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07 March 2012

Dear Harpal,

Response to Promoting smarter energy markets 174/11

Thank you for the opportunity to respond to the above consultation. This is a very important area of development for the energy industry and it is timely that it examined.

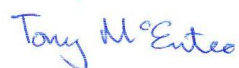
We believe that Ofgem's approach as outlined in the consultation paper is inadequate. The single fundamental that will enable smart grids and smart energy markets is a smart demand side response from a smart customer. Without the customer being smart, there will be very little sustainable change to the overall operation of the energy supply chain, and a missed opportunity to contain its overall cost.

There is a need for the energy supply industry to help customers become smart. We believe that this actually means that customers' appliances, particular those in emerging areas such as electric vehicles and heat pumps, but also white or wet goods, need to be smart. Smart markets do not stop at the smart meter: they encompass smart customer behaviour too.

We believe that there is currently insufficient engagement with all the relevant players across the energy supply chain, particularly with manufacturers of domestic appliances and vehicles, and insufficient thought to market structures etc to enable the smart supply chain and the smart customer. One of the key initiatives that is in place to do something about these gaps is the Smart Grid Forum, and we will be raising this issue there as the Forum plans its second year of work. We would then expect work inside Ofgem, including the important issues that this consultation does raise, to be organized to support the direction developed in the Forum.

However, recognizing that there is still work to do, we have provided our view on the answers to the questions in your current consultation paper below.

Yours sincerely,



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Specific Questions

CHAPTER: Three

Proposition 1: Time-of-use tariffs should help many consumers lower their energy costs, but improved engagement will be needed to help all consumers make informed choices.

Proposition 2: More efficient use of demand-side response can lower overall energy costs, but this will need coordinated changes to regulatory and commercial arrangements.

Proposition 3: Innovation in energy services would increase the consumer benefits of smart metering and can happen without major change to the regulatory framework.

Proposition 4: Consumers will have more payment options, without changes to regulatory arrangements beyond those envisaged as part of the smart metering roll-out.

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

Our response to these questions is focused on Propositions 1 and 2 which relate more directly to the activities of Distribution Network Operators (DNOs). Whilst we agree with both of these propositions as we state in our covering letter it is the development of smart appliances that will make these propositions a reality and we cannot merely rely on a change in customer behaviour which is likely to short-lived and diminish over time..

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?

Time of use tariffs

With regard to time of use tariffs, we would expect all network charges following the introduction of smart metering to include time of use components. The Common Distribution Charging Methodology (CDCM) already includes a simple three rate tariff (red, amber and green rates) which is common across all DNOs. However, anecdotal evidence suggests that even for large customers with demands exceeding 100kW that these price signals, nor any others, are not passed on to customers. The reason given is that many customers, even large users, do not want this level of complexity. This reinforces our earlier point and automated approaches will be required to take advantage of these tariffs and not customer behaviour.

Whilst, in order to ensure that certain time of use signals are passed on to users it may necessary to mandate that these are passed on to end customers, this is probably not appropriate in a competitive market driven by customer needs. Alternatively, as long as suppliers receive appropriate price messages, tariffs will be introduced which will benefit customers who can and do modify their usage to utilise lower cost timebands. However, this should eventually result in higher charges to those who do not choose time of use charges. We would not necessarily expect the timebands for customer tariffs, which will reflect a number of cost message, to align fully with network charges.

Demand response

With regard to demand response, we have undertaken a number of initiatives, primarily through bi-lateral arrangements with larger customers in order to gain a better understanding of their requirements. We agree with the proposition that the move away from profiling for

smaller customers will make demand response more viable. We believe that DNO use of demand response is likely to be focussed on dealing with supply outages and avoiding the need to build as much redundancy in the electricity distribution network. Our Low Carbon Network Fund project, Capacity to Customers, is seeking to demonstrate the significant benefits of this approach in delivering networks which can cater for the predicted significant increase in network demand as we move to a low carbon economy. We have also contracted with an energy aggregator, Enernoc, to provide demand response in two areas of our region to avoid network reinforcement to cater for fault situations.

We would dispute the comments made in paragraph 3.27 in respect of network charges. The arrangements are not particularly complex at present even for large customers and are likely to be simplified in the future if users can be charged on actual rather than profiled usage and avoiding different tariffs for different usage profiles.

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

For the time of use tariffs we believe you have identified the key issues, in particular as stated above the cost of non time of use can be expected to increase over time which may have an impact on vulnerable customers.

For demand response you have identified one of our key concerns in how the various users of demand response can be co-ordinated and whether market arrangements are needed to deliver this co-ordination. We, along with National Grid, recently commissioned Poyry to undertake work in this area and this report has been previously sent to Ofgem.

Question 4: Are there additional opportunities for development in retail energy markets that we should include in the scope of our work?

We have not identified any.

CHAPTER: Four

Proposition 5: Settlement arrangements should use actual daily (gas) and half-hourly (electricity) meter reading data in order to improve their accuracy and efficiency.

Proposition 6: The change of supplier process should be reliable and fast, so that customers can confidently switch supplier on a next day basis.

Proposition 7: Electricity data processing and aggregation services should be procured centrally in order to reduce costs and support fast customer switching.

Proposition 8: 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.

Question 5: Do you agree with the propositions set out in this chapter?

Our responses to this chapter are focussed on Propositions 5 and 7 which we strongly support.

Question 6: For each proposition, have we identified the right sources of costs and benefits associated with achieving them?

We believe it would be a wasted opportunity if the half-hourly data available from smart meters is not used in energy settlement and use of system billing. Recent investigations by ourselves and other DNOs have reduced our confidence in the accuracy of current profiled and estimated data from the settlement process and this needs to be rectified. We would expect the current approach using profiling to cease once smart metering rollout is complete, with much simpler approaches to deal with customers who refuse a smart meter. If this does not happen the industry will be faced with duplicated costs and not deliver the expected benefits of smart metering.

Your consultation does reflect, the costs and benefits of using actual half-hourly meter readings with the exception of the comment on network costs. The increase in costs of moving from non-half-hourly to half-hourly network charging is primarily driven through different cost allocation approaches being used in the CDCM. The DNOs were required in the development of the CDCM to use these two different approaches, however, a change to the CDCM is likely to be proposed in the near future with a implementation date of April 2013 which will remove any impact of DUoS charging. With the availability of actual half-hour data we would expect charging arrangements to be similar to present with all but the largest customers (above around 70kVA) charged on an aggregated super customer basis but using actual not profiled data. The use of real data and time of use charging would also allow the number of low voltage network tariffs to be reduced.

With regard to the central procurement of data processing and aggregation we believe you have captured the right sources of costs and benefits.

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

We believe that for both proposition 5 and 7 the key issues have been identified.

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

We have not identified any.