



Making a positive difference
for energy consumers

Electricity supply licence holders,
electricity distribution licence
holders, code panels, code
administrators, industry bodies,
metering agents, consumers and
their representatives, and other
interested parties

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Date: 24 July 2017

Dear Colleague,

Electricity Settlement Reform Significant Code Review: Launch Statement, revised timetable, and request for applications for membership of the Target Operating Model Design Working Group.

This statement launches the Electricity Settlement Reform Significant Code Review (SCR) and sets out our revised timetable following our consultation on the plan for mandatory half-hourly settlement (HHS) in November 2016. In doing so, it:

- Responds to our November 2016 consultation, and summarises the feedback we received (in Appendix 1).
- Launches the SCR for mandatory HHS of domestic and smaller non-domestic consumers, setting out how we intend to progress with this and the options we are considering to both undertake and complete the process. We would like your feedback on our preferred option for the SCR process.
- Sets out our proposed model for the Design Working Group (DWG) to develop the Target Operating Model (TOM) and the governance structure that we intend to use for decision-making. We are seeking feedback on this model, which has ELEXON leading the working group to provide recommendations to an Ofgem-led Design Advisory Board (DAB), which will advise us on our decisions. We are interested in hearing from you if you would like to take part in the DWG and are seeking applications for membership.

Alongside this SCR Launch Statement, we have also published analysis we commissioned on the distributional impacts of time of use tariffs.

There is a form provided alongside this Launch Statement for stakeholders to provide their feedback on the form of SCR that we propose to use, the model for governance of the DWG and the design principles that will be used to guide our decision-making on products developed by the DWG. We welcome your views on these areas. Please send a completed form to HalfHourlySettlement@ofgem.gov.uk by 1 September 2017.

We would also like to invite interested parties to apply to be a member of the DWG. Please send your CV and a supporting statement to HalfHourlySettlement@ofgem.gov.uk by 1 September 2017. Information on how to apply and the skills and experience we are looking for from members is in Appendix 2.

Background

The need for change

Settlement reconciles differences between a supplier's contractual purchases of electricity and the demand (energy use or production) of its customers. Currently, most domestic and smaller non-domestic customers' usage is settled on a 'non half-hourly' basis, as they do not have meters that can record consumption in each half-hour period. These customers are settled using estimates of when they use electricity, based on a profile of the average consumer (within a given Profile Class).

Smart and advanced meters can record a customer's usage during each half hour period, enabling HHS, where suppliers' contractual purchases of electricity are reconciled against their customers' actual usage during each half hour. HHS will expose suppliers to the true cost of their customers' usage and incentivise them to take steps to help their customers move their consumption to times of the day when electricity is cheaper to generate and transport eg by offering smart tariffs and other innovative products. This will build on the platform provided by smart metering to enable a smarter, more flexible energy system¹ that lowers bills, reduces carbon emissions and enhances security of supply.

HHS is expected to:

- promote innovation and competition in the energy market and give consumers the opportunity to make savings on their energy bills, eg by paving the way for suppliers to provide and encourage take-up of time of use and other types of smart tariffs;
- help create the right environment for more demand-side response, leading to a more efficient and secure energy system;
- help suppliers forecast demand more accurately, strengthening competition and reducing costs; and
- make the settlement process faster and more efficient, reducing barriers to entry to the energy market.

HHS for medium to large non-domestic consumers has already been introduced through the Balancing and Settlement Code modification P272².

Our first step towards HHS for domestic and smaller non-domestic consumers was to remove barriers to cost-effective HHS on an elective basis. Following our conclusions paper in May 2016 on barriers to elective HHS, a series of eight industry-led code changes were developed and decided upon³. Among other changes, these: introduced new processes for processing half-hourly data from smart meters (and associated data flows), introduced new Change of Measurement Class processes, and prevented overcharging for transmission charges in the year a consumer moves to HHS. These changes were all implemented into industry systems by the end of June 2017. This successful outcome involved significant work by ELEXON and other code administrators.

We see elective HHS as an important first step to encourage a market-led approach to HHS, facilitating innovation by early movers and providing real-world experience to inform further work. We expect that we will need to mandate all suppliers to settle their customers

¹ In July 2017, Ofgem and the government (Department of Business, Energy and Industrial Strategy (BEIS)) published 'Upgrading our Energy System – smart systems and flexibility plan': <https://www.ofgem.gov.uk/publications-and-updates/upgrading-our-energy-system-smart-systems-and-flexibility-plan>

² <https://www.ofgem.gov.uk/publications-and-updates/balancing-and-settlement-code-bsc-p272-mandatory-half-hourly-settlement-profile-classes-5-8>

³ For a list of the changes included in the elective package, see our elective HHS tracker: https://www.ofgem.gov.uk/system/files/docs/2017/03/elective_hhs_-_tracker_for_website.pdf

on a half-hourly basis to realise the full benefits by exposing suppliers to the true cost of supplying their customers in every half-hour period.

Our work on mandatory HHS to date

We originally consulted through our Draft Forward Work Programme for 2016-17⁴ on our intention to launch a SCR on mandatory HHS for all consumers. The final 2016-17 Forward Work Programme⁵ stated that we would announce our decision on the SCR in spring 2016. We noted that we would also take full account of any conclusions from the Competition and Markets Authority's final report from their energy market investigation⁶ when planning and delivering mandatory HHS.

In June 2016⁷, we stated our intention to launch a SCR to progress mandatory HHS, once the work involved had been thoroughly planned and scoped. There was broad support from stakeholders for doing so, but we recognised that mandatory HHS would be a significant undertaking, requiring us to first complete work on elective HHS, with a transition to mandatory HHS over time.

In November 2016, we consulted⁸ on our intended plan for the SCR, seeking stakeholder views on our proposed approach and timetable. We outlined the steps needed to reach a decision on mandatory HHS and arrangements for implementation, and these key products that will need to be developed:

- a TOM, outlining how the settlement arrangements and supporting institutions will deliver mandatory HHS;
- a business case, based on the Treasury's Five Case Model⁹, setting out the strategic rationale for reform alongside how to ensure the right incentives are in place to design, finance and successfully implement mandatory HHS; and
- an impact assessment, including analysis of the distributional impacts of mandatory HHS. The impact assessment represents the 'economic case' in the Treasury's Five Case Model.

The feedback we have received through this consultation has informed our decision on the timetable for the project – see below. We have summarised stakeholders' views on our November consultation in Appendix 1C.

Significant Code Review

Approach

Through this SCR, we aim to develop and then (subject to an Impact Assessment, as part of the Business Case) implement an enduring process to enable HHS of domestic and smaller non-domestic consumers' electricity usage. We aim to deliver benefits for consumers by maximising the opportunities smart metering provides in enabling a smart, flexible energy system.

⁴ See consultation and responses here: <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

⁶ The CMA's Final Report and associated documents appear on the CMA website here: <https://www.gov.uk/cma-cases/energy-market-investigation>

⁷ Our open letter on our intention to launch an SCR is on our website here: <https://www.ofgem.gov.uk/publications-and-updates/open-letter-mandatory-half-hourly-settlement-intention-launch-significant-code-review>

⁸ Our November 2016 consultation is on our website here: <https://www.ofgem.gov.uk/publications-and-updates/consultation-mandatory-half-hourly-settlement-aims-and-timetable-reform>

⁹ The Five Case Model is a methodology for producing business cases for spending proposals. See Green Book guidance: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/469317/green_book_guidance_public_sector_business_cases_2015_update.pdf

While the SCR is ongoing, any new code modifications raised and dealing with similar subject matter may be exempted by us from the review, or may be subsumed into it by us because they fall within scope.

We have discretion to allow such new code modifications, even if within scope, to continue, for example where proposed changes are urgent. Code modifications in progress before the start of the SCR may be suspended until the SCR is complete, on the proposer's request and with the relevant code panel's agreement.

We propose to run the SCR as an end-to-end process led by us, with the design of the arrangements developed through a TOM.

As the code administrator for the Balancing and Settlement Code, which is likely to be the code most affected by mandatory HHS, we propose ELEXON lead the TOM work, guided by design principles (see Appendix 2B), and drawing on industry and stakeholder expertise from the DWG and wider engagement to develop and recommend a model to us to approve. Decisions and overall oversight of the development of the TOM will remain with us (see pages 6-8 for details about our proposed governance approach), as will the policy framework for HHS.

We will work with stakeholders as we develop our policy positions, for example on access to half-hourly data and whether or not to centralise functions currently performed by supplier agents. We will work with BEIS on policy related to the settlement of export. We will also continue to build the business case for mandatory HHS. This will be developed iteratively and refined over time as the direction of policy becomes clearer and the TOM is developed.

Timetable

Delivering the TOM and Business Case to support a final decision on mandatory HHS will be a major undertaking, and will require engagement from industry and other stakeholders to succeed. Our November 2016 consultation asked for stakeholder views on the timetable we had set out for this project in December 2015, which had envisaged a decision on mandatory HHS with the central systems in place to facilitate it by the first half of 2018.

Respondents were concerned with this timetable. They said it would be challenging to run (and then implement) several large change projects concurrently alongside business as usual, and highlighted the resource constraints this imposes on industry. They also stressed the need to learn from delivering other large change projects, such as Project Nexus¹⁰, in setting a realistic timetable that can be adhered to. Respondents suggested that the timetable should also take into account the potential for learning from elective HHS and P272 as mandatory HHS progresses.

We have developed a timetable for the project that is robust and fits with other concurrent industry change, taking into account feedback from stakeholders and lessons we have learned from other programmes. We envisage that the decision on if, when, and how to implement mandatory HHS (subject to an Impact Assessment, as part of the Business Case) should be taken **by the second half of 2019**, supported by the final TOM and Full Business Case. This will be preceded by an Outline Business Case in mid-2018, informed by stage 1 of the development of the TOM.

The steps in this timetable are outlined in Appendix 1A, showing the products that will need developing to enable us to reach a final decision on mandatory HHS by the second half of 2019. This will begin with a voluntary request for information to inform the Business Case over the summer, and the DWG for the TOM to start after the summer. The timetable will

¹⁰ <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/project-nexus>

be kept under review depending on the development of the TOM and the policy decisions that are taken.

This decision point will determine if, when and how mandatory HHS moves forward into delivery phase. This phase would begin with code modifications and rule changes to implement the conclusions of the design work, requiring cross-code coordination to deliver the necessary code changes. Changes would then be made to ELEXON's central systems, suppliers' own systems and systems of any other relevant parties, as well as the processes for transfer of data to manage the changes brought about by mandatory HHS. Moving consumers over to HHS would follow this, with the arrangements for this transition to be developed over time as the design work progresses and to be set out fully in the final TOM and Business Case.

Scope

In our November 2016 consultation, we set out the expected scope of issues to be considered through the SCR, the codes that we expect will be affected, the entity responsible for designing and approving interventions, and a timetable for the SCR.

We have carefully considered responses to this consultation in refining the scope. We considered the previous work done by our Electricity Settlement Expert Group¹¹, by the industry led Settlement Reform Advisory Group¹² and by the industry-led Profiling and Settlement Review Group¹³. Several consultation respondents highlighted that HHS of remaining non-half-hourly unmetered supplies¹⁴ should be included in scope of the SCR, given the potential benefits to settlement performance of reducing the amount of inaccurate data processed at each settlement run.

We therefore propose that HHS of remaining non-half-hourly unmetered supplies be included in the scope of the design of the TOM. The revised scope of the SCR is set out in Appendix 1D, with this one addition.

Process options

Our preferred way forward is for us to lead an end-to-end SCR process (Option 3), but this is not the only option.

Following changes resulting from our Code Governance Review (Phase 3), there are three options for us to complete an SCR¹⁵. These are (see also the process diagram in Appendix 1E):

¹¹ We established the Electricity Settlement Expert Group in 2014 to consider a wider range of settlement issues that are discussed further in this Launch Statement. More information appears on our website here: <https://www.ofgem.gov.uk/electricity/retail-market/forums-seminars-and-working-groups/electricity-settlement-expert-group>

¹² The Settlement Reform Advisory Group was established by the Balancing and Settlement Code Panel with the main objective of identify short-term settlement changes to better facilitate elective HHS for smaller energy usage customers. The Settlement Reform Advisory Group has also investigated the impact of embedded generation on settlement. The Settlement Reform Advisory Group delivered a report to the Balancing and Settlement Code Panel on February 2016 and this fed into the Electricity Settlement Expert Group work. More information is on ELEXON's website: <https://www.elexon.co.uk/group/settlement-advisory-reform-group-srag/>.

¹³ The Profiling and Settlement Review Group was a sub-group of the Supplier Volume Allocation Group from 2010-15 and reported to the Supplier Volume Allocation Group about a number of potential settlement improvements, including HHS and to the Balancing and Settlement Code Panel about maintaining the integrity of the settlement arrangements in the short to medium term as smart meters are rolled out. More information is on ELEXON's website: <https://www.elexon.co.uk/wp-content/uploads/2012/01/Profile-Class-1-4-HH-Settlement-Final-Report-v1-0.pdf>

¹⁴ For more information on unmetered supplies, see ELEXON's website: <https://www.elexon.co.uk/reference/technical-operations/unmetered-supplies/>

¹⁵ See the updated guidance on the SCR process (June 2016) on our website here: <https://www.ofgem.gov.uk/publications-and-updates/ofgem-guidance-launch-and-conduct-significant-code-reviews>

- **Option 1: Ofgem directs a relevant licensee(s) to raise modification proposal(s)** following the end of the SCR phase. We set out principles or specific directions to the licensee to develop code change(s) using standard industry processes;
- **Option 2: Ofgem raises a modification proposal(s)** following the end of the SCR phase. The proposal(s) would be based on our SCR conclusions, with the modification(s) developed using standard industry processes;
- **Option 3: Ofgem leads an end-to-end SCR process** concluding with our decisions on code modification(s) developed towards the end of that process. There would be no separate SCR phase (conclusions and directions). We would run the process of consultation and industry engagement to develop appropriate code change(s) using workgroups ourselves, or choose to use standard industry processes.

Delivering mandatory HHS will result in significant cross-code changes and may have licence impacts too. Managing these changes coherently and consistently will require an end-to-end process, from design of the revised settlement processes through to implementation. This is why **Option 3 is our preferred way forward**.

Option 3 allows us to act flexibly in managing the process while retaining overall strategic oversight and control. It gives us the option, for example, to choose whether to delegate certain tasks to another party such as ELEXON to ensure successful delivery of reform.

Do you agree with our preferred option? Please send us your comments by 1 September 2017, using the feedback form provided alongside this launch statement. We will consider these comments and publish a decision on our intended approach¹⁶ on our website.

Communication and consultation

We will seek stakeholders' input to inform the development of the TOM and Business Case, as well as to gather evidence for policy issues and assess consumer impacts. This begins with your feedback to the questions we ask in this letter about the SCR format and the set up and governance of the working group. We will also shortly issue an initial voluntary request for information to build evidence on costs of mandatory HHS to inform the Business Case.

The table in Appendix 1B sets out our current plans for consultation with stakeholders and engagement opportunities. These include periods of evidence gathering that will involve various engagement methods such as bilateral meetings and workshops as appropriate. These milestones are our best estimate based on the information we currently have, but may change over time based on the policy and design decisions that are made and the impact of any unforeseen external factors.

TOM design

Governance and decision-making

We are proposing that ELEXON lead the design work on the TOM, subject to establishing a suitable governance model following feedback to this Launch Statement (see question on

¹⁶ We are considering reform of code governance resulting from the Competition and Markets Authority's Final Report on the energy market investigation through a wider project on code governance ([see our most recent consultation here: \[https://www.ofgem.gov.uk/publications-and-updates/industry-code-governance-initial-consultation-implementing-competition-and-markets-authority-s-recommendations\]](https://www.ofgem.gov.uk/publications-and-updates/industry-code-governance-initial-consultation-implementing-competition-and-markets-authority-s-recommendations)). Depending on when future reform to code governance is implemented, we may decide to change how this SCR process concludes. We will consider whether delegating delivery to others provides a more balanced use of resources between ourselves and industry that allows the efficient delivery of major reform.

page 8). This will include facilitating and chairing a working group of technical experts (the DWG) that will deliver TOM options and recommendations to Ofgem. ELEXON will provide analysis to the DWG and run its administrative side. ELEXON will be responsible for engaging with a wider set of stakeholders not included in the DWG, and securing their input into the development of the TOM. We consider ELEXON is well placed to take on this role because:

- ELEXON is the code administrator for the Balancing and Settlement Code, which will change significantly through the delivery of mandatory HHS. ELEXON's expertise on electricity settlement will provide critical input to deliver any code changes needed as a result of mandatory HHS.
- ELEXON has expertise in delivering code changes, and in chairing and supporting work on these changes with industry participation¹⁷. It has already contributed to thinking on future settlement arrangements, for example through chairing and administering the work of the Profiling and Settlement Review Group, and the Settlement Reform Advisory Group.
- ELEXON is required, along with other code administrators, to adhere to the principles of the Code Administrator Code of Practice, including to ensure efficient cross-code coordination of changes across multiple codes¹⁸. Mandatory HHS is likely to result in significant cross-code changes which ELEXON will have a key role in delivering.

The Competition and Markets Authority's energy market investigation recommended we consider further code governance changes to ensure efficient and timely delivery of major industry reform. These remedies will require the industry to deliver the strategic reforms that Ofgem identifies as beneficial to consumers and competition. Our approach to mandatory HHS is therefore consistent with the direction of travel of the code governance remedies¹⁹ and appropriate given the breadth and complexity of the issues involved in designing the TOM for mandatory HHS.

The DWG will develop options and recommendations for design of the TOM, which will be escalated to Ofgem for our decision. Overall regulatory oversight of the TOM will remain with us. We will regularly review products and work closely with ELEXON and stakeholders in the detailed design work for the TOM throughout the design process, participating in and attending the working group. The Ofgem Senior Responsible Owner will make the final decision on the TOM in light of recommendations from the working group.

Strategic advice on the products delivered by the working group will be provided to the Ofgem Senior Responsible Owner by two governance boards:

- The Design Advisory Board (DAB) will consider, test and evaluate technical recommendations produced by the working group. Ofgem will select members to represent industry, consumer representatives, academia and Government. Further details on this board are in Appendix 2D.
- The Ofgem TOM Board will oversee the design work within Ofgem to ensure technical recommendations from the working group align with the strategic outcomes and objectives of the HHS project and other Ofgem projects.

¹⁷ We recently published the results of a cross-code survey on code administrators' performance. Survey results are available at: <https://www.ofgem.gov.uk/publications-and-updates/code-administrators-performance-survey-findings>

¹⁸ Further information on the Code Administration Code of Practice is available at: <https://www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-administration-code-practice-cacop>

¹⁹ More information on implementing the Competition and Markets Authority's recommendations for industry code governance is set out in our November 2016 consultation: <https://www.ofgem.gov.uk/publications-and-updates/industry-code-governance-initial-consultation-implementing-competition-and-markets-authority-s-recommendations>

Both boards will assess options and recommendations from the working group against a set of design principles (see Appendix 2B), which outline our expectations for the outcomes that the design work should achieve. These principles will ensure the strategic fit of products coming out of the DWG, and will focus decision makers on building forward-looking settlement arrangements for the future electricity market.

The Boards will also assess options and recommendations from the DWG against the objectives²⁰ for the project as a whole, which have been developed as part of our work on the Business Case. These set out our expected outcomes for the mandatory HHS project, as follows:

- incentivise all retailers and suppliers (current and future) to encourage customer behaviour in their future electricity demand that contributes to a more cost-effective electricity system;
- promote the efficient use of, and investment in, energy infrastructure that delivers on government objectives of a flexible, safe and secure low-carbon electricity system; and
- minimise undesirable distributional effects on consumers.

The two Boards will then advise the Ofgem Senior Responsible Owner, who will have final responsibility for taking decisions on the working group's recommendations. More detail on this governance model is set out in Appendix 2A.

We welcome your views on this governance model and on the design principles in Appendix 2 by 1 September 2017, using the form provided alongside this Launch Statement.

The provision of options and recommendations to the Ofgem Senior Responsible Owner, alongside strategic advice from both boards, will provide an appropriate balance between industry-led development of HHS arrangements and Ofgem oversight. This will ensure the final TOM is delivered without us directly undertaking the design work, but preserves our ability to retain effective broader oversight of the process and interactions with other work.

We will retain policy development and decisions on access to half-hourly data, consumer protection and whether or not to centralise functions currently performed by supplier agents. Work on these areas will not be delegated to the DWG, but we expect the group to integrate our policy decisions in these areas into their design work. There is a reciprocal relationship between these policy decisions, the Business Case and TOM work, so all three will progress iteratively.

Design Working Group membership

We would like to hear from you if you want to be a member of the DWG. Members are expected to participate constructively in the development of an enduring process for HHS to maximise the opportunities smart metering provides in enabling a smart, flexible energy system.

Members should possess expert knowledge or experience in one or more of the following areas:

- settlement arrangements;
- development and delivery of settlement reforms;

²⁰ In the Treasury Five Case Model for business cases, the Spending Objectives form a key element of the 'case for change' by describing the expected outcomes of the project. Further information can be found in the Green Book supplementary guidance on delivering public value from spending proposals: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/469317/green_book_guidance_public_sector_business_cases_2015_update.pdf

- regulatory and commercial arrangements and processes which interact with, or may be affected by, the settlement process;
- consumer issues;
- innovation and technology that might influence or be enabled by HHS.

The draft Terms of Reference for the DWG are set out in Appendix 2C, with the intention that these will be finalised in the first DWG meeting. If you become a member, you will be required to attend each meeting over the period outlined. We currently envisage one meeting every one to two months starting in October 2017. ELEXON will publish a forward work plan and all key documents from the DWG on its website so that all stakeholders, whether attending the group or not, can participate in this SCR. We have published ELEXON's initial forward work plan for the working group alongside this Launch Statement.

If you are interested in becoming a member of the working group, please email your CV and a supporting statement to HalfHourlySettlement@ofgem.gov.uk by 1 September 2017. Information on how to apply and the skills and experience we are looking for from members is in Appendix 2.

We will review all expressions of interest with the ELEXON Chair of the DWG to ensure there is an appropriate and broad range of expertise and interests on the group. We will formally and publically confirm membership in advance of the first meeting of the DWG. We may also invite specific people to participate on an ad hoc basis if there is a requirement for particular expertise.

Attending the DWG is not the only way to participate. Consultation will take place at key stages as the TOM develops and we will maintain regular contact with stakeholders throughout the duration of the TOM design work. To do the latter, we will maintain a list of interested stakeholders and regularly engage with them through a range of communication channels such as monthly teleconference calls, newsletters and where requested, individual stakeholder meetings.

If you would like to be added to the list of interested stakeholders, please email HalfHourlySettlement@ofgem.gov.uk.

Next steps

We are seeking your feedback on specific questions related to the SCR process, our model for governance of the DWG and the design principles that will be used to guide our decision-making on products developed by the DWG, using the form provided alongside this Launch Statement. Responses will be published on our website, unless marked as confidential, alongside our decision on these specific questions.

Once we have decided on membership of the DWG, ELEXON will launch this later in the year.

If you have any questions or comments on this letter please contact James.Earl@ofgem.gov.uk or Anna.Stacey@ofgem.gov.uk, or contact the team mailbox at HalfHourlySettlement@ofgem.gov.uk.

Yours sincerely,



Cathryn Scott
Partner, Energy Systems

Appendices

Appendix 1A: Project timeline

Appendix 1B: Opportunities for consultation and engagement

Appendix 1C: Stakeholder feedback from the November 2016 consultation

Appendix 1D: Revised SCR scope

Appendix 1E: SCR process diagram

Appendix 2A: Proposed governance model

Appendix 2B: Target Operating Model design principles

Appendix 2C: Design Working Group Terms of Reference

Appendix 2D: Design Advisory Board Terms of Reference