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FAO: Mike Duncan and Zak Rawle

Response to Consultation: Regulatory treatment of Customer Load Active System Services (CLASS) as a balancing service in the RIIO-ED2 price control

Dear Mike and Zak,

We welcome the opportunity to respond to the Consultation on the regulatory treatment of Customer Load Active System Services (CLASS) as a balancing service in the RIIO-ED2 price control.

As a demand side response (DSR) aggregator and flexibility provider, we have significant concerns about the continued provision of this service alongside competitive providers.

It is wholly inappropriate for DNOs to offer competitive services, and goes against the principles of unbundling, a key element of energy legislation. The risk of conflicts (real or perceived) from DNOs is also mentioned in Ofgem's recent call for input on the future of DSO governance and was a key driver for BEIS and Ofgem's decision to introduce an independent Future System Operator (FSO).

The flexibility industry is united on its position on the continued use of CLASS and it is imperative that Ofgem listen to this message on the impact that this intervention will have on investor confidence and investment in flexibility.

It is our view that a better use of CLASS capabilities would be to achieve permanent energy savings. If the DNOs determine that energy can be saved by reducing voltage, they should implement this permanently in the network segments concerned.

We are concerned that the CLASS project has not undertaken sufficient field measurements to show that Industrial and Commercial (I&C) customers are not adversely affected by



CLASS-driven voltage fluctuations. We have experience of I&C customers experiencing equipment malfunction as a result of voltage dips in other contexts. Some of these are resolved by permanently increasing transformer tap settings, which permanently increases electricity consumption.

On the other hand, if CLASS voltage reductions were implemented permanently, those few I&C customers who experienced equipment malfunctions would then increase their tap settings to bring their site voltage back to the level it was at before the network reduction. Therefore most users would see a reduced voltage, and energy consumption would reduce. A few would pull their consumption back to the pre-existing level. This form of CLASS would achieve permanent reduction in energy consumption.

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 do not agree with the findings of the analysis, as it does not include all relevant costs, or assess what we see at the benefit of the counterfactual (using CLASS to achieve permanent energy reduction).

Costs which are not included include the impact on I&C customers directly, both in terms of their ability to provide balancing services (and the evolution of the Demand Side Response (DSR) industry more generally), as well as the direct impact of voltage fluctuations on their end equipment.

Further, the impact on competition and investment has not been appropriately captured – the focus is on market power primarily, which is too narrow a definition of an impact on competition, and impacts on investment are discounted.

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?

As mentioned above, this approach does not capture the counterfactual – using voltage reduction as an energy efficiency measure instead of a balancing service.

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?

No, we do not agree with this position. As a principle, no market participant should be put out of balance by another party.

Without a Modification to adjust supplier positions, the impact of CLASS will be smeared across suppliers. This introduces another distortion from the use of CLASS in the market.

The impact of this will be particularly important in light of market wide half hourly settlement implementation in 2024 (and increasing proportions of customers being half-hourly settled



before then). Highly volatile imbalance prices that have recently been observed (and which may be expected to continue) will further exacerbate the impact of CLASS actions on suppliers.

There is an existing mechanism in the market (governed by the Applicable Balancing Services Volume Methodology) which adjusts imbalance positions for balancing services delivered. This process should be used to adjust supplier positions if CLASS was used as a balancing service.

Related to this, it is imperative that CLASS actions are properly metered and properly baselined. This should be at the point of delivery with live operational metering. This is important to be able to reflect actions in imbalance positions, but also to ensure appropriately delivery of the service more generally.

Furthermore, Elexon's analysis about the impact of CLASS was based on a period of exceptionally low imbalance prices, due to the COVID lockdown, which will have reduced the overall monetary impact. It is noted that the CLASS impact during this period was 0.8% of the Grid Supply Group (GSP) take, and the impact of greater volumes of CLASS would increase the overall impact on settlement. This further increases the importance of correcting imbalance positions for CLASS actions.

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?

The assessment of impacts on competition focusses primarily on market power, using the Competition and Market Authorities (CMA's) Theories of Harm. Where volumes of CLASS increase in future, there could be potential for CLASS to provide all or most of the requirements for specific services.

However, the impact of CLASS on competition goes beyond market power. DNOs have a unique monopoly position in the market which means they may be capable of impacting competition without having significant market power in these markets. The very existence of DNOs in providing balancing services can impact investor confidence or willingness for competitors to participate in certain markets.

DNOs control access to the distribution networks. If they also provide a service in direct competition to the customers attempting to connect, there is a clear conflict of interest. We are surprised that this has not received more 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?

It is not clear to us that existing safeguards protect against DNOs taking advantage of their position in the market when participating in balancing markets. Ofgem's April 2022 DSO Governance consultation notes these challenges.



It is important that even perceived conflict can have an impact in the market. Given the industry's response to Ofgem's previous consultation on this matter, it is clear that there is a perception of conflict, which could have impacts on investment in flexibility.

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?

If CLASS is to be used, there should be a cap on the volumes that can be offered from DNOs, set at a percentage figure of balancing services, which could be kept under review.

In addition, other measures should be introduced to limit the impact on end users:

- End users, particularly I&C customers, should be given the opportunity to opt-out of being impacted by CLASS
- Where customers are not given the opportunity to opt-out, they should be able to apply for compensation for the impact on their sites

If CLASS were used as a permanent energy efficiency measure rather than a balancing service, there would be no conflict of interest.

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

No, we do not agree with this position.

As set out above, total volumes of CLASS should be subject to a cap on volumes if it is to be allowed to participate in balancing services.

A better use of CLASS would be to create overall lower voltage on the system.

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 do not agree with this statement. As regulated parties and with appropriate price control design, DNOs should be incentivised to engage in efficient investment. The price control mechanism is designed to replace market signals.

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.

In order to properly assess the impact of CLASS, if it is to be allowed to provide balancing services, it is important that there is:

- Appropriate metering and baselining of CLASS actions
- Ongoing monitoring of the impact of CLASS on end-users, particularly I&C customers. This could be via surveys or engagement with aggregators and should



include impact on the ability to offer balancing services as well as financial impact of the service on equipment

- Monitoring volumes of balancing services provided by CLASS
- Monitoring the impact of CLASS on settlement

We would welcome the opportunity to discuss any points in this response in further detail,

Yours sincerely,



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