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Sent by email to:
flexibility@ofgem.gov.uk

Dear Edwin,

Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control

Thank you for the opportunity to respond to your consultation on the regulatory treatment of CLASS for RIIO-ED2.

Electricity North West is an innovative leader as is demonstrated by the development of CLASS which is now providing balancing services to the ESO, delivering cost savings to all Great Britain's customers and reducing carbon emissions.

We welcome your review and fully support your minded-to position which takes a whole system approach to solving system challenges as the electricity system is decarbonised by making best use of assets that have already been installed and funded by electricity customers. We are aware that some parties believe that this decision is inconsistent with other decisions which prevent DNOs to act as commercial aggregators or storage providers. We do not believe this to be the case, other parties can easily provide storage or aggregation and there is no need for DNOs to compete against them: CLASS can only be provided by DNOs and hence it is appropriate for DNOs to provide this valuable service.

DRS8 is clearly the most effective approach to incentivise DNOs to make discretionary investments in network assets that can provide real benefits to both their own customers and more widely to GB customers. The mechanism allows for future revenues to be shared with customers and DNOs are incentivised to make decisions in the best interests of both their customers and their shareholders. It is important, however, that if this mechanism is to be retained, future forecast ED2 revenues in relation to CLASS are not discounted in the ED2 settlement as such forecasts are clearly speculative and uncertain. It would also be appropriate to have separate sharing factors for CLASS services to provide sufficient incentive for DNOs to invest in a technology that provides value to customers.

The technical capabilities of CLASS make it well suited to provide a subset of the NGESO balancing requirement. The NGESO has other needs and evolving requirements which CLASS would be unable to provide. Some of the new technologies should be focussed on addressing these requirements. CLASS can provide demand response on behalf of domestic and smaller commercial customers at a one-off capital cost of around £10 per customer and annual operating costs of less £0.30 per customer. It is



doubtful there is any other approach that can currently unlock this response from these customers so efficiently. This has the potential to unlock significant carbon benefits as highlighted in the Baringa report on the potential benefits of CLASS. Prohibiting CLASS is clearly not in the interest of current and future electricity consumers and would be detrimental to the fight against climate change.

From our participation in this market we have learnt that the Fast Reserve market is clearly in need of urgent reform. Much of the market is closed to competition because of opaque bilateral contracts. The Fast Reserve market is worth more than £90 million annually with over 80% of the requirement being provided by hydro and large fossil-fuel generators through such contracts. This is particularly true of Hydro Spin where NGESO pays providers around £60M per annum with no visibility that this is providing value for money to customers. Even in the market-based Firm Fast Reserve service, pump storage generators were selected ahead of CLASS despite their being over three times more expensive. If there is a need to ensure strategically important generators remain on the system, then they should be removed from the market and separately and transparently price controlled. If they do not need to be protected, then they should bid into the market on the same basis as every other provider. We are aware that NGESO are planning to review the operation of the Fast Reserve market, but this needs to be progressed as a matter of urgency. Even if other DNOs deployed the CLASS technology, they could only provide a relatively small proportion of the total requirement, were the whole Fast Reserve market opened to competition. As the total requirement is expected to grow significantly as more flexibility is needed to manage the whole system, the need to demonstrate that Fast Reserve continues to be an attractive market for many participants, including CLASS providers, is very important.

In summary, we are supportive of Ofgem's minded-to position, and agree that this is reflective of best interests of customers, and in alignment with Ofgem's strategic objectives. We have provided answers to the specific questions raised in the consultation.

I hope these comments are helpful however please do not hesitate to contact either Tony McEntee or myself if you would like to follow up on any particularly aspect of our response.

Yours sincerely,

Paul Bircham
Regulation and Communication Director

RESPONSE TO CONSULTATION QUESTIONS

Q1. Are there other options we should have considered? Please provide reasons.

We agree that the options identified in the consultation are the only ones available and we do not believe there are other options that need to be considered.

Q2. Do you agree that market based mechanisms can provide the most efficient incentive for CLASS participation in balancing services?

We are fully supportive of market-based mechanisms to resolve system issues. These can then test traditional network build solutions against new flexible services and is demonstrated by our support for new flexibility markets. However, this also requires allowing new innovative ways of operating networks to challenge other traditional approaches for providing network services.

Q3. What is your view on DNOs' sharing profits with consumers, even if this means consumers are also exposed to DNOs' losses (including how this might affect DNOs' competitive behaviour noting this is different to other providers of balancing services)?

This is clearly appropriate. Where DNOs provide services, it is likely to be through a combination of new and existing assets. DNOs are incentivised to maximise the value to customers connected to their network and to themselves in the same way as other providers of balancing services.

Q4. How might limits on charges to the ESO in DRS9 affect investment and utilisation signals for CLASS?

If an administrative approach to setting prices were used this would either necessitate setting different prices for different DNOs as incremental levels of CLASS investments and costs or a single averaged price across all DNOs. This could clearly distort the operation of these markets and potentially distort investment.

Q5. Do you agree that requiring CLASS in the price control would not promote efficient investment signals in CLASS and could distort competitive outcomes?

We agree with this position. If future cheaper alternative options to CLASS are developed, then CLASS services should not be protected through guaranteed price-controlled returns as this is not in the best interests of consumers.

Q6. Do you have evidence CLASS could affect the likelihood of system reliability issues?

We have been operating CLASS either through the original trial and through the commercial deployment since 2014 and there is no evidence that it affects system reliability.

Q7. Do you have evidence competition is currently being distorted or impeded by the participation of CLASS? Do you agree with our assessment that it is unlikely DNOs have or would have market power in future, and the reasons we have provided in Appendix 2?

CLASS can provide a non-dynamic demand reduction capability of quite short duration of typically less than 30 minutes. It is well suited to the current NGESO requirements for non-dynamic Secondary Frequency Response and Fast Reserve. We estimate our maximum response will be of the order of 100MW and this will vary through the year and through the day and hence will be a relatively small proportion of the total NGESO requirement.

As described in the consultation document, the approach NGESO uses to procure Firm Frequency Response is that dynamic providers can meet the non-dynamic requirement but not vice-versa. Tenders are also evaluated against the mandatory frequency response market. Even if CLASS provision into the non-dynamic market were increased significantly by other DNOs providing services, prices for non-dynamic response will be effectively capped at the level of prices in the mandatory and dynamic markets and hence it is not possible, with these arrangements, for CLASS, to have market power whatever volume participates in the market.

Similar issues arise in the Fast Reserve market, where the tendered services are competing against alternative actions, which are opaque in terms of both who is providing them and the prices paid. The Fast Reserve market is clearly dysfunctional and in need of urgent reform to demonstrate it is providing value to customers. This should include the removal of the protections for the providers of Hydro Spin as these requirements should be exposed to a full transparent market. It is clear that the traditional providers of Fast Reserve, the large hydro generators, clearly do have market power as they were able to achieve prices at over three times the market rate in the July 2019 tender round. If there is a need to protect these providers from market prices then they should be price-regulated, and any additional support they require above the market price should be transparent.

Q8. What information could the DNO have privileged access to that that could offer it an unfair advantage in balancing services provision? How might this change in future if the DNO and ESO increasingly coordinate?

The NGESO markets operate on a GB basis and hence only a small fraction of providers will be in any DNO area. DNOs have no visibility of which customers are providing these services and hence they have no privileged access to any information that could provide any advantage. This will remain the case even if DNOs and the ESO increasingly coordinate their actions. It is appropriate for DNOs to have in place clear policies on the separation of duties to ensure that those determining the strategies for bidding into the ESO markets are not involved in the assessment of flexibility tenders to the DNO, outage planning in the control room and the provision of new connections.

Q9. What measures would you consider effective and proportionate to ensure that privileged information the DNO has access to is not used inappropriately to benefit the commercial performance of CLASS?

As answered above, DNOs do not have access to information that would benefit the commercial performance of CLASS but, regardless, DNOs should have clear policies on the separation of duties. There are clear regulatory and legal sanctions on companies to prohibit this sort of behaviour.

Q10. In what other ways do you think DNOs could take advantage of their DNO role in the context of providing balancing services with CLASS?

Having operated in the markets for two years we are not aware of any advantages our role as a DNO gives us in the context of providing balancing services other than providing low cost and efficient services which is displacing less efficient market participants to the benefit of consumers.

Q11. How far 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?

We believe current safeguards are clearly sufficient and to support this DNOs ought to produce policies to identify potential risks of non-compliance and how these can be mitigated. We take our obligations under competition law very seriously and keep our compliance under review.

Q12. What additional measures would be effective and proportionate to address actual or perceived risks of DNOs taking advantage of their DNO role?

As stated above, it would be beneficial for DNOs to provide to the regulator statements which demonstrate how they manage and mitigate any actual or perceived risks.

Q13. Are there other specific effects to competition that are relevant to our decision? What effects would these have on consumers?

Prohibiting CLASS from providing these services into the market is clearly detrimental to consumers interests and to Ofgem's desire to get the right outcome for consumers through fair competition.