



Making a positive difference  
for energy consumers

Suppliers, network companies,  
industry code panels and  
administrators, other interested  
parties

Telephone: 020 7901 7000  
Email: [smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk)

6 February 2014

Dear Colleagues,

### **Industry role in creating market conditions necessary to support realisation of the benefits of smart metering**

This letter sets out Ofgem's expectations on industry to help create the market conditions necessary to support the realisation of the benefits of smart metering.<sup>1</sup> The importance of industry's role has been highlighted by Balancing and Settlement Code (BSC) Modification Proposal 272 ('P272') and related changes to the Distribution Connection and Use of System Agreement (DCUSA) that seek to develop new half-hourly (HH) Distribution Use-of-System (DUoS) tariffs for Profile Classes 5 to 8.

Ofgem is committed to maximising the benefits for consumers from the roll-out of smart metering. However, we are concerned by the lack of co-ordination between industry parties - suppliers and electricity distribution network operators (DNOs) alike - which is hindering the timely consideration of code modifications, the consideration of cross-code issues and delaying the realisation of these benefits for consumers. We consider that industry has a responsibility to develop code change in a co-ordinated way as far as is possible.

We have signalled in a letter to the BSC Panel today that we expect industry to take steps in order that our decision on P272 can take account of changes to DUoS charging arrangements. However, in light of the lack of co-ordination between industry parties, we are also considering in parallel whether new licence conditions or other measures, including a Significant Code Review (SCR)<sup>2</sup>, are necessary to ensure licence holders facilitate the realisation of the long-term benefits of smart metering.

### **Roll-out of smart metering**

The roll-out of smart metering has the potential to create smarter energy markets that work better for consumers. Smart meters allow consumers to take control of their energy usage by providing easily accessible information on their consumption. This can help them to make informed choices about how they buy and use energy, driving competition in supply. Smart metering can also promote competition by creating new opportunities for innovation in business models, products and services, as well the potential for faster and easier switching between suppliers. Some of these new offers can help consumers to use

---

<sup>1</sup> For the purposes of this letter, when we refer to smart meters or smart metering this encompasses smart and advanced metering.

<sup>2</sup> The Significant Code Review (SCR) process is designed to facilitate complex and significant changes to a range of industry codes. It provides a role for Ofgem to undertake a review of a code-based issue and play a leading role in facilitating code changes through the review process. We are not at this stage proposing to consult on the launch of an SCR specifically on the changes P272 and the related DCUSA proposals seek to introduce. We may reconsider this position if we are not satisfied with the pace of progress.

gas and electricity more efficiently, bringing down the costs of producing and transporting energy. Moreover, the roll-out can enable streamlining of the systems and processes that underpin the competitive market, helping to reduce costs and barriers to entry.

### **Smarter Markets Programme**

Government, Ofgem and industry are agreed that smarter markets cannot be realised without changes to the arrangements that underpin how market participants interact with each other and consumers. With the regulatory and commercial framework for the roll-out largely in place, now is the right time to consider these market arrangements.

We have established the Smarter Markets Programme ('the Programme') to help drive changes to market arrangements. Following consultation with stakeholders, we identified four priority areas of reform.<sup>3</sup> In identifying priorities, we focused on areas where there was a need for Ofgem to take action. We are grateful to all stakeholders for their general commitment to the Programme to date.

Much of the detail of the market arrangements is set out in codes governed by industry. While Ofgem is often responsible for deciding whether modifications to industry codes are made; industry is responsible for raising, developing and assessing these modifications. Therefore, industry has a vital role to play in helping to create the right conditions for smarter markets.

We have tools available to direct industry to take action, where they have failed to do so or to act in the consumer's interest. However, we remain of the view that progressing the necessary modifications through industry's governance processes should be the norm.

### **Balancing and Settlement Code (BSC) Modification Proposal 272**

In April 2011, Smartest Energy raised P272. This modification relates to the electricity settlement process set out in the BSC. At present, most consumers are assigned to a Profile Class and settled on a non-half-hourly (NHH) basis, using an estimate of the energy they consume in each half hour. P272 would mandate that consumers in Profile Classes 5-8 (generally considered to be larger non-domestic consumers) are settled using HH consumption data. Moving these consumers to HH settlement is an important step towards smarter markets. P272 would allocate more accurately the costs that suppliers incur in purchasing and transporting energy, thereby putting in place stronger incentives on suppliers to manage these costs efficiently.

Today, we have written to the BSC Panel in relation to P272.<sup>4</sup> We remain of the view that this modification is in the interests of existing and future consumers. However, current DUoS charging arrangements, as set out in the DCUSA, are not fit-for-purpose to allow Profile Class 5 to 8 consumers to move from NHH to HH settlement. Since 2012, industry has been working on changes to the Common Distribution Charging Methodology (CDCM) that aim to create more appropriate HH DUoS tariffs. While we recognise the complexity of this area, we are disappointed that industry has not progressed the changes necessary to enable consumers to move from NHH to HH settlement. This is holding up the realisation of the benefits of smart metering, both because of the cross-code impacts with P272 and the importance of having appropriate DUoS tariffs that send time-of-use signals to consumers.

The proposed implementation date and lead time for P272 as currently drafted would require us to take a decision before potential changes to the CDCM have been assessed. Therefore, in accordance with paragraph 2.11.18 in Section F of the BSC, we have directed the BSC Panel to consult on a revised proposed implementation date for P272 to enable us to take account of the current proposals to change the CDCM.

---

<sup>3</sup> Ofgem, 2012. *Promoting smarter energy markets: a work programme.*

<sup>4</sup> Ofgem, 2014. *Direction to the Balancing and Settlement Code (BSC) Panel to consult on a revised implementation date for BSC Modification Proposal 272.*

In relation to the proposed DUoS charging arrangements, we note industry's intention to have these changes in place from April 2015, subject to Ofgem approval. We urge industry to develop any modifications in a timely way that would allow this date to be met.

### **Role of industry**

We expect that industry should play its part in helping to support the realisation of smarter markets by progressing necessary changes to industry codes. This is particularly important because the governance arrangements for these codes place the onus on industry to raise, develop and assess modifications.

Unfortunately, the lack of co-ordination and pace is not confined to P272 and the related DCUSA modifications. We note that there are other examples where the industry has not progressed important changes to market arrangements in a timely way. This includes Project Nexus, which among other things seeks to reform the gas settlement arrangements such that they provide an ongoing accurate link between a consumer's consumption and their supplier's charges. While this work has been constructive, progress has been slow and gas settlement systems have remained largely unchanged since the start of domestic competition. The changes proposed by Project Nexus are critical to deliver a more accurate allocation of costs and to support competition between gas suppliers.

We expect that industry, whether suppliers, network companies or any other market participants, should not take actions through the code modification processes that delay the realisation of consumer benefits. Moreover, market participants must commit sufficient resource to undertake robust and timely assessment and implementation of modifications.

If we are not satisfied with the pace of progress going forwards, we will look at the options at our disposal to ensure that relevant market participants help to realise the benefits of smart metering. We are actively considering the introduction of licence obligations to this effect, to supplement existing requirements in licences relating to smart metering. We may also consider other options, including an SCR. In parallel, we also request that the industry consider how to manage interactions between industry codes more effectively where appropriate. We invite parties to present their proposals to us on how this could be achieved. Our view is that the panels responsible for overseeing the industry codes would be well placed to bring together proposals, with support from other stakeholders.

### **Next steps**

Realising smarter markets will require all relevant parties – government, Ofgem and industry – to work together in delivering the roll-out and progressing complimentary changes to market arrangements. In this context, we will monitor closely the progress of industry work aiming to put in place new HH DUoS tariffs for Profile Classes 5 to 8. We also await a response from the BSC Panel in relation to our direction to consult on a revised proposed implementation date for P272.

If you would like to discuss this letter further please contact Rob Church at [smartermarkets@ofgem.gov.uk](mailto:smartermarkets@ofgem.gov.uk).

Yours sincerely,



**Rachel Fletcher**  
**Interim Senior Partner, Markets**