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Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control – RWE Response.

Dear Edwin and Freya,

RWE welcomes the opportunity to respond to the Ofgem consultation on the “Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control” published on 10th February 2020 (the Consultation Document).

We are responding on behalf of RWE Supply & Trading GmbH, RWE Generation plc (RWE) and RWE Renewables GmbH. This is a non-confidential response.

RWE does not support the proposed treatment of CLASS as a balancing service in RIIO-ED2. DNOs should be prohibited from providing balancing services on an enduring basis as it is not compliant with legislation currently in force. In particular the following provisions should be taken into account:

- i. **Enduring provision of balancing services using network assets by DNOs is not permitted under the Electricity Act 1989 without a time limited derogation:** The provision of balancing services on an enduring basis by DNOs is in breach of the Electricity Act. The balancing services provided under the CLASS arrangements results in a despatch instruction to deliver energy to the network utilising electricity network assets¹. This is the same as or equivalent to dispatch of a generation or demand unit. DNOs cannot undertake such activities since DNOs are not permitted to hold a generation licence under the Electricity Act unless there is a specific time limited derogation from the requirement to hold a Generation Licence.

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¹ An electricity network asset is defined as a ‘relevant grid element’ in the System Operator Guidelines (SOGL) which “means any component of a transmission system, including interconnectors, or of a distribution system, including a closed distribution system, such as a single line, a single circuit, a single transformer, a single phase-shifting transformer, or a voltage compensation installation, which participates in the outage coordination and the availability status of which influences cross-border operational security”.

- ii. **Commission Regulation 2017/2195 establishing a guideline on electricity balancing (EBGL) and Commission Regulation 2017/1485 establishing a guideline on electricity transmission system operation (SOGL) do not permit the provision of balancing services from DNOs:** DNOs are not “balancing service providers” under the EBGL and therefore have no role in the provision of balancing services from reserve providing units² ³. In this context DNOs are not “market participants” as envisaged under EBGL and SOGL (where the role of DNO is set in the context of the Electricity Directives⁴).
- iii. **Provision of a balancing service by a network company is in contravention of the EBGL:** Provision of balancing services by network companies on an enduring basis would not better meet the EBGL objectives, particularly in relation to Objective (e) “*ensuring that the procurement of balancing services is fair, objective, transparent and market-based, avoids undue barriers to entry for new entrants, fosters the liquidity of balancing markets while preventing undue distortions within the internal market in electricity*”. We are particularly concerned that the DNOs may discriminate in favour of utilising network assets for the provision of balancing services at the expense of competing balancing services providers and that provision of balancing services using network assets will distort the balancing services market.
- iv. **The network assets that are utilised under CLASS do not and cannot comprise demand facilities under EBGL and the SOGL or BMUs under the BSC.** The provision of balancing services using network assets is not envisaged under the EBGL or SOGL and Balancing and Settlement Code (BSC). The EBGL SOGL and the BSC do not permit network assets to provide balancing services. The SOGL defines a ‘reserve providing unit’ as “a single or an aggregation of power generating modules and/or demand units connected to a common connection point fulfilling the requirements to provide FCR, FRR or RR”. Network assets are neither power generating modules nor demand units;
- v. **DNOs providing balancing services compromise the integrity of the BSC settlement arrangements:** The utilisation of CLASS at scale will have an impact on the imbalance of all BSC parties affected by the dispatch of the balancing service. This compromises the settlement arrangements distorting party imbalances and corresponding residual cash flows which affect all BSC parties.

² The EBGL defines balancing service providers as “a market participant with reserve-providing units or reserve-providing groups able to provide balancing services to TSOs”.

³ The SOGL defines ‘reserve providing unit’ means “a single or an aggregation of power generating modules and/or demand units connected to a common connection point fulfilling the requirements to provide FCR, FRR or RR; and ‘reserve providing group’ means an aggregation of power generating modules, demand units and/or reserve providing units connected to more than one connection point fulfilling the requirements to provide FCR, FRR or RR”.

⁴ iii. Directive 2009/72/EC concerning common rules for the internal market in electricity, recast as Directive 2019/943 on the internal market for electricity which defines “distribution” by reference to Directive 2019/944 on common rules for the internal market for electricity as “the transport of electricity on high-voltage, medium-voltage and low-voltage distribution systems with a view to its delivery to customers, but does not include supply” and a ‘distribution system operator’ means “a natural or legal person responsible for operating, ensuring the maintenance of and, if necessary, developing the distribution system in a given area and, where applicable, its interconnections with other systems and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of electricity”.

- vi. **Provision of balancing services may breach Condition 4 of the electricity distribution licence:** Enduring provision of balancing services by DNOs will distort completion in the supply and generation of electricity, particularly in relation to the impact on balancing in the wider electricity market.

In our view DNOs should focus CLASS on enhanced network operation rather than balancing services provision to the ESO. We recognise that ENWL has undertaken important work to demonstrate the technology required to provide the enhanced management of voltage using distribution network assets. This technology can enable remote management of transformers and circuit breakers and enable DNOs to reduce or increase electricity demand and absorb reactive power. DNOs can therefore utilise the technology to provide enhanced system operation and better meet Grid Code obligations, particularly with respect to using voltage control as part of Demand Control arrangements.

We consider that it would be premature to enable DNOs to provide CLASS as a balancing service without understanding of the role of a Distribution System Operator in managing low voltage electricity networks. Deployment of CLASS may be one measure that could be adopted by a DSO in the management of network issues on their network. Deployment of CLASS as a balancing service may complicate the role of a DSO in managing the relevant network.

Further work is required to understand better the pathways to delivering the DSO role in the current price control. Balancing services provision will compromise the independence of a DSO in performing local (i.e. low voltage) system operation and network management. We consider that there could be a case for investment to invest in CLASS for system management purposes (not energy balancing) for DNOs undertaking a DSO role as part of the RIIO-2 price control.

DNOs should be prohibited from providing balancing services to the ESO using CLASS.

Our response to the questions in the Consultation Document is included in Annex 1.

If you have any comments, or wish to discuss the issues raised in this letter, then please do not hesitate to contact me.

Yours faithfully

By email

Bill Reed, Market Development Manager

Annex 1: Response to the Questions in the Consultation Document⁵

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

We note that Ofgem have considered the options from the perspective of remuneration under the price control. This approach does not capture the wider implications associated with the utilisation of network assets for the provision of balancing services by DNOs. There are a number of aspects that require consideration (in addition to the legislative framework outlined above) and these include:

- i. the role of the DNO with respect to DSO activities and active network management and system operation;
- ii. the way in which the DNO and/or DSO facilitates market participants in the provision of balancing services;
- iii. the impact of the DNO in the settlement arrangements under the BSC if it were permitted to perform balancing services using network assets; and
- iv. the potential for undue discrimination in the provision of balancing services were DNOs to be permitted to perform this activity.

These aspects influence the design of the service, the interaction between the DNO and other service providers, the role of the DNO in the BSC and any requirements for licence provisions to enable and ring fence provision in relation to network management. Ofgem should undertake a much deeper review of the role of DNOs prior to consideration of funding under the price control.

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

We support market based mechanisms for the procurement of balancing services by the ESO and by the DNO/DSO. However, DNOs should not be permitted to provide balancing services using CLASS as this compromises the independence of the DNO in the procurement process and creates issues of undue discrimination. Network assets should not and cannot be used for the provision of balancing service to the ESO.

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)?

Ofgem has identified potential customer savings arising from the trial of the CLASS service by ENWL. However, Ofgem have failed to consider the wider economic impact of the provision of balancing services by the DNO. These detrimental effects include:

- Impact on efficient system operation if DNOs are providing balancing services;
- Impact on wider competition since the provision of balancing services using network assets will distort the competitive market;

⁵ See page 23 of the Consultation Document

- Impact on the wider settlement arrangements through the creation of imbalances for market participants which affects the integrity of the settlement arrangements and creates risks that cannot be hedged; and
- Specific impacts on particular market participants that may be affected by dispatch instructions, particularly where that increases costs for consumers as a result of the imbalances that are created.

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

Ofgem have focused on the specific aspects of the price control with regard to the decision as to whether CLASS should be a directly remunerated service. We do not believe that CLASS should be a directly remunerated service at all and that there should be no provision for funding CLASS as a balancing service under the price control.

If DNOs were permitted to provide CLASS as an unregulated activity then DNO shareholders should underwrite the costs and risks of the service provision. The service itself should be ring fenced from all other DNO activities and be subject to the same requirements as all other balancing service provisions. Such arrangements would create a level playing field whereby the CLASS service would compete on the same basis as all other providers of balancing activities.

DNOs could seek competitive tenders for the utilisation of network assets by balancing service providers. This would allow third parties to undertake the balance responsible activities.

Network assets subject to CLASS must be aggregated to form a BMU with appropriate levels of metering and associated imbalance adjustments. This is analogous to “secondary BMUs” operated by Virtual Lead Parties under the BSC. Competitive tenders could enable some value to be recovered for customers related to the provision of balancing services using network assets.

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

Allowing CLASS in the price control would not promote efficient investment signals and would distort competitive outcomes. Allowing DNO to invest in balancing services as part of the price control is not permitted under the Distribution licence. We do not see how such assets could form part of a regulatory asset base.

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

We do not have any evidence that CLASS would affect the likelihood of system reliability issues.

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?

We do not have any evidence that competition is currently being distorted or impeded by the participation of CLASS under the current temporary trial arrangements. Since this is a trial of the technology and a proof of concept approach, the potential impact is limited.

We do not agree with the assessment that it is unlikely that DNOs have or would have market power in the future with respect to the provision of balancing services.

There are a number of specific concerns in relation to distortion of the competitive market:

- DNOs are operating network assets to provide the service and there is limited transparency of the nature of these assets. In essence network asset utilisation is a “black box” as far as market participation is concerned since there is no market information that corresponds with the information that other balancing service providers have to submit. This includes for example, Maximum Export Limits, Stable Export Limits and availability of units as required under the REMIT or Transparency Regulation;
- If permitted to undertake the activity as part of the price control arrangements, DNOs are not operating on a level playing field in relation to investment decisions by balancing service providers. In essence the balancing service provision is underwritten by customers if the activity forms part of the regulatory asset base; and
- The provision of balancing services using network assets creates the potential for third party imbalance with consequential competitive distortions.

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 CLASS service involves the dispatch of network assets and the DNO has privileged access to information on such assets. There is currently no information on the nature of the assets that comprise the CLASS service, there is no metered data on the assets and there is no transparency on the impact of dispatch decisions on wider network users (e.g. on metered consumption data). The CLASS assets do not form BMUs as required under the BSC and do not comprise demand or generation units as envisaged under the EBGL. The CLASS assets are not currently required to be reported under REMIT nor are they envisaged under the Transparency Regulation. Consequently the DNO has privileged information.

If DNOs were to provide balancing services then they should undertake such activities on the same basis as all other market participants including

- a requirement to meter accurately;
- to establish BMUs,

- to provide information under the Grid Code, REMIT and the Transparency Regulation; and
- to comply with the terms and conditions for balancing set out in the EBGL and SOGL, as transposed in the BSC, CUSC and Grid Code.

It is also important that the relevant dispatch units under CLASS are be subject to all relevant costs to ensure a level playing field This could requires that CLASS dispatch units are subject to transmission and distribution network charges on the same basis as other generating units or demand units.

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 noted above if DNOs were to provide balancing services then they should undertake such activities on the same basis as all other market participants including

- a requirement to meter accurately;
- to establish BMUs,
- to provide information under the Grid Code, REMIT and the Transparency Regulation; and
- to comply with the terms and conditions for balancing set out in the EBGL and SOGL, as transposed in the BSC, CUSC and Grid Code.
- The relevant units could be subject to Transmission and Distribution network charges on the same basis as other generating units or demand units.

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?

We are concerned that DNOs may discriminate in favour of network assets in the provision and facilitation of balancing services. There is limited information on the nature of the assets providing the service and we are concerned that the operation of the CLASS assets may restrict other users from providing balancing services. If the DNO were to use the CLASS assets to provide balancing services then the ability to use these assets to manage local constraints efficiently may be restricted if “headroom” is lost. This could impact on the costs of network operation.

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 do not believe that 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 licence obligations are framed in relation to the efficient operation of the network and do not envisaged provision of balancing services. Therefore it is not clear how the licence conditions apply when providing balancing services. For example it is not clear under the licence whether the dispatch of a network asset to provide a balancing service relates to the supply or generation of electricity as envisaged under the Electricity Act.

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

DNOs should be prohibited from the provision of balancing services using network assets. There are no mitigating measures that could be introduced to address the risks of DNOs taking advantage of their DNO role.

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

We are concerned about the impact of the provision of balancing services by DNOs on market participant imbalance. The dispatch of the network assets would have a distortive effect on supplier imbalances and increase costs for customers. It creates risks for suppliers that cannot be effectively managed. In effect the DNO is using the electricity supplied by suppliers to customers to provide the service without any compensation and permission from the suppliers.