Balancing and Settlement Code Modification Proposal 272 – draft impact assessment

Response by E.ON

We welcome the opportunity to respond to Ofgem's 'Balancing and Settlement Code Modification Proposal 272 – draft impact assessment'. We understand the end vision for the market that Ofgem have in mind and agree that a transition to a more accurate settlement process is aligned with the principles of the Smart meter rollout. However, we do have concerns about the speed and implementation process which is proposed for P272.

We would prefer a phased roll out aligned with the SMART programme which allows for customers to be transitioned at contract renewal.

We have split our response into three sections. In the first we cover our high level comments; secondly we have provided detailed responses to the consultation questions. Section 3 (Appendix 1) contains confidential supporting data we request that this data is not made publicly available and remains confidential.

Section 1 – High Level Comments

Consumer impacts – it is our experience that customers in the PC 5-8 segment do not want HH settlements or increasingly complex tariffs. This assumption is based on

1. Experience of mandatory Half Hourly (HH) settlement upgrades (>100kW customers) where customers have to be transferred to the HH settlement regime due to an increase in consumption
2. Demand from our current HH metered customers

Our process for mandatory settlement upgrade for customers, despite communications explaining why they have to go through the process, generates a high number of complaints. The main complaint is that the customer does not want to move to HH settlement as the transition is seen as an inconvenience and detrimental to their business once their current NHH contract ends.

We have made the assumption that these customers will not have to pay kVA charges, although the DNO charging structure in place now would result in this. We would like Ofgem to confirm that these customers would not be charged kVA if they are transferred to HH settlement.

In the current HH market we offer a number of Demand Side Response (DSR) and complex Time of Use (TOU) tariffs, but the majority of customers prefer the simpler 2 rate TOU product.

Customers on our Flex (DSR) product have, on average, consumption levels in the region of 55 times more per annum[1] than that of customers in PC 5-8. Therefore the benefits that are likely for these smaller consuming customers may not be enough to warrant the extra effort required to manage DSR products such as Flex.

Our initial investigation suggests that approximately 40% of PC 5-8 customers will see increased costs in moving from NHH to HH, this is based on current HH costs. Whilst we are not in disagreement that customers should pay the actual costs of their consumption, if these customers feel that they cannot alter their usage in order to mitigate the increase or if they do not understand how, they may be even less engaged in the market than they are now. We believe an extensive programme of raising awareness and understanding of the transfer is necessary to mitigate any negative associations with the move to HH settlement, which could create negativity towards the wider Smart programme.

Costs – we do not believe that the Supplier upfront costs are representative of the industry. Implementation costs will be very specific to each individual supplier and will be based on how they currently structure their business as well as whether or not they currently operate in the HH market.

There is also an assumption that the industry could move to aggregated HH DNO billing, however, change proposal P280 which would have allowed for this and was accepted by the industry was rejected by Ofgem in November 2012. There is no guarantee that this would be successful if raised again.

Suppliers may also pick up further costs for micro business customers who are in contract. Whilst Suppliers may be able to issue contract variations, only customers who are likely to benefit from the transfer to HH style contracts are likely to agree to them. Suppliers will have to choose whether or not to absorb costs that cannot be passed on until contract renewal, such as HH MOP costs, or allow the customers to exit their contracts early if they do not wish to accept the variation.

We also believe that in order for the customer experience to be a positive one, Suppliers will have to invest heavily in customer communications and support as part of the implementation process. This is particularly important for those customers that will see an increase in costs as well as those who are at the smaller consumption end of the segment and may be less engaged in the market.

Benefits – whilst we believe that there are benefits to the implementation of P272, they are far harder to quantify and less assured to occur.

[1] Appendix 1 – Confidential Data, paragraph 1.

We do agree that customers should pay for what and how they consume as it is more equitable and they will feel pricing signals more strongly if they are not being cross subsidised by all NHH customers.

We also believe that there will be a cost reduction in central administration charges and HH Agent costs; however, the latter will benefit current HH customers rather than the PC5-8 customers as they will see in an increase in the transfer from NHH settlement.

We are concerned that PC 5-8 customers will be adversely impacted by a forced move to HH settlement as, unlike the current HH market, they are generally much smaller businesses that may not have the money to invest in energy management teams to enable them to derive the benefit of complex DSR electricity supply products. Nor do they have the flexibility to change their usage patterns as some customers do due to the nature of businesses.

Implementation – We believe that transfer of all customers by 1st April 2015 is not reasonable for a number of reasons

- Suppliers will need 1 year's worth of HH data in order to benefit from improved forecasting. Whilst AMR allows for the retrieval of HH data, systems may not be in place to handle HH data as there is currently no obligation to do so. These changes will need to be implemented prior to us recovering HH data in advance
- Customers will have to go through a BSC Change Of Measurement Class process which is in itself time consuming, completing all of these by April 2015 will result in increased costs for energy suppliers
- If the DCUSA change to deliver appropriate DNO tariffs is delayed suppliers will not be able to price tariffs, which will leave them to absorb costs or increase prices
- Industry costs could be greatly minimised if the mandation of HH settlement was considered more broadly regarding the future of electricity settlement reform as a consequence of the implementation of Smart meters.
- Customers will see disruption mid contract if they are transferred before their terms end, which is in direct conflict to the work carried out under RMR which gives greater protections to micro business customers in relation to how contracts are administered
- We believe that a significant customer awareness campaign should be carried out in order to make the transition a positive one for those impacted. We would like Ofgem to consider a joint campaign with Energy UK such as the one carried out to advanced meter customers to help pave the way for a smoother transition

We would urge Ofgem to consider a roll out window aligned with the Smart programme, rather than a deadline implementation.

Section 2 – Consultation Questions

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

Whilst the approach to assessing the impacts of P272 seems sensible, we do not believe that all the impacts have been considered. We are disappointed that more effort was not made to understand the reasons for the disparities in submitted costs. Given the high uncertainty surrounding the inputs the Monte Carlo simulation was bound to produce a wide spread of uncertainty around the Expected Value.

We believe that customers in the PC 5-8 segment may have limited ability to take advantage of price signals to manage the likely price increase that they would see if transferred to an HH pricing structure. This is due to the type of businesses which this segment covers. Shops, offices etc cannot choose to stop consuming during opening hours which minimises their ability to load shift.

Nor do we believe that energy costs for these businesses are significant enough against other costs to motivate customers to engage in the market to a level which would enable DSR.

If P272 is imposed on customers who do not feel empowered to manage their consumption or whose consumption is not great enough to invest in market engagement, the transition will be negative and will taint the Smart roll out programme.

We believe that negativity can be avoided by managing the transition for PC 5-8's. Conducting a thorough awareness raising campaign, linking implementation with the SMART roll out or rolling out HH at contract renewal when customers are most engaged and offering simple ToU tariffs to build engagement and set the foundations for more complex products such as DSR.

Question 2: Are there any additional, material impacts that we should consider?

As well as the consumer reaction to P272 mentioned in Question 1, we do not believe that the outcome of the DCUSA modification relating to DNO charging methodology has been fully considered.

Currently, if a PC 5-8 consumer was transferred to HH, they would see an immediate increase in their DNO charges. We have also made the assumption that kVA charges will not be passed on to the consumer but this is not yet clear and if they are passed on the consumer will see even higher charges. We also do not see what protections customers would have from DNO's shifting their red banding, for example should significant numbers move usage to the morning what would prevent DNO's moving the red band to the morning?

If the DCUSA modification does not address the above issues so that a level playing field is achieved and customers can be confident that they understand the market, P272 will be detrimental to customers affected.

Given that 60% of PC 5-8's are likely to be micro businesses and Standard Licence Condition 7A, (prohibiting termination of a Micro Business contract in instances of mandatory HH metering, as per Ofgem RMR decision document, published 26th June 2013) prevents Suppliers from unilaterally changing a NHH contract to a HH, suppliers will have to pick up costs where customers do not agree to contract variations or lose customers. We believe that if implemented, P272 should be rolled out as customers renew their contracts to minimise cost to suppliers and disruption to customers who believe that they have their energy requirements arranged for the contract period.

As we have stated earlier in our response, we believe that in order for a transition to HH for PC 5-8 customers to be positively received, a substantial awareness and engagement campaign will be required as well as additional support for customers as they move to HH. This cost has not been considered.

If P272 is not favourably received, we believe that there will be an impact on how the roll out of the Smart programme is received. This may lead to a slower realisation of benefits as customers are harder to engage and take longer to bring onboard.

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

We believe that P272 sets the foundations for DSR, but we disagree that P272 in itself will drive the sudden emergence of DSR products. We currently offer 2 DSR products and ToU products ranging from 2 to 8 rates to our current HH customers. The majority of demand is for a two rate product[2], we believe this is due to the simplicity. It is therefore our experience that customers prefer simpler products.

We also believe that the PC 5-8 segment is less able to realise the benefits of ToU or DSR because they have less flexibility in their usage and are less likely to be able to take advantage of complex DSR products, particularly at the smaller end of the segment. Those customers that currently use our DSR (Flex) product are very large users to whom it is cost effective to employ energy management teams. In our experience customers in PC 5-8 range are unlikely to have dedicated energy management teams.

[2] Appendix 1 – Confidential Data, paragraph 2

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?

No. Although we do not disagree with the benefits of load shifting, we do not agree with the hypothesis that more innovative ToU tariffs will lead to load shifting. As discussed previously, we do not believe that customers at this end of the consumption scale could actively seek to significantly reduce their consumption during peak hours as we do not consider these customers to be in a position to make major changes to their operational hours and times of peak demand. The Ofgem analysis uses evidence from a domestic consumer base and we do not believe that this is reflective of the PC 5-8 segment.

We are also nervous about claiming carbon reduction associated with DSR. Large users who take advantage of DSR do not necessarily shift their load but switch to on site generation, the benefit they receive from removing demand from the grid covers the cost of fuel for on site generation. We again feel that customers in the PC 5-8 segment will be disproportionately impacted by an assumption that they can use DSR as their energy consumption is not great enough to invest in alternative generation.

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?

As we do not agree that DSR will be widely taken up in the PC 5-8 segment we do not believe that benefits associated with it will be realised.

We see no benefit in load shifting at critical periods, at times other than peak to off peak or increased value over time.

Question 6: Do you agree with our approach to quantifying the value of improved forecasting, including the assumptions we made?

We think that the 40% improvement in forecasting is not unreasonable; however, this is as a result of receiving accurate data daily and not by virtue of it being HH metered. If we were to recover the HH data weekly the benefit would not be realised.

It should be made clear that the 40% improvement is only for those customers in the PC 5-8 segment and given they only make up 16% of overall consumption the improvement overall is negligible.

We agree that benefits in reduction of imbalance will be counter balanced by the Residual Cashflow Reallocation Cashflow mechanism, resulting in a cost neutral position for customers.

We do not agree with the savings related to purchasing costs. We believe that this benefit is actually about reducing the risk of exposure to cash out prices rather than an actual quantifiable saving. Buying forward allows you to reduce the risk of exposure to the price that the System Operator (SO) will charge, considering that the SO could buy power more cheaply but equally power could be more expensive than a supplier could procure in advance. The benefit is that more accurate forecasting should reduce the volume of energy that is exposed to the price risk inherent in accepting System Sell Price (SSP) or System Buy Price (SBP)

Question 7: Could the costs of investing in forecasting capability for HH demand impact disproportionately on smaller suppliers or new entrants?

We do not believe that investment in forecasting capability will be disproportionate for small suppliers. We believe that the most significant impact will be on those existing small suppliers that only operate in the NHH market. They will have to decide whether or not to lose customers or invest in entering the HH market in which case the costs of HH forecasting capability will be a small part of the overall investment required.

New entrants would not have the costs of changing existing systems and they would need forecasting capability to enter the market, so costs would likely be less than for those already operating in the market.

Question 8: Do you agree that we have correctly identified the cost savings that suppliers could realise in managing the settlement process?

We agree that HH Data Collector and Data Aggregator fixed costs would come down due to the increased number of meters in the segment, however, HH Meter Operator costs are greater than NHH.

We do believe that there will be an improvement in data quality, however, we believe that in the first 6 months data quality is likely to be impacted while systems and processes bed in. We would, therefore, ask that a transitional 'grace period' before BSC service level charges is levied for not achieving 99% at SF and R1, is included in the scope of implementation.

We believe that there will be negligible benefit in the amount of credit cover we have to hold for imbalance purposes, the main factors in calculating credit cover are volume, Regulated Asset Value, credit rating and regulated revenue. How data is settled is not significant and will not result in a benefit. However, other suppliers may be impacted differently depending on their portfolio mix.

We agree that HH settlement would remove the need for the production of NHH profiles year-on-year, and agree in principal that this would lead to reduced central administration costs; however, as there would be gaps in customer HH data, suppliers would need to spend a greater amount of time

patching gaps in HH profiles. Therefore, any savings in BSC admin costs would be countered by increased supplier activity.

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

Yes, we believe that the assumption is not unreasonable, although this will vary between suppliers.

We do not agree with the cost savings in resource due to improved data quality, any resource saved from the data quality area will be redistributed to other areas which will see an increase in resource requirements such as settlements.

Question 10: Do you agree that meters of consumers in Profile Classes 5-8 are mostly read at the end of each month?

No. We read our AMR customers on the 1st and 15th of each month.

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.

No. It is our belief that industry upfront costs have been significantly under estimated based on our and other suppliers cost submissions.

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

N/A

Question 13: We welcome information from suppliers on (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.

We have included our response to this question in paragraph 3 of Appendix A – Confidential Data, due to the commercially sensitive nature of the information.

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

The costs for Supplier Agents are usually built into the standing charge or unit rate for NHH supply of energy, therefore the customer is paying them indirectly. Although consumers can contract directly with agents should they choose to, this is not common practice in the NHH market.

Suppliers are more likely to incur Supplier Agents costs due to contract termination, particularly if their agents are NHH only.

Customers will incur unnecessary costs where they have contracted for the supply of HH data from a data provider. If P272 is implemented they will receive HH data for no additional cost above the cost of their energy but may be in a contract for provision of data at a cost so would either have to continue paying for data they could receive for free or incur contract termination fees.

Question 15: Do you have any comments on the results of our quantitative analysis?

As discussed in our response to other questions:

We believe that key impacts have not been considered when assessing the costs of P272 these are

- Consumer ability to respond or engage with DSR products
- Outcome of DCUSA modification into DNO charging
- Impact of RMR, the expansion of the definition of micro business and the restrictions imposed by the code of conduct on changing prices during contract terms
- Cost of awareness and education campaign for customers and additional support required in transition
- Negative reaction to P272 and impact on Smart metering due to poor implementation

We believe that the Supplier upfront costs have been under quantified.

We do not agree with the benefits stated relating to DSR as we do not believe that customers in the PC 5-8 segment will be able to take advantage of the benefits offered for load shifting, either because of business practices or energy costs not being significant enough to invest in energy management.

We believe that a positive consumer response to implementation can be achieved and supplier costs can be lowered if a roll out aligned with the SMART implementation is considered.

Question 16: If P272 is approved, would it be possible to implement the modification in less than 14 months?

No. There is a great deal of preparation required to implement P272. This includes:

- Changes to billing, settlement, forecasting and data retrieval and storage systems
- Collection of HH data for customers effected to enable the effective forecasting for those transferred under P272
- Business structure changes
- Significant consumer engagement and support campaign to ensure that the implementation is positively recieved

- Having tariffs available is dependent on the outcome of the DCUSA modification on DNO charging, as this is not due to be implemented until April 2015 any delay will result in suppliers having no tailored products to offer

We strongly believe that if P272 is to be implemented then it would be beneficial to do this in the context of wider reform of the electricity settlement market linked to the implementation of Smart.

We believe that transition from NHH to HH would be better for customers if carried out at contract renewal. It would provide an appropriate time to engage and prepare the customer for the change as they would already be considering their next contract.

The transition to NHH settlement to HH settlement for customers within the current PC5-8 would reduce the costs for Suppliers and customers. The timescale for this transition should be over a sufficient period to allow all customer contracts to have ended and therefore a period of 3 years after 2015 would seem a logical minimum time period.