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National Grid ESO response to regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control (2022 consultation).

Dear Sir or Madam,

We welcome the opportunity to respond to your Regulatory treatment of Customer Load Active System Services (CLASS) as a balancing service in RIIO-ED2 network price control consultation.

National Grid ESO is the electricity system operator for Great Britain. We move electricity around the country second by second to ensure that the right amount of electricity is where it's needed, when it's needed – always keeping supply and demand in perfect balance. As Great Britain transitions towards a low-carbon future, our mission is to enable the sustainable transformation of the energy system and ensure the delivery of reliable, affordable energy for all consumers. The ESO holds a unique position at the heart of the nation's energy system. We use our unique perspective and independent position to facilitate market-based solutions which deliver value for consumers. To date, we have facilitated the participation of the CLASS technology in the provision of balancing services as we would for any other provider.

Key points of our response:

- The ESO has a strategic ambition to drive competition for the benefit of consumers. As such we welcome confirmation of a market-based approach to utilise CLASS as a balancing service in RIIO-ED2. We believe that this approach provides an appropriate means to continue to increase competition in our balancing services markets and consequently drive down costs for consumers.
- The ESO recognises the inherent uncertainty in the scale and impacts of the CLASS roll out in RIIO-ED2. We believe that the ESO can assist in highlighting concerning behaviours through our existing market monitoring processes. Furthermore, we believe there could be merit in Ofgem reporting on the deployment of CLASS mid-way and/or at the end of RIIO-ED2. These activities could help to give confidence to the market and mitigate any potential system risks.
- Actual or perceived conflicts of interest between DNOs as a potential CLASS provider and DSOs as a neutral market facilitator must continue to be a key consideration in the wider rollout of CLASS in RIIO-ED2. We welcome Ofgem's recent call for input on 'future of local energy institutions and governance' to address such actual or perceived conflicts of interest.
- The use of CLASS should be where it is demonstrably the best option for consumers. We wish to highlight that there may be other opportunities both now and in the future to use regulated DNO assets for greater consumer benefit. Therefore, the ESO recommends that the treatment of revenues for CLASS in RIIO-ED2 does not cause a perverse incentive to discourage further innovations in voltage optimisation using regulated assets in future that offer greater value to consumers.
- System integrity and operability should not be reduced as a result of CLASS. Whilst we have no evidence to suggest this is an issue, existing DNO obligations such as Grid Code OC6 demand control should be maintained. Consideration may also be required in the future to management of risks associated with single technology types.

Please find the answers to the consultation questions appended to this letter. Should you require further information or clarity on any of the points outlined in this paper then please contact Andy Wainwright in the first instance at andy.wainwright@nationalgrideso.com.

Yours sincerely

Julian Leslie

Appendix 1 – Consultation Question Responses

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?

We support Ofgem's Impact Assessment (IA), which provides further clarity on the costs and benefits of the regulatory treatment options displayed in the consultation. We wish to put forward the following which may need further consideration:

- The IA presents information on Electricity North West Limited (ENWL's) market participation with CLASS between September 2019 and 2020. We note that this period was a time of major market change in the ESO's response markets, and so this may not be completely representative of expected prices in the longer term.
- The IA assumes that CLASS can participate in all of the ESO's balancing services. There may need to be a greater understanding of the market impact of CLASS if this is found not to be the case in RIIO-ED2.

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 range of uncertainty captured in the sensitivity analysis emphasises the difficulty in predicting the costs and benefits of deploying CLASS as a balancing service. We welcome further detail regarding the figures used in the analysis, including the use of costs that are 50% higher than those reported by ENWL. Nonetheless, it is worth noting that even under this scenario CLASS is still the cheapest provider.

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?

We do not believe that adjusting supplier imbalance positions via the modification process in response to CLASS at this stage is necessary. We believe that existing mechanisms within the settlements process are sufficient to manage any impacts on settlement caused by CLASS participation. To add to this, the ESO believes that the relative size of the potential impact in monetary terms is not currently deemed large enough to warrant any changes to the settlement process. However, if CLASS activations do increase or have an unforeseen impact on settlements, the ESO would support a review of the current process. Whilst the macro impact may not be large, we would like to highlight there may be potential distortive distributional impacts on those consumers where CLASS is used.

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?

We have no evidence that competition is currently being distorted by the utilisation of CLASS. The participation of CLASS could increase competition, as a historical precedent of ENWL participating in the markets has yielded positive results through increased competition. Introducing (potentially) six DNOs into the existing market could increase competition and drive down costs for consumers.

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?

At this point in time, we consider there are sufficient safeguards. We expect that the ESO's market monitoring team would pick up any potential concerning behaviours which could then be investigated, as the relevant authorities see fit. However, the need for changes to licence obligations or the market rules in the future may be needed should we see any consistent behaviour which negatively impacts the market.

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 actual or perceived conflicts of interest relating to DNOs and its utilisation is an important consideration regarding the rollout of CLASS. We emphasise that future models for DSO need to include appropriate safeguards to ensure that a DNO's role as a provider of CLASS does not conflict with a DSO's role as a neutral market facilitator. To that end, the ESO welcomes Ofgem's work in this area, noting the recent call for input on the 'future of local energy systems and governance'.

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

We believe that as a market-based approach Ofgem's minded to position provides the most efficient incentive. Utilising CLASS as a balancing service in RIIO-ED2 is an appropriate means to continue to increase competition in ESO balancing services markets and consequently drive down costs for consumers. Should market fundamentals change in the future, new and cheaper providers will also have opportunity to compete, particularly if new technologies emerge. This ensures that the use of CLASS is activated where it is demonstrably the best option for consumers.

We recognise the merits and drawbacks of existing remuneration routes (DRS8, DRS9). We do note that, in Ofgem's Impact Assessment, the proposed remuneration sharing mechanism through DRS8 lowers consumer value compared to some alternative options. However, on balance we support Ofgem's minded-to position recognising that the future regulatory treatment of CLASS needs to incentivise efficient uptake and facilitate its use where it is demonstrably the best option for consumers. We also understand that the proposed DRS8 approach ensures that consumers who are affected the most receive the benefits of CLASS through DUoS charge reductions. We do note that an alternative remuneration sharing mechanism could potentially increase consumer value and that this option may be worth further consideration.

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

We believe that requiring CLASS to be funded through the price control may not allow for market price discovery, risking inefficient outcomes which could ultimately reduce the level of consumer value associated with CLASS.

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.

We believe that additional reporting and monitoring in RIIO-ED2 could be valuable in assessing the ongoing impact of CLASS. The ESO would be happy to assist in these areas. We believe there could be merit in Ofgem conducting a review of the deployment of CLASS, including its impact on the market and consumer benefits, in the middle and/or end of the RIIO-ED2 period.