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By email: HalfHourlySettlement@ofgem.gov.uk

Centrica response to Ofgem consultation on Mandatory Half Hourly Settlement: aims and timetable for reform

Dear James

Centrica supports the principle of cost reflectivity and we agree that demand reduction and demand shifting can deliver significant benefits. Therefore we support the rationale for considering the half hourly settlement (HHS) of all domestic and small business customers.

However, HHS should not be mandated unless Ofgem can be sure that the costs outweigh the benefits. Any mandatory change must also be implemented in a sensible timescale that does not cause undue cost or disruption to industry or consumers.

There is a large amount of industry change underway. Programmes include: smart metering rollout, implementation of CMA remedies, Project Nexus, and faster and more reliable switching (FMRS). The scope of transformational change in progress means that industry change capacity is already being tested.

The design and implementation of mandatory HHS will be a large and resource-intensive programme. Therefore there is a risk to customers and industry of adding further transformational change to an already stretched capacity.

We are extremely concerned with Ofgem's desire to implement central systems changes by early 2018. We do not think this is a realistic timescale nor do we see a proven consumer need for such early implementation.

Using the timings of FMRS, which seems like a good proxy, our expectations are that 2017 will largely be taken up with finalising the design of any potential settlement reform.

We welcome Ofgem's proposal to produce a robust business case and impact assessment for settlement reform.

Changes to industry systems should not go ahead until a business case and an impact assessment has been finalised. Otherwise this could place a large cost on consumers when it is unknown whether settlement reform will deliver benefits for the majority of consumers.

We support Ofgem's plan to facilitate elective HHS in early 2017. Elective HHS provides a route to market for innovative products without placing a large cost across the wider energy industry.

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It is important that the business case for mandatory HHS demonstrates that there is additional benefit above and beyond what may be delivered by elective HHS.

The business case for mandatory HHS should reflect learning from the movement of profile class (PC) 5-8 customers to HHS. Many of the expected benefits for PC 5-8 customers have not been realised, for example there has been no significant reduction in supplier agent costs and we have seen very little customer demand for propositions enabled by HHS.

Both elective HHS for PC 1-4 and mandatory HHS for PC 5-8 are real world examples to benchmark our expectations for mandatory HHS for PC 1-4 against. These examples should inform the business case and impact assessment for mandatory HHS for PC 1-4.

Smart metering will enable HHS but it will not be the driving force behind propositions that take advantage of HHS. An increase in large moveable loads such as electric vehicles (EVs) and an increase in home automation are likely to drive the need for more dynamic tariffs.

Therefore the majority of households having a smart meter should not be seen as the trigger point for mandating HHS. It is only when the majority of households have the technology and the inclination to take advantage of HHS enabled propositions that the business case for mandatory HHS is likely to become positive for consumers.

Our response to Ofgem's consultation sets out some important challenges that need to be addressed before deciding on a move to mandatory HHS. However, we are supportive of Ofgem doing the policy ground work in 2017 and working with industry to determine how settlement should be reformed, and most importantly when any reform should take place.

Centrica is willing to commit resources to work with Ofgem to help develop the industry business case, target operating model and impact assessment.

If you have any questions, please contact Tabish Khan in the first instance on 07789 575 665 or Tabish.khan@britishgas.co.uk.

Yours sincerely

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Centrica

Response to Ofgem's consultation questions

In this section we answer the questions posed in the Ofgem consultation document.

Proposed Approach

Question 2.1: Do you have views on our proposed approach?

Centrica strongly supports Ofgem's suggested approach to produce a business case, an impact assessment and a target operating model (TOM).

The use of a TOM was particularly helpful in the Faster and More Reliable Switching (FMRS) programme, and we consider it will be equally helpful for settlement reform.

Our covering letter sets out our concern as to whether the benefits of settlement reform will outweigh the costs. Therefore we welcome Ofgem's approach to develop a robust business case and impact assessment.

We note that Ofgem has commissioned some analysis on the distributional impacts of settlement reform. The distributional impacts are a key part of the business case for settlement reform. Because the distributional analysis will set out which types of energy consumers stand to benefit and those that may lose out from reform.

The distributional analysis will be very helpful in setting out the business case for reform and we would be keen to see the outputs of this work once it has been completed.

Centrica supports using a Significant Code Review (SCR) to take forward this work programme. It is a large programme that will require significant input from industry stakeholders and central co-ordination by Ofgem. Therefore an SCR is the appropriate vehicle to take settlement reform forward.

Lessons can be learned from the recent FMRS programme where central co-ordination by Ofgem has resulted in a more organised structure to a programme. FMRS compares favourably to an approach led by an industry participant, such as Project Nexus.

Improvements could also be made to the FMRS approach. Having a fixed deadline and working backwards from it has resulted in some elements of the FMRS work package being rushed with inadequate time for consultation. The work packages in the settlement reform programme should ensure there is sufficient time for consultation and potentially several rounds of consultation where required, e.g. due to the complexity of the subject matter.

Ofgem has not yet set a date for when mandatory HHS should be implemented, should the business case prove positive. This is an approach we strongly advocate. By not placing a final deadline on this programme, it ensures there is time to rigorously analyse any potential changes before a decision is made on whether to proceed with mandatory HHS for domestic and small business consumers.

However, we have significant concerns around Ofgem's proposal to put in place central system changes by 2018. Our concerns are expressed in our answer to question 3.4.

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Aims

Ofgem has set out the four key aims of settlement reform, largely centring on facilitating innovation and competition¹.

While we agree with three of these aims, we remain unconvinced that settlement reform will reduce barriers to entry.

We can see that it may make it easier for new entrants whose business models are predicated on settlement reform – i.e. a company looking to offer dynamic time of use tariffs.

However, for new suppliers who are not offering innovative products, settlement reform may act as a barrier to entry. The increased cost-reflectivity of settlement reform may make it harder for new suppliers to hedge and purchase energy when customer usage is no longer made uniform by profiling.

Question 2.2: Our Impact Assessment will evaluate the costs and benefits of mandatory HHS for domestic and smaller non-domestic consumers. We will be seeking evidence of costs and benefits as part of that process. Do you have initial views on the costs and/or benefits? If so, please provide these with your supporting evidence.

Below is an extensive, though not necessarily exhaustive, list of costs and benefits broken down by category. These do not just apply to Centrica but to the wider industry as well:

Supplier costs

- Proactive messaging from suppliers to alleviate any concerns and answer questions from customers around what HHS means for them.
- A training cost to customer service agents to deal with queries relating to what HHS means to customers. This will also be an ongoing cost as it will impact the average call length.
 - The costs of marketing half-hourly tariffs will be a commercial decision for suppliers. But if the business case includes the benefits that these tariffs will deliver, then the marketing and customer communication costs for supplier should be included in the business case.
- Changes to the billing engine to handle half-hourly data and pricing. We understand that most suppliers operate on an SAP system. SAP is not designed to scale up to handle the levels of half-hourly data that mandatory HHS would entail, so additional third party systems will be required to interface with SAP.
- The pricing of offers for customers will need to become more sophisticated to process a customer's half-hourly data. We could then use this data to come back to the customer with the best offer for them.
- Suppliers are currently implementing a very large amount of change and a new programme for mandatory HHS may lead to increased costs for ongoing

¹ Paragraph 1.6 of the consultation document.

programmes. This increased cost will be due to managing many large scale industry programmes simultaneously using shared resources.

Supplier benefits

- More accurate cost reflectivity should drive greater competition between suppliers by incentivising suppliers to offer more cost-reflective tariffs to customers. This benefit will be limited to a subset of customers as only customers who can benefit from cost-reflective tariffs will take advantage of them.
- Supplier access to actual half-hourly data is likely to make supplier forecasting more accurate in the long run. Suppliers are likely to have varying levels of sophistication when it comes to forecasting. Therefore some suppliers may incur an upfront and ongoing cost in setting up and maintaining a monitoring capability to predict when there will be consumption spikes and falls. This is different to today where profiling smoothes these peaks and troughs in domestic and small business consumption.

Central system costs

- Changes to Elexon's systems to handle HHS data. We understand that Elexon is currently going through a re-procurement of their systems so the counterfactual would be a like for like system replacement versus a system able to handle a massive increase in the number of reads it has to process.
- The increase in costs to suppliers and other affected parties, including supplier agents, of greater data travelling through Electralink's data transfer network.
- The cost of changing the current profiling regime in line with a future where there will be less need for profiling / frozen profiles.
- Costs incurred by the DCC. We understand the DCC is scaled up to handle this volume of data but will incur testing costs, both for suppliers and communication service providers, and some implementation costs.

Central system benefit

- Elexon will no longer need to procure a Profile Administrator (PrA) service. Or the PrA role will be greatly reduced. This cost savings will be passed back to customers via suppliers.

Supplier agent costs

- There will be costs to supplier agents to qualify to handle half-hourly read meters and the increased costs of processing and sending this data to suppliers. This cost will be passed through to customers via suppliers.
- The move to mandatory HHS for PC 5-8 CBA (P272) assumed that economies of scale would reduce the costs of supplier agents significantly. This has not been seen by Centrica, we have noted very little reduction in supplier agent costs. Therefore any assumptions around supplier costs should draw from this real world example.

Network cost

- DNOs will incur change costs to manage any HH data they receive, this is likely to include changes to how they send, receive and process HH data.

Other costs

- Some customers may experience the inconvenience of shifting load to save on costs, which may have an impact on their lifestyle. E.g. they will not be able to use television, microwave, dishwasher or washing machine at the most convenient time. This cost only needs to be factored in if all customers move to cost-reflective tariffs, or the cost of remaining on a flat rate tariff becomes too high for most consumers.
- Many of the costs identified are subject to when the changes will be implemented. This is an important variable that should be included in the CBA. For example it is likely to be cheaper to implement mandatory HHS once the smart metering rollout is complete. This is because there will be less strain on industry resources from other major programmes and it will be easier to manage the transition if most customers are HH metered.

Other benefits

- Half-hourly settlement will enable customers to have access to dynamic time of use tariffs. For some customers, this will have been already enabled by elective HHS. Any benefit must be shown to be additional to those benefits facilitated by elective HHS and what is referred to as 'chunking' – the use of time pattern regimes and standard settlement configurations to approximate a proportion of the benefits of HHS.

Distributional impacts

We welcome Ofgem's initiation of distributional analysis, as it will highlight the types of customers who are colloquially referred to as 'winners and losers'. When carrying out this analysis it will be important to separate out customers who do not want to shift load from those who cannot shift load.

The 'will not switch' customers are making an active choice, while the 'cannot switch' customers may feel unfairly penalised. If the cannot switch group contains many vulnerable customers, then this would be a significant concern.

We have no evidence to suggest there is a higher chance of a vulnerable customers being unable to shift load, but it is a concern that the distributional analysis should either confirm or disprove.

It is also important that the concept of a level playing field is adhered to. There would be a detrimental impact to competition if certain types of customers were favoured, thus leading to some suppliers having a financial and commercial advantage over others.

Question 3.1: Do you think we have identified the necessary reforms? Are there other reforms that should be listed? If so, what are they and how would they fit in the proposed plan?

We agree that the table in the consultation document contains most of the necessary changes to enable HHS reform.

We would expand on the following points:

Data access

Ofgem has identified this as an issue. We agree that any solution needs to find a balance between consumer protection and enabling HHS. However, it's likely that the full benefits of HHS cannot be offered to all customers without enabling access to HH customer data first. This is likely to be a legally contentious issue and we would encourage Ofgem to hold a separate workshop on data access.

The supplier benefits of greater forecasting and cost-reflective customer offers would be negated if suppliers did not have access to HH data for forecasting and pricing purposes.

Transition to HHS

The table does not acknowledge that transition may require parallel running of old and new settlement systems. Parallel running is likely to add cost and complexity to the solution and we consider that a key aim of any settlement reform should be to avoid parallel running as much as possible.

It is unclear how a transition to mandatory HHS will be managed if there is significant elective HHS take up. Is there a point at where elective HHS becomes significant enough that all remaining customers are mandatorily transferred to HHS? And at what level of penetration does this arise?

Customer engagement is key and it is unclear whether there will be centralised messaging from Ofgem or consumer organisations to inform customers as to how HHS will impact them. Or will this be largely left to suppliers who offer HHS enabled tariffs to manage these conversations.

Wider reform impacts

The table looks at the settlement process but not at the wider issues such as the offering of demand side response tariffs facilitated by HHS. While customer offers may not be part of the settlement reform programme, if the benefits case of HHS reform is predicated on new offers coming to market, it must be considered within this table of industry changes.

Ofgem has noted that the rollout of smart meters will ensure most people have the capability of being HH settled. But the true customer benefit of HHS is when propositions enabled by HHS become available to customers.

In our view we are not seeing demand for dynamic propositions yet largely because large moveable loads like electric vehicles and home automation are still limited to a small percentage of households. It is only when most customers have the technology in place, will they be in a place to take advantage of HHS enabled propositions.

As Ofgem are aware, the European Clean Energy Package published by the EU commission is asking for all member states to have a 15 minute settlement period by 2025. It would be useful to understand how Ofgem views this interacting with Ofgem's programme for settlement reform.

Question 3.2: What industry expertise is needed to deliver these reforms in the timetable we have given?

Suppliers have settlement teams and their expertise will prove invaluable in delivering future proof settlement reform. By consulting with experts within supply businesses, it will ensure that the business case and impact assessment for settlement reform is as robust as possible. And any subsequent reform minimises system impacts, therefore delivering a solution to end consumers at the lowest cost possible.

We also have marketing and customer experience experts who can highlight the likelihood of customer demand for products facilitated by HHS in the near future.

Industry experience from the provision of HHS to profile classes (PC) 5-8 and from facilitating elective HHS will also help inform Ofgem's decisions and cost-benefit analysis on mandatory HHS.

Both elective HHS and HHS for PC 5-8 may be seen as 'real world trials' on the impact of introducing HHS to a large number of customers. The costs and benefits of mandatory HHS for PC 1-4 should be based on these previous experiences.

Question 3.3: How much expertise and time can your organisation provide? How does this interact with other Ofgem initiatives?

The introduction of mandatory HHS will be a major programme of work. We envisage that it will require as much industry participation as the faster and more reliable switching programme.

This will require significant resource commitment from Centrica and other key industry participants. However, we see this as a key area of industry development and are willing to commit sufficient resources to help Ofgem manage this programme to deliver the best outcome for consumers.

Secondment of an industry expert into Ofgem could be one way of helping Ofgem manage settlement reform. If Ofgem considers this a viable approach we would be happy to have further discussions on the possibility of a secondment.

Question 3.4: What are the key risks and constraints to delivering to the timetable outlined?

An evidence based decision by early 2018 does not seem feasible.

Our experience from the Ofgem led switching programme (FMRS) has shown it takes approximately a year to design the new process. We consider HHS reform to be as complex as FMRS and therefore it is reasonable to assume the design of the new HHS reform process will not be completed until 2018.

The consultation document also proposes that changes be made to central systems to facilitate mandatory HHS by early 2018. It is not clear to us how any changes can be made to central systems without first having carried out the detailed design work. This would mean that central systems changes could not be initiated until early 2018 at the earliest.

We are currently in a period of unprecedented levels of industry change. Ongoing programmes include: smart metering rollout, implementation of CMA remedies, Project Nexus, and faster and more reliable switching. The scope of transformational change in progress means that industry change capacity is already being tested. To add further workload to this change plan may not be possible

Any changes to central systems will need to be impact assessed by industry parties as they will inevitably impact them. Our own systems are struggling with the capacity to change, and these will be further strained by additional change.

It would be useful for us to understand why Ofgem is working towards a decision by early 2018.

In our experience of being involved in many energy industry projects and large internal programmes, working back from a fixed date often leads to rushed decisions and inefficiencies in design due to insufficient time for rigorous analysis.

Our key concern is that there will be additional pressures will be placed upon our own and central systems to meet what appears to be an arbitrary deadline.

Question 3.5: Do you agree with the dependencies in Figure 1? If not, please explain what changes you suggest and why.

Our major concern with the dependencies in figure 1 is the lack of clarity when it comes to consulting on proposals.

The diagram implies that there will be no formal consultation on the final TOM, business case and impact assessment before Ofgem makes a decision.

Considering that there will be further policy changes on network charging and the settlement process after the draft impact assessment, this suggests changes to policy will be made without industry consultation.

As part of due process and the principles of better regulation, all major decisions and documents supporting this decision should be publically consulted on with sufficient time for industry parties to raise any concerns.

Question 3.6: What are the barriers to making changes to central systems and industry rules by the first half of 2018?

We do not believe that first half of 2018 allows sufficient time to make an evidence based decision.

We have set out reasons for this in our answer to question 3.4.

Question 3.7: Do you have any other comments on the proposed plan?

We do not agree with the CMA's view that elective HHS is unlikely to be an effective substitute for mandatory HHS.

If the tariffs that are launched due to elective HHS are popular then we could see a large migration of customers to elective HHS. This could incentivise suppliers to seek out those customers who most stand to benefit from being electively HH settled.

A large increase in the numbers of customers on elective HHS could then make the case to migrate all remaining customers to HHS in a mandatory regime. This will ensure cost-reflective charges pass through to end consumers.

While a low take up of elective HHS among customers could suggest that the market is not ready for the types of tariffs that will be enabled by HHS.

Centrica's view is that elective HHS is a stage gate that enables innovative tariffs to emerge, but also acts as an indicator as to whether the market is ready for mandatory HHS.

Therefore elective HHS should be given sufficient time to lead to new customer propositions. Only once a market for HHS enabled propositions emerge, can the industry then give serious consideration as to whether mandatory HHS should be the next step.

Question 4.1: Do you agree with the conclusions of the ESEG and the PSRG? Do you think anything has changed since they considered these issues?

We agree with the conclusions of ESEG and PSRG.

Question 4.2 (Roles and Responsibilities): Do you agree with the scope of issues identified in this section? Are there any others we should be considering?

We agree with the scope of this section.

Question 4.3 (Settlement Process): Do you agree with the scope of issues identified in this section? Are there any others we should be considering?

We agree with the scope of this section.

Question 4.4 (Policy Enablers): Do you agree with the scope of issues identified in this section? Are there any others we should be considering?

We agree with the scope of this section.

Question 4.5 (Consumer Issues): Do you agree with the scope of issues identified in this section? Are there any others we should be considering?

This section explores consumer protection, but does not cover consumer demand.

It is customer demand for innovative tariffs that will drive the need for mandatory HHS. So it is important that customer demand is understood first before we migrate the entire market to HHS.

In our view we are not seeing demand for dynamic propositions yet largely because large moveable loads like electric vehicles and home automation are still limited to a small percentage of households. It is only when most customers have the technology in place, will they be in a place to take advantage of HHS enabled propositions.

This will include how likely it is that new propositions will come to market once mandatory HHS is in place. Data on customer demand may be obtained from suppliers own research and the uptake of HHS enabled propositions by customers in profile classes 5-8 and once elective HHS is in place.

Question 5.1: What is the best way for us to use the expertise of stakeholders? What have you found helpful in the past?

We would like to remain as engaged as possible in this work programme, including bilateral meetings and a series of workshops to design the new settlement process.

The FMRS programme has a governance structure that could be co-opted, with multiple work streams to tackle the big policy issues and the detailed design.

There are also lessons to be learned from FMRS in terms of greater transparency and consultation on decision making, and allowing for greater consultation with industry. It is important that any complex decisions that require multiple discussions should be given the time needed to reach a cost-effective solution that has considered all the pros and cons.