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# DRAFT ADE Response | Ofgem Consultation - Regulatory treatment of Customer Load Active System Services (CLASS) as a balancing service in the RIIO-ED2 price control | 9 May 2022

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## Context

The ADE welcomes the opportunity to respond 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.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 140 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

## Overall Evaluation

The ADE has consistently opposed the use of CLASS since it undermines both the role of DNOs as neutral market facilitators and undermines commercial markets by allowing DNOs to bill customers for the construction of CLASS-capable assets and then bid them into balancing markets cheaply. It is appreciated that Ofgem has set out the safeguard and conditions for the use of CLASS in this consultation. However, it is our view that such conditions do not fully or adequately mitigate the risks posed by the expansion of CLASS. From the final RIIO-ED2 DNO business plans, the ADE does not support ENWL and NPG's desire to continue the ED1 treatment of Project CLASS and incentivise expansion.

Expanding the use of CLASS does not cohere with the objectives of creating strong, competitive flexibility markets and unlocking the true value of flexibility set out in both the Smart System Flexibility Plan and Full Chain Flexibility Project.

More fundamentally, voltage reduction, as used in the CLASS project, is an energy efficiency measure if the DNOs can reduce the voltage without any noticeable difference to end consumers and thereby, reduce electricity demand. If this is the case, then they should already do this as standard as part of an efficient operation of the network.

This raises two fundamental issues with CLASS. The first is that fast-acting flexibility should not be done at the expense of energy efficiency. As with the broader sector, energy efficiency should always take precedence and only once the energy is used efficiently, should the remaining energy be considered for flexibility needs. Secondly, CLASS shows that the DNOs are not operating their networks as efficiently as they could be. The answer to this is not to provide them access with further commercial revenues but to require them to fulfil their obligations under existing RIIO price control arrangements.

**Q1. 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 ADE does not agree that the IA adequately balances the trade-offs. While we appreciate the different scenarios explored, it is not possible to fully model the market interactions and effects that may be created by implicit or explicit conflicts of interest.

**Q2. 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 ADE does not consider that the analysis captures all costs, especially the impact on DSR and investment.

**Q3. 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?**

Firstly, without adjusting imbalance positions via the Applicable Balancing Service Volume Data process, suppliers will be subject to imbalance volumes as a result of CLASS. The negative impact of this is more significant as Market Wide Half Hourly Settlement expands, and if high imbalance prices continue.

Secondly, given the fact that within BSC Code Modification Proposal P415 there is provision for flexibility providers to compensate suppliers for imbalances incurred by flexible assets participating in the wholesale market, DNOs not having a similar responsibility for CLASS activations would give DNOs an unfair market advantage.

**Q4. Do you agree with our assessment that there is no evidence that competition is currently being distorted or impeded by the participation of CLASS?**

This is not an informative data point. At present, only one DNO is activating CLASS and the demand side flexibility sector is nascent. The pace of DSF growth needed in the next decade demands strong market signals and competition. Anything that interferes with the growth of these markets should be avoided.

Various potential conflicts are at issue. In the first instance, only one DNO has pledged to create legal separation between DNO and DSO functions. Therefore, without formal separation there can be no guarantee that business interests presented by CLASS do not affect system facilitation responsibilities. Furthermore, Ofgem has consistently argued for increased coordination between the DNOs and NGESO on system planning and operation. If DNOs are actively participating in ESO balancing services, this special relationship cannot help but give them a privileged market position.

Likewise, as service rules develop, particularly through the Open Networks focus group, there is no safeguard against DNOs arguing for primacy of other DNO services such as Active Network Management over private assets participating in balancing markets in curtailed areas. This could create conflicts of interest if their CLASS assets are in a different area and therefore, are more able to participate in balancing services compared to those blocked by primacy for ANM.

The definition of impact on competition in Capture 6 'Competition Impacts' is quite narrow. The primary concern is not necessarily intentional collusion or crowding out of other participants. The more salient point is the concern over monopoly network providers engaging in competitive activities. Even if a DNO doesn't have dominant market power with CLASS, there remains a concern about the impact on competition more generally. They have a unique monopoly position in the market that other participants do not.

**Q5. 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 ADE does not consider existing safeguards to be a strong enough check on DNOs conflict of interest.

**Q6. What additional measures do you think would be effective and proportionate to address actual or perceived conflicts of interest with respect to CLASS?**

The ADE reiterates that if CLASS is to be allowed as a balancing service a cap should be placed on how much volume can be offered.

Furthermore, customers must be able to opt out. DNOs are not in a position to judge the impact of step voltage changes on industrial customers, because such customers vary enormously.

**Q7. Do you agree that out minded-to position provides the most efficient incentive for CLASS's participation in balancing services?**

As above, the ADE does not agree with the minded to position.

**Q8. Do you agree that requiring CLASS in the price control would not promote efficient investment signals in CLASS and could distort competitive outcomes?**

The price control mechanism that DNOs are subject to is designed to replace market signals therefore DNOs should be incentivised to engage in efficient investment.

**Q9. 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.**

The impact on end users should be continuously assessed, especially industrial and commercial customers. End users should be consulted directly on their experience of CLASS as opposed to over reliance on academic studies.

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**For further information please contact:**

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