

Electricity suppliers, distribution companies, consumer representatives, Code Panel chairs and other interested parties

Email:
half-hourlysettlement@ofgem.gov.uk

Date: 28 June 2016

Dear colleagues,

Mandatory half-hourly settlement (HHS): intention to launch an SCR

We have agreed with the Secretary of State for Energy and Climate Change to take forward a project to reform the electricity settlement arrangements in Great Britain. Our December 2015 open letter 'Half-hourly settlement: the way forward'¹ outlined a two-phase plan:

- Elective HHS. This project seeks to identify and remove the barriers facing suppliers wishing to settle their domestic and smaller non-domestic electricity customers on a half-hourly basis. Our ambition is to enable elective HHS for these consumers in early 2017.
- Mandatory HHS. We expect that we will need to mandate all suppliers to settle their customers on a half-hourly basis to realise the full benefits.

Update on elective HHS

Our ambition remains to enable elective HHS in early 2017. We have issued a conclusions paper on our work to enable cost-effective elective HHS for Profile Classes 1-4², following engagement with stakeholders on a bilateral basis and through a workshop in April. A summary of responses to the December 2015 open letter was published in March 2016³.

Alongside the changes identified in our conclusions paper, work is also ongoing to progress the changes recommended by the BSC Settlement Reform Advisory Group, which was organised by ELEXON.

Update on mandatory HHS

We consulted through our Draft Forward Work Programme⁴ on our intention to launch a Significant Code Review (SCR) on mandatory HHS for all consumers early in 2016-17. This consultation set out the scope of the potential SCR, with associated timescales and our proposals for the how the work should progress. The final Forward Work Programme⁵

¹ For consultation and responses, see: <https://www.ofgem.gov.uk/publications-and-updates/half-hourly-settlement-way-forward>

² See: <https://www.ofgem.gov.uk/publications-and-updates/elective-half-hourly-settlement-conclusions-paper>

³ See: <https://www.ofgem.gov.uk/publications-and-updates/elective-half-hourly-settlement-publication-responses-december-open-letter>

⁴ For consultation and responses, see: <https://www.ofgem.gov.uk/publications-and-updates/draft-forward-work-programme-2016-17>

⁵ See: https://www.ofgem.gov.uk/system/files/docs/2016/03/forward_work_programme_2016-17.pdf

stated that we would announce our decision on the SCR in spring 2016. We also noted that we will take full account of any conclusions from the Competition and Markets Authority (CMA) in its Final Report in planning and delivering mandatory reform.

This letter sets out the way forward for mandatory HHS following this consultation with industry and other developments.

Consultation feedback

Using the SCR process as the delivery vehicle for mandatory reform

Stakeholders broadly support the use of Ofgem's SCR powers to deliver mandatory reform. There is current draft legislation to give Ofgem enhanced powers to expedite settlement reform which the Energy and Climate Change Select Committee has recently considered⁶. Stakeholders asked for clarity over how any new powers granted to Ofgem following the legislative process would affect the delivery of mandatory settlement reform.

The timeline for launching the SCR and delivering mandatory HHS

Feedback highlighted that the issues under scope for consideration are significant, so the plan for doing so needs to be realistic, pragmatic and with deliverable timescales. Stakeholders felt that the timeline needs to take into account a period of learning from elective HHS and consider other major changes in the industry, such as the smart meter rollout, the move to principles-based regulation and market design work under the flexibility project.

Stakeholders highlighted the interactions between our mandatory and elective work. Some stakeholders noted that an SCR on mandatory HHS should not distract from our immediate work to remove barriers to cost-effective elective HHS.

We stated in our December 2015 open letter that it is currently too early to fix an end date for the transition of small sites to mandatory HHS. This should be considered in the context of other industry changes, and with the knowledge that we will develop from policy work on mandatory HHS and from observing the effects of elective HHS. We agree with the importance stakeholders attach to careful and realistic planning, as well as the need to ensure timely delivery of elective reform.

Consideration of costs and benefits, distributional effects and issues with consumer engagement and protection

There are potentially substantial benefits to consumers and the system from peak load shifting, but these rely on opportunities to exploit within-day price differentials. A move to half-hourly settlement on a significant scale to enable innovation in smart tariffs will be a necessary step in achieving the higher end of potential benefits from demand-side response.

However, implementing mandatory reform is likely to involve initial and ongoing industry costs, while incentives through smart tariffs may have distributional effects across different groups of consumers. Stakeholders stressed the importance of robust, thorough analysis to quantify these costs against the potential benefits, and felt that this cost-benefit assessment needs to then inform decision-making as the SCR progresses.

⁶ See: <http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/inquiries/parliament-2015/pre-legislative-energy-15-16/>

Other issues

Stakeholders raised a number of other key issues related to the transition to mandatory HHS. These included:

- The schedule for implementing mandatory reform, particularly the changes to IT systems that will be necessary, and how this fits with other industry obligations over the next few years;
- Data protection and privacy;
- The ACER recommendation to harmonise European imbalance settlement periods (ISPs) at 15 minutes⁷;
- The impact of HHS on residual non half-hourly consumers;
- Transitional and enduring network charging issues;
- The design of the institutional framework to deliver half-hourly settlement.

The Competition and Markets Authority (CMA): Energy Market Investigation

The CMA consulted on its Provisional Decision on Remedies in March, and their Final Report was published in June. Their remedy package sets out a number of recommendations to DECC and Ofgem related to reform of the electricity settlement arrangements:

- to consider removing any potential barrier for suppliers to collect consumption data with greater granularity than daily in the context of the review of the Data Access and Privacy frameworks;
- to conduct a full cost-benefit analysis of the move to mandatory half-hourly settlement and consider options for reducing the costs of elective half-hourly settlement; and
- to publish and consult jointly on a plan setting out timescales and responsibilities relating to the introduction of half-hourly settlement.

The CMA's report is an important milestone towards making the market more competitive and fairer.

Decision on Significant Code Review

In light of consultation with industry and the CMA's recommendations, our intention to use our SCR powers to progress mandatory reform has not changed. The majority of consultation respondents were supportive of using this route, and we consider that it is currently the best available tool for Ofgem to successfully manage the changes that will be needed across multiple industry codes and licence conditions. The potential new legislation referred to above would further strengthen our ability to efficiently drive through the necessary changes, and if these powers were provided we would expect to stop the SCR and use the new powers for the remainder of the process.

We recognise that moving to mandatory HHS is a major undertaking that will involve significant changes for suppliers, supplier agents and other impacted parties, as well as substantial changes to central systems. The scale of the issues under consideration was evident in stakeholder feedback, which highlighted the need to carefully plan the timetable of mandatory reform to consider concurrent industry change and the complexity of the issues within scope. This emphasis on the need for robust and transparent planning was echoed by the CMA's recommendations.

⁷http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Recommendations/ACER%20Recommendation%2003-2015.pdf

We also welcome the emphasis that the CMA and stakeholders have put on the need to conduct a full cost-benefit analysis of the move to mandatory HHS. An Impact Assessment will be central to the programme of work covered in the SCR as we develop these reforms.

We agree that in order to deliver these reforms in the best manner possible, planning timescales and responsibilities is critical. For this reason, while we have decided to launch an SCR to progress mandatory reform, we will do so only after the work involved has been thoroughly planned and scoped. We intend to consult jointly with DECC on the timing for our work as recommended by the CMA, setting out timescales and responsibilities for progressing mandatory reform. We remain committed to enabling cost-effective elective HHS by early 2017⁸ following our May conclusions paper.

Stakeholder involvement

We will be looking to work with industry as we develop our approach to mandatory half-hourly settlement and the Impact Assessment, and asking them to provide the necessary information to inform our analysis. While we will be issuing requests for the provision of such information at the appropriate time, we are interested to receive any information in advance of this that can assist us as we develop the Impact Assessment.

Please send any relevant information and analysis to half-hourlysettlement@ofgem.gov.uk, clearly marking where information is confidential.

Contact

We are very keen to continue to speak to stakeholders as we progress our work on elective and mandatory HHS. Please send any comments or questions about this letter or on the electricity settlement project in general to James Earl at half-hourlysettlement@ofgem.gov.uk.

Yours sincerely,

Cathryn Scott
Partner
Energy Systems

⁸ The precise timing will depend on practical factors such as the BSC Release schedule, which will affect any central systems changes.