



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

Northern Powergrid's response to Ofgem's consultation on the regulatory treatment of CLASS services

KEY POINTS

- The provision by distribution network operators (DNOs) of Customer Load Active System Service (CLASS) services to the ESO has the potential to reduce the costs of balancing the system. An effect that would lead to lower bills for customers. This is one of the benefits that could be delivered to customers by DNOs increasingly taking on more active distribution system operation (DSO). Any risks introduced by DNOs performing this role are readily mitigated.
- We support the minded position for a market-based approach, and a continuation of the same regulatory treatment of RIIO-ED1, (option 1A) which indicates that this solution provides the most value for customers.
 - The market based approach delivers the highest likelihood that investments in CLASS will be taken ahead only to the extent they are efficient i.e. their cost is less than the expected revenues.
 - DNOs would have a strong profit motive to ensure this, since they would be exposed to a large share of those profits (or losses).
 - The provision of these services by DNOs is a sustainable outcome since it is a secondary benefit of an asset that would otherwise still have been built.
- We agree with Ofgem that requiring CLASS within the price control would not promote efficient investment signals and could distort competitive outcomes as this approach would remove the 'margin' element.
- Since the balancing services market is national, individual DNO groups would not have sufficient market power to distort outcomes; and neither could their visibility of information and special position in their local area confer any particular advantage.
- Allowing DNOs to provide CLASS on a competitive basis plays into an open market, pushing down the clearing price to the benefit of the customer.
- It is worth noting that the principal CLASS service is the demand reduction service, however this service directly conflicts with our voltage optimisation proposal in our RIIO-ED2 plan.
 - Both seek to minimise voltages to reduce demand; where voltage optimisation would seek to do this continuously, whereas a CLASS demand reduction service would seek to do this only when required to manage frequency on behalf of the ESO.
 - Due to the estimated benefit customers from voltage optimisation it is to be prioritised, therefore our underlying assumption is that CLASS will not be offered as a demand reduction (upward frequency response) service.
 - Therefore, we are proposing to provide CLASS to the ESO to provide efficient whole system solutions where it is complementary to our voltage optimisation CVP that provides 10 times the net present value benefit.

Responses to specific Ofgem consultation questions

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?

1. Ofgem's impact assessment appears to be comprehensive.

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?

2. Yes, we believe a reasonable range of uncertainty has been captured.

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?

3. Yes, we agree it would not be proportionate due to the limited impact of historical distortion.

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?

4. Yes, we agree with Ofgem's assessment that it is unlikely DNOs have or would have market power in future.
5. Since the balancing services market is national, individual DNO groups would not have sufficient market power to distort outcomes; and neither could their visibility of information and special position in their local area confer any particular advantage.

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?

6. Yes, the existing obligations are extensive and would prevent the DNO taking advantage of their DNO role in providing connections. These obligations are additional to competition law, which would provide further protection.
7. DNOs would not be able to take advantage of their role for two reasons:

- a. The obligations placed on DNOs by legislation and their licence (in particular standard licence condition 19) would ensure continued market access for balancing service providers. Any DNO that breached those obligations could potentially be subject to significant penalty.
 - b. Each individual DNO could have only a limited impact on the national balancing services market; therefore its incentive to use whatever position it has to prevent other balancing providers connecting to its network would in any case be limited.
8. The combination of extensive penalties and limited potential payoffs means the risk of such conduct is low.

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

- 9. There are extensive measures in place already that would address actual risks.
- 10. To help address risks that other stakeholders perceive, Ofgem could publicise in its decision the obligations which it considers could prevent DNOs from taking advantage of its position, along with the potential penalties.
- 11. Transparency of data over the longer term, including the share of the balancing services each DNO holds, and its revenues, could also help address perceptions of risks.

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

- 12. Yes, we agree with Ofgem that market based mechanisms can provide the most efficient incentive for Customer Load Active System Service (CLASS) participation in balancing services.
- 13. If Ofgem adopts a regulated approach, then this could mean:
 - a. DNOs under-invest in CLASS, for example if a regulated price (under directly remunerated services) is considered too low to warrant the investments; or
 - b. DNOs over-invest in CLASS, for example if Ofgem mandates its provision free of charge to the ESO (with costs covered via the price control), with no price feedback mechanism to prevent excessive use of (or investment in) the service.
- 14. In the first scenario, consumers would pay too much for balancing services directly, since they would be provided by more expensive solutions instead of CLASS.
- 15. In the second scenario, consumers would again overpay, although this time the effect would be indirect; cheaper technologies could be frozen out of the balancing services market, raising overall consumer costs (since consumers would pay for the DNO costs via the price control).

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

16. Yes, we agree with Ofgem that this option would not promote efficient investment signals and could distort competitive outcomes.
17. This approach would remove the 'margin' element as companies would look to find the efficient solution and maximise performance against totex incentive mechanism which would have an obvious impact on competition.
18. Should Ofgem effectively mandate the ESO to procure CLASS ahead of other energy services, this would have significant competition effects.
19. Ofgem should not specify capacity capability that DNOs make available. Such micromanagement risks driving perverse incentives that do not benefit consumers i.e. forcing the hand of companies towards certain solutions when these may be sub optimal for networks or customers.
20. Building this into cost assessment is also be inefficient as if Ofgem went down this route it should form part of totex and be benchmarked at that level.
21. Allowing DNOs to compete with CLASS, and not funding it automatically through the price control, gives DNOs an incentive to participate in balancing services markets only where it is expected to be competitive and therefore assist in delivering lower balancing costs.

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.

22. In the same way that DNOs are reporting on customer flexibility, it would be reasonable to expect DNOs to include an annual (say) report of the provision of these network services.
23. The aim is the same, to use openness and transparency to build trust in flexibility markets and the actions being taken by DNOs to ensure that customers benefits from a smarter and more flexible whole energy system.