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## **Regulatory Treatment of CLASS as a balancing service in RIIO-ED2 network price control**

### **Ofgem consultation**

#### **Background to ENGIE**

In the UK, ENGIE employs 17,000 people in a number of activities across the energy value chain, as well as through its extensive services and regeneration businesses.

In generation, ENGIE owns First Hydro in a 75/25 joint venture with Brookfield Renewable Partners. With a total capacity of 2088MW, it is the UK's largest pumped storage operator.

ENGIE also has a 50% stake in over 80MW of renewable generation and a 23% stake in the Moray East offshore wind project which secured a CfD FiT for 950MW in the 2017 CfD auction. In supply, ENGIE operates an Industrial and Commercial (I&C) and Small and Medium Enterprise (SME) B2B electricity and gas supply business.

It owns the country's largest district heating business, providing district energy solutions to the public, commercial, industrial and residential sectors. A key site is the Olympic Park District Heating facility in London. Following the acquisitions of Balfour Beatty Workplace, Lend Lease FM and the Keepmoat regeneration business, it is also one of the top five service companies in the UK.

#### **Response to consultation questions**

We have not provided answers to all of the questions.

ENGIE, Sembcorp, Drax and Centrica have funded a study by NERA into this area. NERA's study will be submitted by Energy UK.

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

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

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

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

Currently, CLASS is a distortion which sits outside of the price control; moving it into the price control would simply expand the distortion.

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

The ESO and the DNOs are best placed to answer this question. Intuitively, it seems that the impact on system reliability would depend on the proportion of the reserve and response market that CLASS provides.

The consultation document categorically states that “CLASS does not and shall not undermine the ability of the DNOs to deliver their Grid Code obligations”<sup>1</sup>. As CLASS is currently being employed it seems clear that the analysis has been undertaken already, a decision made and measures are in place to ensure that there are no negative impacts (and, indeed, that no negative impacts develop in the future).

***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 would encourage Ofgem to take a wider view. The investments being made to deliver CLASS are not standalone investments but, rather, incremental investments predicated on a set of regulated assets. One investor (the DNO) can rely on regulated returns (i.e. access a lower cost of capital) and one investor (the consumer) has no role in the investment decision. It seems like the consumer is getting a poor deal with this investment: it pays for a set of assets and only gets a partial share in the upside from using those assets in a different way (notwithstanding the additional capex). Further, the service itself was developed using subsidies<sup>2</sup> paid for by the consumers. More thought should be given to the sharing factors involved in the investment.

In general, the DNOs face a very different set of investment conditions to that confronted by the rest of the market. The DNOs have been provided with the opportunity to make privileged investments. It is difficult to characterise this as a competitive market and it goes against the spirit of unbundling (e.g. that DNOs should not operate storage).

Finally, it is noticeable that the consultation makes no comment on the impact of DNOs spending time/resources on developing new business rather than delivering their obligations.

***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?***

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<sup>1</sup> Page 9

[https://www.ofgem.gov.uk/system/files/docs/2020/02/regulatory\\_treatment\\_of\\_class\\_as\\_a\\_balancing\\_service\\_in\\_riio-ed2\\_network\\_price\\_control\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/02/regulatory_treatment_of_class_as_a_balancing_service_in_riio-ed2_network_price_control_1.pdf)

<sup>2</sup> The Low Carbon Network Fund subsidised the project. Consumers paid £7.2m of the £9m development cost. See *CLASS: Presentation to Energy UK* ENWL July 2018

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The developing co-ordination of the ESO and DNO/DSO needs to be monitored to ensure that there are no negative impacts.

***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?***

***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?***

***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?***

***Q12. What additional measures would be effective and proportionate to address actual or perceived 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?***

The impact on suppliers has never been addressed; this is surprising. CLASS can impact a supplier's imbalance and yet there is no mechanism by which the DNOs compensate the relevant suppliers. This important aspect has been missed off in assessing whether or not CLASS results in lower costs to consumers. Further, it could impact the ability to deliver demand response (when that response is located behind a CLASS asset).

There have been extensive efforts made to develop the demand response market. Allowing CLASS may be to the detriment of the DSR market and this aspect should be given some consideration.

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