As an example, even if Option 1B resulted in lower deployment through reduced incentives compared to Option 1A, the Impact Assessment shows it can still be expected that consumer benefits will be higher under Option 1B.

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.

It is critical to CLASS that there is ongoing monitoring and transparency of activity in ED2 to provide market actors clarity on the relevant context in which they are looking to invest.