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Dear Áine,

Response to Ofgem’s open letter ‘Half-hourly settlement (HHS): the way forward’

This submission was prepared by Citizens Advice. Citizens Advice has statutory responsibilities to represent the interests of energy consumers in Great Britain.

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Citizens Advice welcomes the opportunity to respond to this open letter. We recognise the potential benefits of half-hourly settlement (HHS) for smaller sites, which could improve the efficiency of the energy system and lead to lower costs for consumers. However, we also have a number of concerns about the proposals set out by Ofgem, and the impact that they may have on consumers.

We examined the consumer impact of Demand Side Response (DSR), and in particular non-traditional Time of Use (ToU) tariffs, in our report, *Take a Walk on the Demand Side*.¹ It contained recommendations for both Ofgem and industry, to ensure that changes to enable DSR work for consumers. These form the basis of our considerations in relation to the introduction of elective HHS, although we have also set out some concerns related to the proposed timeline and process for moving to mandatory HHS.

An accessible market

Our research emphasised the need for clear information to enable consumers to understand ToU tariffs, and to meaningfully compare these with other ToU and non-ToU tariffs. We understand that Ofgem’s planned work on the application of the Tariff Comparison Rate and Tariff Information Label for ToU tariffs has been

¹ Citizens Advice (2014) available at https://www.citizensadvice.org.uk/Global/Migrated_Documents/corporate/take-a-walk-on-the-demand-side-final-2.pdf

delayed pending the final remedies proposed by the CMA.² Nonetheless, we believe that work on information provision will need to be completed before non-traditional ToU tariffs become widely available to consumers, in order to ensure that consumers are able to understand these tariffs, including what action they would need to take, and at what times, to shift their load and reduce their bills.

New tools will also be needed to help consumers determine whether these emerging tariffs are suitable for them. Ofgem should work with price comparison sites and other information providers to ensure that these can be developed. In addition, changes to the Confidence Code may need to be considered, as this does not currently require price comparison sites to provide comparisons for non-traditional ToU tariffs. To achieve these aims suppliers will need to share detailed information on their time bands for different tariffs, both with consumers and price comparison sites.

Even if tariffs are easy to understand and compare, the emergence of a multitude of ToU tariffs with different characteristics could introduce excessive complexity for consumers. The introduction of elective HHS should learn the lessons from the past, to avoid the problems of confusing marketing and tariff proliferation. An agreement between industry parties and Ofgem on the principles by which non-traditional tariffs will be designed in the elective HHS period would help consumers navigate these new products more easily.

The introduction of smart meters and non-traditional ToU tariffs will fundamentally change the way that most consumers interact with the market. In addition to suppliers providing clear information to consumers, DECC and industry should consider whether a broader communications strategy may be required. Citizens Advice is concerned that there is the potential for confusion and fear around mandatory ToU tariffs. This could result in an unintended, negative impact on the smart rollout, with consumers potentially refusing to have a smart meter installed. As the national campaign for the smart meter rollout Smart Energy GB may be well placed to inform consumers about the potential for ToU tariffs.

Monitoring the early consumer experience of these tariffs will be vital to identify best practice and any new forms of consumer detriment. We welcome Ofgem's commitment to use the period of elective HHS to learn about the types of

² Ofgem's draft Forward Work Programme 2016-17, available at https://www.ofgem.gov.uk/sites/default/files/docs/draft_forward_work_programme_2016-17.pdf

non-traditional products suppliers offer and how consumers react to them. Citizens Advice will also monitor the consumer experience during this period to gain an understanding of the consumer experience of emerging tariffs. However, the proposed timeline for settlement reform means that there will be relatively little time to learn these lessons ahead of a final decision on mandatory HHS in early 2018. Further factors, including the time it will take for suppliers to introduce new these tariffs and the relatively small (and not necessarily representative) number of consumers with smart meters who are able to take up these tariffs mean that the decision on whether to proceed with mandatory HHS may have a limited evidence base to draw on. The regulator may need to secure a coordinated programme of research in order to fully understand both the consumer and supplier experience of HHS. Citizens Advice would welcome the opportunity to better understand Ofgem's plans in this area.

Consumer protection

In principle, DSR should lower bills for consumers who change their behaviour (with any reward for load shifting proportional to the costs saved by their changed usage profile) without negative impacts on participating consumers who do not do so. However, this is unlikely to be the effect in practice. For example, in previous ToU trials a large minority of consumers failed to shift their load, and would in fact have seen bill increases if they had not been protected by the conditions of the trial.³ Similarly, our predecessor body Consumer Futures conducted research in 2012 which found that 38% of consumers on traditional ToU tariffs do not get any benefit from them.⁴

New consumer protections will be required to mitigate this risk, by limiting financial liability for consumers who switch to non-traditional ToU tariffs and by ensuring that they are able to switch to other non-ToU tariffs without penalties if they find their bills rise. The limits on liability could take a number of forms, including caps on bill increases or 'shadow billing', whereby consumers are billed on the lower of either a ToU or non-ToU tariff. Given the wider system benefits of DSR, providing these protections should not lead to an overall increase in costs to consumers. Furthermore, such protections will be required to give consumers the confidence to participate in a nascent ToU tariff market.

³ Customer-Led Network Revolution (2014), Progress Report 7, available at <http://www.networkrevolution.co.uk/wp-content/uploads/2014/07/CLNR-Progress-Report-7-New-links-.pdf>

⁴ Consumer Focus (2012) available at <http://webarchive.nationalarchives.gov.uk/20140728011208/http://www.consumerfutures.org.uk/files/2013/07/From-devotees-to-the-disengaged.pdf>

It is also clear that accurate and timely bills will be even more important for consumers on innovative ToU tariffs, to enable them to quickly identify any bill increases and reduce susceptibility to shock bills. We would like to take this opportunity to reiterate our support⁵ for the Smart Billing proposals put forward by Ofgem last year, which would prevent back-billing beyond six months for consumers with smart meters, with this period reduced to three months from 2020 (subject to review). Given the increased risks for consumers with non-traditional ToU tariffs, we consider that a three month period would be appropriate from the outset for these consumers. Consumers should also be provided with easy access to their usage data between billing cycles, and guidance on how to use this information to change their behaviour to reduce future bills.

Any discussion of HHS must also factor in the critical protections provided in supply licence conditions which ensure that consumers retain control over the detail of meter reads their smart meter provides to their energy supplier. While consumer views vary significantly by demography, when they are asked what they want, need and expect from data-driven services two requirements are consistently raised: transparency and control.⁶ The licence conditions go some way to provide this by providing consumers not only with the protection provided by the need for an explicit opt-in to share half-hourly data but the opportunity to opt-out down to a monthly meter read should they wish. This control has wider benefits in terms of providing consumers with some leverage; energy suppliers or other organisations will have to provide a compelling reason, ideally in the form of additional benefits, for consumers to share more of their data rather than simply receiving detailed data by default.

Distribution of benefits and vulnerable consumers

We welcome Ofgem's commitment to assess the distributional effects of moving to mandatory HHS. We would recommend that this work is prioritised so that these effects are understood ahead of the introduction of elective HHS.

This work should consider that while emerging tariffs may only be adopted by a minority of consumers, there is the potential for their introduction to have wider

⁵ Citizens Advice 'Smart Billing' consultation response available at <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-h-and-consultation-responses/energy-consultation-responses/ofgems-consultation-smart-billing-for-a-smarter-market-our-proposals/>

⁶ Consumer Futures (2014) available at <http://webarchive.nationalarchives.gov.uk/20140728011208/http://www.consumerfutures.org.uk/reports/smart-and-clear-customer-attitudes-to-communicating-rights-and-choices-on-energy-data-privacy-and-access>

impacts, both positive and negative, for the non-participating majority of consumers who are left behind. System cost reductions and other efficiencies may be achieved in the medium to long term, but in the early transitional phase consumers who stand to benefit (in some cases without altering their behaviour at all) will switch to ToU tariffs to lower their bills. Until the efficiency savings from this change are realised, suppliers may seek to increase costs for their non-ToU consumers.

Furthermore, if DSR proves to be valuable to suppliers then they may prioritise their ToU consumers to the detriment of their non-ToU consumers, who could receive a relatively lower standard of customer service, or be offered less attractive deals. These considerations are important as it is clear that a large number of consumers will not receive smart meters until towards the end of the rollout, and a small minority will be unable, or unwilling, to have a smart meter installed.

Consumers in vulnerable circumstances will require particular consideration, to ensure that they are protected from unsuitable tariffs, but also to enable their participation in DSR where this is beneficial. The widespread introduction of ToU tariffs could also affect considerations of a consumer's vulnerability, such that a consumer's inability to load shift may become a circumstance which can place them in a vulnerable position.

Some suppliers may wish to specialise in ToU tariffs in future, but there are risks if they do not offer any non-ToU tariffs. This could cause vulnerable or unsuited consumers to accept a ToU tariff (with associated risks for the consumer) or switch to another supplier (which could have implications for the wider market). Ofgem should closely monitor the market for these effects after elective HHS is introduced, and consider introducing requirements for suppliers to offer at least one non-ToU evergreen tariff.

Issues related to mandatory HHS

In addition to our general concerns related to the introduction of DSR into the market, we also have some comments on the scope and process of Ofgem's review into mandatory HHS. Ofgem's open letter states that a Significant Code Review (SCR) on proposals to transition to mandatory HHS is planned for early 2016. This commitment is also included in Ofgem's draft forward work programme 2016-17, which states that a "SCR is the best tool currently available to examine an issue which may require changes across multiple codes. As our work develops, we will look to take advantage of any further tools which become

available.”⁷ In January 2016 DECC published draft legislation that would give the Authority new powers to modify industry codes when this is necessary to achieve settlement reform.⁸ Ofgem should make clear as soon as possible what impact these changes will have on the proposed process and timeline for the introduction of both elective and mandatory HHS.

We would expect that regardless of the process used to introduce these changes Ofgem will proceed with both an assessment of distributional impacts and full cost-benefit analysis, as is currently proposed as part of the SCR.⁹ The cost-benefit analysis should consider whether elective HHS can meet the same policy aims and provide better value for money than mandatory HHS. Any decision to proceed with a mandatory approach should learn the lessons of the process to introduce mandatory HHS for larger sites.¹⁰

As recognised in the open letter, these changes will also coincide with a large number of other major changes in the industry, in particular the smart meter rollout, the move to principles-based regulation and market design work under the flexibility project. Any associated impacts that the introduction of HHS may have, including any reputational risks to the smart meter rollout, should be considered and mitigated by DECC and Ofgem.

A small minority of consumers may be unable, or unwilling, to have a smart meter installed. It is also possible that teething problems with the technology may make some sites hard to serve. It will therefore be important that settlement systems continue to provide a mechanism to settle sites non-half hourly (NHH) in these cases. The introduction of mandatory HHS may nonetheless necessitate some reforms to processes for these residual NHH sites. For example, profiling may need reform, both because of reduced appetite to maintain the services of the Profile Administrator, and because of the opportunities that a majority of HHS sites provide to create more sophisticated profiles for the residual NHH sites. It may also be necessary to monitor and manage the effect that the transition of sites to HHS is having on the Group Correction Factors applied to the residual

⁷ Ofgem’s draft Forward Work Programme 2016-17, available at https://www.ofgem.gov.uk/sites/default/files/docs/draft_forward_work_programme_2016-17.pdf

⁸https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/493848/Draft_Legislation_on_Energy.pdf

⁹<https://www.elexon.co.uk/wp-content/uploads/2016/01/Ofgem-letter-to-BSC-Panel-Chairman.pdf>

¹⁰ See BSC Modification P272

<https://www.elexon.co.uk/mod-proposal/p272-mandatory-half-hourly-settlement-for-profile-classes-5-8/>

NHH sites, where the balance of error attributable to unmetered supplies (street lighting etc) and to NHH supply is likely to alter over time.

The open letter letter suggests that one of the benefits of mandatory HHS may be faster and more efficient settlement, and a reduction to barriers to entry. In that area, we would particularly encourage Ofgem to consider reforms to the settlement timetable and to the 29 day window¹¹ against which trading parties have to lodge credit cover. The current credit window appears sub-optimal, and appears to create a barrier to entry and expansion.¹²

We look forward to working closely with Ofgem as you move forward with settlement reform.

Yours sincerely,

Alexander Belsham-Harris

Citizens Advice, Smart and Sustainable Energy

¹¹ Although nominally 29 days, in practice the Balancing and Settlement Code trigger for entering credit default of a party's estimated indebtedness exceeding 80% of the collateral it has lodged means that they have to lodge credit equivalent to at least 36 days of their trading charges (eg $100 / 80 \times 29$).

¹² Small suppliers are more likely than large suppliers to lodge credit in the form of cash rather than a letter of credit. In addition, past Ofgem analysis conducted during its Electricity Balancing SCR has suggested that smaller parties have greater imbalance exposure than larger vertically integrated parties. In combination, these factors mean that credit cover requirements are likely to tie up disproportionately more working capital for small players than for large suppliers.