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Dear Jonathan

24th December 2013

British Gas Balancing and Settlement Code Modification Proposal 272 – draft impact assessment response

Thank you for the opportunity to comment on Ofgem’s IA on the above Modification. We strongly disagree with Ofgem’s minded to position for three reasons:

1. Imposing mandatory half hourly settlement is an unnecessary and disproportionate mechanism to achieve the desired outcomes.
2. The current status of this market, and customer priorities do not support the requirement for mandatory half hourly settlement
3. The underlying inputs to the IA do not support a positive case for mandatory half hourly settlement

1. Imposing mandatory half hourly settlement is an unnecessary and disproportionate mechanism to achieve the desired outcomes:

An assumption is made that, without mandatory half hourly settlement the benefits of moving peak load will not be achieved; this is incorrect. Multi rate tariffs, settled using Standard Settlement Configurations and Time Pattern Regime combinations enable incentives to be provided to customers, and changes in consumption pattern to be reflected in existing settlement arrangements.

Indeed, prescribing a very granular level of data to be passed into settlement will make no difference to the benefits achieved in terms of time of consumption unless suppliers offer (and customers accept and respond to) pricing signals based on half hourly consumption periods. This will remain true unless and until there is a need for dynamic time of use tariffs to support demand side response. There is no evidence that this is required in the short to medium term, and even less evidence that this will be required for all customers.

For customers who wish to have fully granular pricing, the existing elective half hourly regime is available to support this.

2. The current status of the market, and customer priorities do not support the requirement for mandatory half hourly settlement

Ofgem acknowledges that it has no robust research on the requirements of this customer group (“*There is limited evidence available on the potential for consumers in Profile Classes 5-8 to respond to price signals by shifting from peak to off-peak period*”).

British Gas supplies nearly 25% of energy to customers in this market and has considerable experience of providing complex tariffs. We have shared with Ofgem analysis which illustrates that over 50% of customers in this group are already on a multi-rate tariff, and have opportunities and incentives to manage their consumption and cost. Our breakdown of customer types in this group highlights that a large proportion are in the retail sector (circa 40% of energy use), with limited discretionary load to be redistributed from peak periods. These customers would see half hourly settlement as an additional overhead providing little opportunity for benefits.

In addition, customer feedback from this group, (reinforced by product take-up) is that there is no interest in engaging with complex tariffs with more than 6 or 7 rates. British Gas has shared the breakdown in terms of volumes of customers on multi rate tariffs, and split across different numbers of rates with Ofgem on a confidential basis.

It is evident therefore that suppliers are already engaging with time of use propositions where there is a demand for them, and further, that customers are not seeking complex half-hourly priced products.

Given that the market is already meeting these requirements, and that the settlement arrangements can support them without amendment, it is difficult to see what benefits can be achieved by mandating half hourly settlement.

As and when there is a need for half hourly settlement to support dynamic time of use tariffs to support demand side response, the elective regime is already fit for purpose, particularly once changes to DUoS charging have been implemented.

3. The underlying inputs to the IA do not support a positive case for mandatory half hourly settlement.

The counterfactual should reflect that the current arrangements already provide for the benefits of time of use tariffs to be realised. It is probable that customers who have the most opportunity to benefit from such tariffs have already adopted them and therefore a large proportion of the available benefit has already been realised. This is not fully reflected in the IA, resulting in benefits being overstated. The analysis we shared with Ofgem demonstrated that 95% of the benefit of load shifting and reduction can be achieved through existing NHH settlement mechanisms of TPR/SSC combinations. We have proved the effectiveness of this approach through our Free Saturdays and three-rate Customer Led Network Revolution (CLNR) tariffs.

Ofgem's analysis estimates that approximately 30% of the load used by PC 5-8 sites is discretionary. We believe this estimate is high given the nature of the majority of PC 5-8 sites. A typical customer is British Gas's largest customer in this sector, which operates a chain of public houses. The opportunity to shift load away from peak in this instance will be severely constrained.

In terms of costs we would strongly challenge Ofgem's assumption that the industry will save £31.2m in agent services costs from this change. We have repeated our original analysis of likely agent costs in meeting the performance levels. Our estimates for services required under the BSC from competent providers are in excess of four times Ofgem's estimates. Given that, even as currently stated, the IA is neutral, and that any sensitivity in these costs would introduce negative benefits, our view is that these costs should undergo greater scrutiny.

We would also flag that Ofgem has made the assumption that the meters currently being installed to meet the April 2014 mandate can be seamlessly migrated to full HH settlement and to meet the performance levels of 99% by R1. There will be significant challenges and added cost in achieving this. Currently a large majority of the meters in PC 5-8 are only communicated with on a monthly basis to collect a single set of readings and a step change in performance would be needed to meet the required levels, which can only be achieved with a significant increase in costs.

Even with optimistic assumptions about agent costs, and assuming DUoS charging changes, our estimate is that this change will introduce additional costs of £55 per site and for one our largest customers over £65k per annum. Customers may associate this cost with the advanced meter rollout, creating negative perceptions at a time when engagement in new metering technology is key.

The profile class 5-8 market represents a relatively small proportion of the total energy demand in the UK, around 5%. To impose such a costly solution which is, in effect a pilot, on such a small sector of the market whilst Ofgem is conducting a complete review of the settlements system via its Smarter Markets programme appears to be short sighted and an inefficient use of resources.

Combining the uncertain benefits with the fact that availability of benefits will be severely constrained for a large portion of customers in this market, represents very poor value.

There is also a significant cost of creating unnecessary and costly technical debt in our IT solutions for this change, if we are required to do so ahead of visibility of the full market solution.

We are aware that Ofgem's rationale for approval of this modification is that imposing the requirement (and cost) of half hourly settlement upon all customers will increase competitive pressure on suppliers to innovate and incentivise customers to be more open to moving or reducing their energy consumption. In today's market where our customers are already finding energy costs difficult, this is a wholly disproportionate approach. It is also clearly not the case that energy suppliers do not feel intense competitive pressure to keep prices down and offer customers the opportunity to save costs.

In summary we support the view of the P272 Working Group, the BSC Panel, the majority of energy suppliers who responded to the P272 Panel Final Report and Consumer Futures in that this modification would not better achieve the objectives of the BSC and that this modification should be rejected.

We are fully supportive of the inclusion of this element of work within the wider Electricity Settlement Reform workstream of the Smarter Markets Programme and believe that this offers the opportunity to consider the requirement for HH settlement holistically, and to put in place a proportionate and timely roadmap for change.

More detailed responses to your consultation questions are attached to this letter but should you require any further information please do not hesitate to contact Kevin Woollard (kevin.woollard@britishgas.co.uk or 07979 563580)

Yours sincerely

Kevin Woollard

Kevin Woollard
Regulatory Manager
British Gas

Question 1: Do you agree with our approach to assessing the impacts of P272

- 1.1. Whilst we agree with Ofgem's approach to assessing the impacts of P272 we do have significant issues with the values that Ofgem has used to model the impacts of P272. We have commented on these in our response.
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Question 2. Are there any additional, material impacts that we should consider ?

- 2.1. We do not believe that Ofgem have considered the impact on consumers sufficiently in their assessment. During the P272 BSC consultation process we understand that Ofgem engaged directly with consumers to gauge their support for this proposal. During these discussions Ofgem reported that representatives of non-domestic consumers expressed some concerns around both the potential complexity of pricing that may be used by suppliers if P272 is implemented and consumer's ability and willingness to respond to prices incentives.
- 2.2. Our own analysis indicates PC 5-8 consumers are very different from the existing over 100kw HH consumers. They do not all have dedicated energy procurement specialists and want simple tariffs.
- 2.3. It is our view that if P272 is implemented the reliance this group will have upon their old supplier, who has access to their half hourly data could cause a disincentive to switching. Customers in this group do not generally have the capabilities or the inclination to store and manipulate the data themselves.
- 2.4. When considering whether or not to approve P272 Ofgem should also examine the tariffs currently being offered in the over 100kw HH market. Although this market has been in operation for many years consumers do not actually get charged individually for each half hour period. The half hour periods are still grouped between 2 to 7 rates and suppliers take an amount of pricing risk on what customers will actually use during the different time bands. This pricing risk is currently reduced in the PC 5-8 market because consumer's usage is allocated via a profile and suppliers can price against the profile. If energy is allocated using actual HH data those suppliers with the largest portfolios may benefit from their ability to spread the pricing risk across many more consumers. We believe this may act as a barrier to smaller suppliers and new entrants.

Question 3. Do you agree that P272 would drive suppliers to encourage DSR among their customers?

- 3.1. No. The primary requirement for the emergence of a DSR market is sufficient financial incentive being present to make such offerings appealing to both DSR providers and customers, with suitable market arrangements in place to support this. The relevant market arrangements are largely in place to enable this and HH settlement is not a requirement for DSR to become a feasible product offering.
- 3.2. The two changes that will encourage a DSR market are
 - a. A greater differential between peak and off-peak wholesale electricity prices; and
 - b. A change to the DuoS charging arrangements so that if a supplier chooses to electively settle a customer half-hourly then their customer is charged a cost reflective DuoS charge.
- 3.3. With these changes, the incentives will be in place for DSR providers to engage with consumers on how they consume their energy and their willingness (and ability) to reduce or shift consumption.
- 3.4. Any changes to market arrangements needed to support DSR would need to be cost-effective for customers, otherwise additional costs would act as a disincentive.
- 3.5. For this group of customers, there is already suitable provision for suppliers to offer and for customers to take up time of use tariffs, and for the majority of the settlements benefits to be realised through the use of TPRs and SSCs. Our analysis with non-domestic customers has shown that 95% of the benefits of half-hourly settlement may be achieved with multi-rate tariffs settled using TPRs and SSCs.
- 3.6. When changes to DuoS charging are implemented in April 2015, there will be a further incremental improvement allowing these customers to move to elective HH settlement in a cost-effective way. This improves the settlement benefit business case and would facilitate time of use tariffs for these customers.
- 3.7. The only benefit of half-hourly settlement is for the efficient settlement of customers with dynamic demand side response – i.e. those who are able to

shift load at variable times of the day depending on supplier and/or network constraints. This market is still largely theoretical and even if it were to evolve in the near future, then elective half-hourly settlement would be sufficient for these customers. A mandatory regime is over-engineered unless all customers will take up dynamic demand side response: this appears unlikely.

- 3.8. It is unclear what incremental benefit mandatory HH settlement for all customers in this segment would bring over and above these arrangements and were this position correctly modelled as the counterfactual within Ofgem's IA, then the costs would significantly outweigh the benefits.
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Question 4. Do you agree with our approach for quantifying the value of load shifting and load reduction, including the assumptions we made? Is there any evidence we have not identified that could inform our analysis?

- 4.1. We note that Ofgem has consulted a varied set of research papers on load shifting and load reduction. However as Ofgem acknowledge in Appendix 3 para 1.18 "There is limited evidence available on the potential for consumers in Profile Classes 5-8 to respond to price signals by shifting from peak to off-peak periods" We note there is a much greater variance in types of customer and usage patterns in profile classes 5-8 than there are in profile classes 1-2. This supports our view that the amount of shiftable load will be less than the research suggests. Our customers are largely in the leisure and retail sectors and they are very rarely able to reduce or shift load as they are reliant on customer demand.
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Question 5. For those impacts stemming from suppliers reducing the costs of supplying energy (for example, by promoting DSR) that we did not quantify, do you have any suggestions on how we might do so?

- 5.1. This is very difficult to quantify as there are numerous factors that will influence this cost. We do not have any suggestions on how this reduction in costs may be quantified.
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Question 6. Do you agree with our approach to quantifying the value of improved forecasting including the assumptions we made?

- 6.1. We broadly agree with your approach to quantifying the value of improved forecasting. We think that there would be an initial period during migration when forecasting would become more difficult, however once all PC 5-8 sites have been settled on a HH basis for a longer period of time forecasting may be easier.
- 6.2. However the costs of implementing P272 still outweigh the benefits by far.
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Question 7. Could the costs of investing in forecasting capability for HH demand impact disproportionately on smaller suppliers or on new entrants?

- 7.1. We are not best placed to respond to this question.
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Question 8. Do you agree that we have correctly identified the cost savings that suppliers could realise in managing the settlement process ?

- 8.1. Lower HH Supplier Agents costs
- a. We agree that there would be some economies of scale. However moving from NHH to HH would significantly increase Data Collector activity and read storage requirements as we move from 1 read per month to 1440 per month. We recently contacted a HH agent and we estimate that the additional costs we would incur over and above our existing NHH charges would be in excess of 4 times of that modelled by Ofgem in the IA.
- 8.2. Impact on consumers and competition
- a. We agree that there could be some saving to existing HH customers by increasing the size of the HH market. However overall costs to consumers

would increase because of the higher costs involved in servicing PC 5-8 customers in the HH market.

- b. We have spoken to existing NHH agents regarding their appetite to enter the HH market and their view is that they would be cautious with regard to investing in this new activity where such uncertainty exists over both the future direction of settlements in the profile class 1- 4 market and the future role of the DCC. We do not, therefore, share Ofgem's view that new entrants are likely to enter this market and drive down costs further.

8.3. Better Data Quality

- a. While we agree that there may be some small benefit in data quality from not having to convert meter readings into HH consumption there are also data errors in the HH market. HH settlement performance is not 100% and HH data collectors often have to estimate data where consumption is missing. Analysis of HH settlement performance shows the market starts at 99.6% at R1 and actually deteriorates to RF. This suggests reads are actually withdrawn due to accuracy or failure of deeming in the absence of reads.
- b. We also believe it will be significantly more difficult to meet the HH settlement performance levels for the customers we migrate from PC 5-8. This is because the communications technology is different and less reliable. Existing HH customers have fixed line PSTN communications which is expensive but more reliable. GSM technology is less reliable and there would be additional cost involved if it became necessary to drive up performance.
- c. With regard to the change of supplier process it is our experience that it takes longer to transfer a HH customer than a NHH customer. This is because we would have to set up new agents, carry out proving tests and obtain contract reference numbers.

8.4. Faster Settlement

- a. Whilst we agree that there is some fluctuation in energy volumes between SF and R1 the financial movement at a macro level as a customer moves from estimated to actual in PC 5-8 sector is minimal. Therefore, moving existing AMR customers to HH settlement will not realise any material benefit.

8.5. Lower Administration Charges

- a. We agree that there will be a small benefit if the profiles for classes 5-8 are frozen.

Question 9. Do you agree with our assumption regarding the typical size of data quality teams employed by suppliers ?

- 9.1. We fundamentally disagree with this assumption. We currently have teams managing HH data exceptions managing around 6.5% data exceptions on our existing HH portfolio and would expect at a least a similar proportion of exceptions requiring action for PC 5-8 customers. We therefore estimate that based on our experience and the costs per FTE used in the IA the cost of handling data quality teams required by all suppliers would be between £1.44m and £1.56m
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Question 10. Do you agree that meters of consumers in Profile Classes 5-8 are mostly read at the end of the month ?

- 10.1. Yes, currently our PC 5-8 meters are read at the end of each month.
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Question 11. Do you agree with our approach to quantifying the costs of P272 for suppliers and DNOs? If not, we encourage respondents to suggest alternative approaches

- 11.1. We do not agree with the approach used in quantifying costs for suppliers and DNOs.
- 11.2. One-off costs
 - a. We agree that Ofgem should use the actual costs submitted by Suppliers in implementing P272. Suppliers will have different systems and process issues with implementing P272 and implementation costs will differ by supplier.
- 11.3. Ongoing Costs

- a. Ofgem has estimated that suppliers would incur ongoing costs of around £45 per meter to support P272.

We do not agree with Ofgem's estimate of costs. The P272 working group received cost estimates from suppliers and produced the following estimates: Low £34.72 Median £77.77 and a Weighted Average of £142.83. Ofgem has assumed that suppliers will over time be able to procure agent services at the lower end of this range. We estimate that the costs for HH settlement will be significantly higher than the £45 per annum used by Ofgem in the IA.

We have recently contacted a HH agent and have received a quote for HH services in excess of 4 times of those used by Ofgem in their impact assessment. Given the marginal nature of the IA, and the fact that very significant costs will be introduced to the entirety of this group of customers, this assumption is wholly inappropriate.

Question 12. We welcome evidence from smaller suppliers of larger non-domestic consumers on the costs they could incur if P272 is implemented

- a. We are not best placed to answer this question.

Question 13. We welcome information from suppliers in 1) how many consumers would need to move electively for them to incur upfront costs and 2) the costs that would be incurred, broken down by the cost categories listed in this chapter.

- 13.1. We are currently migrating our HH portfolio to a new SAP billing system and this has been sized to deal with our current portfolio. We estimate we could handle a few hundred more customers with no material increase in costs. However any volumes over and above this would incur additional costs. Our estimate of these is still in line with our confidential cost submission submitted under the P272 impact assessment process.

Question 14. Would consumers incur cost from termination of contracts with Supplier Agents? If so, we welcome information that could help us to assess these costs.

- 14.1. We do not have visibility of the commercial terms our existing NHH customers have with agents where they have contracted directly with them.
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Question 15. Do you have any comments on the results of our quantitative analysis ?

- 15.1. In the quantitative analysis Ofgem have assumed that under the counterfactual Use of System charges will remain unchanged. Whilst we appreciate that Ofgem have to compare P272 against the current baseline Ofgem should also compare P272 against the scenario where the barriers to elective HH settlement have been removed.
- 15.2. In this scenario most of the perceived benefits of P272 could be achieved by those customers electing to use HH settlement.
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Question 16. If P272 is approved, would it be possible to implement the modification in less than fourteen months?

- 16.1. Not in our view. There are a number of factors that will need to be taken into consideration before suppliers would be able to start to migrate all existing PC 5-8 customers to HH settlement.
- a. A number of systems including billing, pricing, demand forecasting and DuoS bill validation will require upgrading to handle the increase in volume of HH sites
 - b. The current distribution charging methodologies mean that customers who move to HH settlement generally incur higher costs. We do not believe it would be correct to implement P272 before suppliers have certainty regarding the charging arrangements for existing PC 5-8 customers who migrate to HH settlement. We have a number of significant issues around the change designed to address this (DCP 179). DCP 179 proposes a fundamental change to the basis of setting DuoS charges for *all* customers and needs careful consideration to ensure all customers are treated equitably.
 - c. We would be very concerned if the assessment process for DCP 179, or any alternative approaches, was effectively expedited at the potential

expense of due rigour to meet an implementation date to align with P272.

- d. We would need to have contractual discussions with all of our PC 5-8 customer base for both the supply of energy and the procurement of agency services
- e. We do not believe the current change of measurement class process is robust enough to handle the volumes it would need to should P272 be implemented. We understand that BSC Issue 49 has been raised to examine this issue and has recommended some changes to the existing process.

16.2. In view of the above factors we do not believe it would be practicable to implement P272 in less than 14 months and we believe that even 14 months given the above is extremely challenging.

16.3. It is also relevant to consider the outcome of Ofgem's ongoing work on electricity settlement reform for the whole market. There is a high likelihood that introducing changes for profile classes 5-8 without certainty on requirements for the rest of the market will prevent an aligned and consistent solution for both, or introduce costly technical debt.