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Dear Adhir

Promoting Smarter Energy Markets Consultation 174/11

1. The roll out of smart metering is a transformational opportunity for the energy market in the UK. To leverage the full benefits of Smart Metering requires changes to industry processes that are additional to those necessary to facilitate the roll-out of smart metering. Present industry processes and some central systems are out-dated and badly need reform. We are therefore very pleased that Ofgem has responded to our calls for a planned facilitation of change.
2. With today's technologies and smart metering it can't be right that, for a customer to change supplier, 48 data flows across must be exchanged across 8 different parties. This is inefficient and results, not only in a convoluted and overly complex switching process, but also requires significant intervention by energy suppliers to ensure the process succeeds. So we agree that there is real merit in centralising certain key industry processes because this will reduce the number of hand-offs and points of potential failure that are in place today.
3. Ofgem are quite right to explore how the customer switching process can be shortened, (as well as made more efficient). This needs to be considered carefully within the context of other consumer protections, such as the cooling off period, and the wider operation of the wholesale market to ensure that speeding up the transfer process does not introduce excessive volatility into the trading market.
4. We also support a move to harmonised and simpler industry code governance arrangements. The delivery of the first dual fuel retail focused industry code, the Smart Energy Code, is a tremendous opportunity to put the customer at the heart of the industry processes that support their engagement with the energy market – in terms of both the process of decision making, and the basis on which decisions are made. For example, currently the shippers who provide services to 98% of customers only have 20% of the influence on the Network Code Panel, this cannot be right. The Smart Energy Code Panel must be constituted on the basis that those closest to customers, domestic retailers and consumer groups have the appropriate level of influence.

5. It is important to ensure that suppliers have confidence that energy is being allocated to them fairly and accurately. Presently this is not always the case and so settlement arrangements do need reform. There is of course a trade off between the added cost of more refined settlement processes versus the increased accuracy, fairness and confidence that arises.
6. The interventions needed differ greatly between gas and electricity settlement. Gas settlement arrangements are based on an outdated annual estimate, are unfair, and inequitable. Therefore the case for a move to a new meter point reconciliation regime is obvious and widely supported. Electricity settlement arrangements are much more sophisticated by comparison. The incremental benefits of reform to electricity settlement seem smaller and the costs much higher and more uncertain. For example the level of Time of Use take-up will influence the extent to which data collection and processing costs for settlement are incremental to today's costs. So it is far too early to arrive at a conclusion as to the best enduring mandatory electricity settlement regime. However there is merit in more urgent work to remove the barriers to suppliers settling sites on an elective Half Hourly basis.
7. We agree with Ofgem that demand side management (DSM) can deliver real benefits to consumers in terms of lower bills. However the success of DSM will to a large degree be determined by the way in which consumers are engaged. If DSM is in any way "imposed" on consumers, (e.g. following a "network push" rather than "customer pull" approach) we could face real customer or indeed public disenfranchisement. Time of Use (ToU) tariffs are an essential tool in the delivery of customer led DSM. However, we believe that changing customer behaviour to vary consumption by time of use will be challenging, even when there are large price differentials between peak and off-peak usage. So we need a regulatory framework that provides access to ToU to as many customers as possible.
8. We have real concerns that the RMR could have a significant detrimental impact on customer take-up of ToU, and that Ofgem should not prohibit suppliers offering ToU tariffs to customers who prefer flexible tariffs over fixed term contracts. Banning flexible ToU tariffs will delay the point at which ToU can be shown to enable reliable demand side response. Therefore to avoid costs of peaking plant the market must have confidence that demand side response can be delivered before not after the peaking plant has been built. So Ofgem must provide confidence that the Regulatory Framework will be able support the future challenges of Demand Side Management.
9. British Gas is hugely supportive of the general direction of the Smart Markets Strategy and the overwhelming majority of the propositions set out in it. We are keen to see a road map that sets out when various reforms can take place and for further exploration around Time of Use and Electricity Settlement where we believe further policy refinement is required

Our response to the consultation questions is attached as an appendix to this letter and should you require any further information please do not hesitate to contact me.

Yours sincerely

Steve Briggs
Head of Industry Codes and Metering

Appendix One

Chapter 3 Enabling Retail Market Development

Question 1: Do you agree with the propositions set out in this chapter?

- 1.1 We agree with the intent behind the propositions in this chapter but recommend a set of revisions to enable customers to fully realise the benefits offered by them. These proposed revisions seek to increase the number of customers who will be able to take up Time of Use Tariffs; enable improved accuracy of energy settlement without imposing onerous cost constraints on suppliers and improving the regulatory framework for ESCO's.
- 1.2 Time of Use Tariffs (ToU) will, we agree, help certain customers to lower their energy costs. We are concerned however that there will be restrictions on our ability to offer ToU tariffs to all the customers who could benefit from them. The primary constraint is that with the implementation of the Retail Market Review proposals, suppliers will only be able to offer ToU tariffs to customers willing to take a fixed term contract (FTC). We are concerned that this creates a constraint that will make ToU tariffs unattractive to customers. Our concerns are that many customers do not want a FTC and that we will lose the ability to market innovative propositions including a ToU tariff that will increase engagement in the flexible tariff segment.
- 1.3 We agree that more efficient use of demand response can lower overall costs and that a co-ordinated package of commercial and regulatory reform is required to enable this. The cost savings associated with demand response are likely to be higher in the I&C sector than the domestic sector in the short to medium term.
- 1.4 We agree that innovation in energy services will increase the consumer benefits of smart metering and that this can happen without major changes to the regulatory framework. The changes we believe are required can be delivered via the introduction of a proportionate data access regime via the Smart Energy Code.
- 1.5 We agree that the introduction of smart metering provides customers with more payment options without the need for additional changes to the regulatory arrangements beyond those envisaged as part of the smart metering roll out.

Question 2: For each proposition, have we identified the elements of current market arrangements that could help or constrain the realisation of benefits for consumers?

Proposition One: Time of Use Tariffs should help many customers lower their energy costs, but improved engagement will be needed to help all customers make informed choices

- 2.1 Our analysis indicates that only 28% of customers on a standard tariff would be willing to take up a FTC. 37% of customers also indicated that being forced to move to a FTC would reflect poorly on suppliers, and could actually reduce receptiveness to innovation. Therefore the RMR requirement to only offer ToU on a FTC basis creates an immediate limitation on the number of customers who will sign up to a Time of Use tariff.

- 2.2 For domestic customers, ToU tariffs are new and understandably in our view, there may be reluctance from customers to commit to an annual contract for such tariffs. This restriction will have the effect of immediately reducing the population of customers able to take advantage of a ToU tariff.
- 2.3 Customers should be able to test out new tariffs on an evergreen basis. This will provide customers with the flexibility to choose a ToU tariff without being tied in to an annual contract.
- 2.4 Our interpretation of the RMR proposals is that suppliers will only be able to offer one ToU tariff per year. Suppliers may wish to offer a number of ToU tariffs, to support initiatives such as the Low Carbon Network Fund as well as for products to support electric vehicles. We will therefore wish to be able offer at least two ToU tariffs to customers. Therefore the proposal to only allow suppliers one ToU per year will prevent us from doing this.
- 2.5 A final impediment to the development of ToU tariffs, is the smart metering data access regime. In order to demonstrate the benefits of behavioural shifts to customers (for example moving demand to off peak periods), suppliers need access to half hourly data on an individual premise basis.
- 2.6 Without access to half hourly data suppliers will only be able to provide generalised advice. This unnecessary constraint will stifle supplier's abilities to actively engage with customers in a meaningful way.
- 2.7 A proportionate data access regime will enable suppliers to enter into more proactive and effective dialogue with customers. The provision of accurate targeted energy efficiency advice derived from half hourly data will help customers to make more informed choices. This will in turn assist with engendering further confidence in the energy market as the customers will have evidence that behavioural changes have an effect on their energy bills.

Proposition Two: More efficient use of demand side response can lower overall costs, but this will need co ordinated changes to regulatory and commercial arrangements

- 2.8 We agree with the constraints referred to in the consultation and have a number of additional constraints to highlight.
- 2.9 Reform is required to enable customers to be able to participate in multiple demand side response programmes. Currently I&C customers who participate in the TRIAD regime are prevented from participating in the National Grid STOR programme. This restriction is an unnecessary barrier to engagement. Flexibility should be provided in order to enable customers to be given access to all applicable benefits.
- 2.10 There is a risk that the commercial and regulatory framework is skewed to favour Distribution Network Operators led action rather than customer led action facilitated by suppliers. This could lead to Distribution Network Operators receiving preferential access to balancing services payments. This would be inequitable. The framework must

be reviewed holistically to ensure that all parties with value to exchange are enabled to do so, e.g. customers, suppliers, aggregators, and Distribution Network Operators.

- 2.11 There is a need for market reform to fully balance out the costs and benefits of demand side response across the value chain, with the objective of providing enough incentive for customer participation. The benefits of avoided peaking plant construction, avoided grid reinforcement, avoided renewable generation shutdown (in times of high wind) and increased energy security, all while helping the government meet its low carbon targets, need to be able to be aggregated in order to provide sufficient incentive to the customer to engage.

Proposition Three: Innovation in energy services would increase the consumer benefits of smart metering without major changes to the regulatory framework

- 2.12 For the energy services proposition we agree with description of the current constraints that limit domestic customer access to energy services. We are aware of an additional current constraint that affects I&C customers who use energy brokers to manage their supply contracts.
- 2.13 For those customers who use energy brokers to manage their supply contracts, there is anecdotal evidence that they are not aware of the current opportunities to benefit from energy management services. This indicates that certain larger customer groups who would be able to extract potentially significant value for certain demand response products may be being excluded from them currently.

Proposition Four: Consumers will have more payment options, without changes to regulatory arrangement beyond those envisaged as part of the smart metering roll out

- 2.14 For the pre payment proposition, we agree with the current market arrangement constraints referred to in the consultation. Once we approach the conclusion of the mass rollout there will still be a population of customers with legacy pre payment meters. Consideration will be required by Ofgem and suppliers as to how best to retire the legacy PPMIP infrastructure. It is not clear whether there is any requirement for central coordination activity or whether suppliers will retire their PPMIP contracts on an individual basis. We think the latter is the optimal approach.

Question 3: For each proposition have we identified the key issues, such as the timescales for any changes to market arrangements?

- 3.1 The key issues for each proposition have been well described in the consultation.
- 3.2 For the demand response proposition an additional issue to address is the current limited effect of domestic customers taking action e.g. the value of Direct Control. In one Distribution Network Operator region, the annual average value of interrupting load at peak is estimated at £0.20/year for cold appliances, £2/ year for individual wet appliances (dishwasher / washing machine) and £4/year for dryer. Hot water heating offers £15/ year and heat pumps £15/year. ¹

¹ Frontier Economics Report on CLNR tariffs, the prices quoted were prepared by one Distribution Network Operator for the 2012-2013 period for one specific region.

Are there any additional opportunities for development in retail energy markets that we should include in the scope of our work?

- 3.3 We would recommend including the concept of the “Negawatt Market” in the scope of work for retail energy market development. The “Negawatt Market” would consist of parties effectively auctioning off the capability **not to consume energy**. The successful bidder would receive a payment for those customers not consuming in the peak period. This also could reduce the incentive for energy suppliers to innovate and promote customer-centric propositions.
- 3.4 Further analysis should also be undertaken to assess how to incentivise energy consumption during peak periods of wind generation. It is likely that there will be competing requirements between Distribution Network Operators and suppliers. Distribution Network Operators will be seeking to reduce demand at peak periods of wind capacity whereas suppliers will be seeking to encourage customers to consume. These competing requirements need to be managed via a combination of regulatory and market mechanisms.

Question 4: Do you agree with the propositions set out in this chapter?

Proposition Five: Settlement Arrangements should use actual daily (gas) and half hourly (electricity) meter reading data in order to improve their accuracy and efficiency.

- 4.1 It is important for suppliers to have confidence that energy is being allocated to them fairly and accurately. This is not always the case today and so settlement arrangements do need to be reformed. Recognition is required however, of the trade off between the additional cost of more refined settlement processes versus the increased accuracy, fairness and confidence that arises from such reform.
- 4.2 The interventions needed to deliver such reform differ greatly between gas and electricity settlement. Gas settlement arrangements are based on an outdated annual estimate, are unfair, and inequitable. Crucially any small supplier that delivers a reduction in demand that is greater than market average is penalised. This creates a massive inequity and perverse incentive such that those who do most to help customers reduce their energy consumption are penalised. Inequitable allocation of costs amongst large and small supply points has been the subject of multiple industry code modifications and significant concerns remain despite the creation of the Allocation of Unaccounted for Gas Expert (AUGE). Therefore the case for a move to a new meter point reconciliation regime is obvious and widely supported. There is an obvious link to the rollout of smart meters, and low confidence in the AUGE creates a need for more urgent reform.
- 4.3 Electricity settlement arrangements are much more sophisticated by comparison to the gas settlement arrangements. For example because meter point reconciliation is in place the problems described above do not manifest. The incremental benefits of reform appear far smaller and the costs much higher and more uncertain.
- a) Key costs relate to the collection and processing of data, and a move from settling on 1 read per 14 months to 1 read per 30 minutes, (a 20,000 fold increase). Of course this data may be collected and processed anyway for those customers that are billed on a Half Hourly basis such as those on a Time of Use tariff. However,

the level of Time of Use Take-up is not known and could represent the minority of customers.

- b) The costs of half hourly data collection will not be known until the DCC procurement exercise has been completed.
- c) The costs of data processing and aggregation will not be known until industry processes have been reformed and any structural change completed.

4.4 It is far too early to arrive at a conclusion that half hourly settlement is the best enduring electricity settlement regime.

4.5 We are concerned that some have called for default half hourly settlement to be imposed on all customers with smart meters. This would create a cost and a regulatory burden upon those suppliers that rolled out smart meters first and would manifest as a perverse incentive. However there is merit in more urgent work to remove the barriers to suppliers settling sites on an elective Half Hourly basis.

Proposition Six: The change of supplier process should be reliable and fast, so that customers can confidently switch supplier on a next day basis

4.6 We agree that the change of supplier process should be fast and reliable. The opportunities to streamline rationalise and improve the change of supplier process created by the migration of registration services to the Data Communications Company should be leveraged by Ofgem and the industry.

Proposition Seven: Electricity data processing and data aggregation services should be procured centrally in order to reduce costs and support fast customer switching

4.7 We agree that electricity data processing and aggregation services should be procured centrally. We also believe that gas data processing and aggregation services should be procured centrally to support the simplification of industry data processing activities.

Proposition Eight: The Smart Energy Code should be used as a vehicle to consolidate existing industry codes dealing with retail issues in gas and electricity to facilitate market development and reduce administrative burdens

4.8 We agree that the Smart Energy Code should be used as a vehicle to consolidate existing industry codes dealing with retail issues in gas and electricity to facilitate market development and reduce administrative burdens. The introduction of the Smart Energy Code combined with the centralisation of change of supplier processes, facilitates the harmonisation of retail energy processes into one industry code.

Question Six: For each proposition, have we identified the right sources of costs and benefits associated with achieving them?

Proposition Five: Settlement Arrangements should use actual daily (gas) and half hourly (electricity) meter reading data in order to improve their accuracy and efficiency.

6.1 The proposition for electricity settlement does not fully recognise the scale of the costs associated with implementing the mandatory use of half hourly reads in settlement compared with the marginal associated benefit.

- 6.2 Analysis carried out by Elexon indicates that for profile class 5-8 there is an error in allocation of approximately £17m. The eradication of such an error would not result in a cost saving, merely a re adjustment between those affected suppliers. We carried out additional analysis on the costing model provided by Elexon and this indicates the error is nearer £8.5 million due to the use of automated meter reading equipment in these profile classes.
- 6.3 The direct costs to suppliers, network operators and therefore consumers of moving to a mandatory HH settlement regime for profile class 5 – 8 customers will be significant. The estimates submitted to Elexon were in £m's rather than £000's range for changes that would impact a small subsection of customers.
- 6.4 We do, however, agree that utilising smart metering data within the Non Half Hourly (NHH) profiling regime should increase profiling accuracy. We are supportive of removing barriers to voluntary settlement of NHH customers in the half hourly market. We agree with the current set of cost barriers e.g. Network Charging Arrangements and metering agent charges referred to in the consultation.

Proposition Six: The change of supplier process should be reliable and fast, so that customers can confidently switch supplier on a next day basis.

- 6.5 We agree that fast customer switching could stimulate product innovation (bearing in mind the RMR constraints highlighted earlier in our response) and that a positive experience of the change of supplier process should increase customer confidence and engagement with the market.
- 6.5 However we are concerned that the risks associated with a next day switching market are potentially significant. Specifically there are risks associated with opening up a market for auction sites to carry out bulk supply contract switching on a quasi daily basis.
- 6.6 Collective purchasing arrangements where customers delegate their energy purchasing decisions using price as the only factor used to determine the product they obtain may have a series of unintended consequences. Customer engagement could decline dramatically leaving suppliers with little incentive to actively pursue interaction with customers on peak shifting products, low carbon technologies and energy efficiency. Given the crucial nature of customer engagement and education as a tool for suppliers to use to assist with the acceptance of Time of Use and other innovative products, this does create a new set of risks for suppliers to manage.
- 6.7 We agree that the introduction of the Data Communications Company into the retail energy market creates the opportunity to streamline and improve the change of supplier process. This will enable the use of smart meter reads in the change of supplier read process. The use of an actual smart meter read will enable faster account set up and close down processes.
- 6.8 The centralisation of registration and change of supplier processes within the DCC, will enable reform to the objections process and will improve the management of Erroneous Transfers.

6.9 The use of the DCC's registration and change of supplier services for legacy metering to support faster switching should form part of the Ofgem strategy review. The potential effects of two switching process, one for smart metered customers and one for legacy metered customers should be assessed to determine the optimal customer experience regardless of meter type.

Proposition seven electricity data processing and data aggregation services should be procured centrally in order to reduce costs and support fast customer switching

6.10 The centralisation of data collection and data aggregation services has long been supported by suppliers as a key element of simplifying the industry design. The benefits that can be realised from this centralisation outweigh the issues highlighted in the consultation.

6.11 We do not support the proposition that a party other than the DCC should be responsible for the central procurement of these services. The DCC will be in a unique position to design the procurement to ensure the optimum design of data services is delivered.

6.12 The DCC should have the responsibility for procuring these services and it would make sense for the procurement to be coincident with the procurement of registration and change of supplier services.

Proposition Eight: The Smart Energy Code should be used as a vehicle to consolidate existing industry codes dealing with retail issues in gas and electricity to facilitate market development and reduce administrative burdens

6.13 We fully support the proposal to use the Smart Energy Code as the vehicle to consolidate existing industry codes dealing with retail issues. This will enable a more customer focused set of energy retail arrangements. The Network Code and the Balancing and Settlement Code change processes do not adequately reflect the voice of the domestic supplier community. This results in suboptimal decision making that favours the status quo rather than implementing changes that benefit suppliers and therefore customers.

6.14 The composition of the Smart Energy Code Panel and the smart energy code change process must be modelled in a manner that ensures that those closest to customers, domestic energy suppliers and consumer groups are appropriately represented.

6.15 It would be inequitable if the current structure of the Network Code or BSC Panel were replicated across into the Smart Energy Code. A far better model is the Master Registration Agreement.

Question 7: For each proposition, have we identified the key issues, such as the timescales for any changes to market arrangements?

Proposition Five: Settlement Arrangements should use actual daily (gas) and half hourly (electricity) meter reading data in order to improve their accuracy and efficiency.

7.1 We believe that the consultation has captured the majority of the key issues associated with changing market arrangements.

- 7.2 However, the proposals for electricity settlement reform do require further investigation. Specifically the benefits case for moving to a mandatory half hourly settlement regime and how the access to half hourly data needed to deliver this would be achievable under a restrictive data access regime.
- 7.3 The consultation refers to, “The use of actual meter reading data for settlement purposes will necessarily require access to a certain amount of consumption data...We are discussing with DECC how data for settlement might be handled in a way that mitigates potential privacy concerns, such as through the use of aggregation. ” (Section 4.24)
- 7.4 The potential use of aggregated half hourly data does not recognise that the requirement for access to half hourly data on an individual customer basis is the mechanism by which suppliers can deliver ToU tariffs that will incentivise those customers to alter their behaviour.

Proposition seven: electricity data processing and data aggregation services should be procured centrally in order to reduce costs and support fast customer switching

- 7.5 Further assessment and discussion is required to assess how gas data processing and aggregation services could form part of the central procurement of such data services. This assessment needs to take into account Project Nexus, standardisation of IGT services and how to achieve the best design for the Data Communications Company.

Proposition Eight: The Smart Energy Code should be used as a vehicle to consolidate existing industry codes dealing with retail issues in gas and electricity to facilitate market development and reduce administrative burdens

- 7.6 The consolidation of the retail elements of industry codes should be timed to coincide with the DCC taking on responsibility for registration and change of supplier processes. This timing would ensure that the management of these key customer focused processes will be governed in one place rather than today’s multi code environment.
- 7.7 This consolidation will deliver efficiencies for suppliers, distribution network operators, transporters and industry agents. It will enable a reduction in the number of industry agreements which will reduce the overall cost of code administration. How legacy arrangements will continue to be managed and funded will need consideration as part of the strategy.

Question 8 Are there additional opportunities to reform market processes that we should include in the scope of our work?

- 8.1 Reform of iGT processes is an area where there would be benefit in the Ofgem Smarter Markets team providing an oversight and coordination role. We are aware of the positive work taking place within Project Nexus to commence an assessment of single service provision by xoserve however we would recommend that this topic is included within the Ofgem scope of work to help to ensure that momentum is maintained.