

Michael Gibbons
BSC Panel Chair
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Date: 15 August 2017

Dear Michael,

Provisional thinking on BSC modification P332 (Revisions to the Supplier Hub Principle)

Thank you for your letter of 17 July 2017 seeking¹ our views on whether the findings of the P332 Interim Report² are consistent with our provisional thinking and strategic direction. We have considered the Interim Report of the workgroup and respond to your questions below. In addition to this, we provide some broader thoughts on P332, based on the information provided to us. For the avoidance of doubt, nothing in this response binds Ofgem as to any future action. We reserve our right to modify our provisional views as regards all matters set out below.

In responding to the Panel's letter and the questions put to us, we discuss a number of concerns that we hope will inform the Panel when issuing a direction to the workgroup on P332, should it see fit to do so.³

There are benefits of customers having choice over their agents, but also that in exercising this choice, suppliers' settlement performance is not unduly affected. However, based on the information presented to us, there is a lack of a clear evidence base that this cannot be achieved under the current arrangements. The interim report and your letter identify potentially significant costs of both the Modification process itself, and implementing the changes proposed by P332 (if approved) but the report does little to explain the benefits of the modification.

We are also concerned that the demand on industry resources to revise the supplier hub principle would divert attention away from a number of projects of strategic importance to the industry. Finally, we foresee the potential for P332 to cut across the scope of our Electricity Settlement Reform Significant Code Review (SCR)⁴.

However, if the Panel believes further work by the workgroup can provide greater clarity on the proposal for change and resolve the above concerns, we would welcome an updated Interim Report being submitted to us six months from the receipt of this letter.

The Panel sought our views on four questions. We respond to your specific questions below, alongside further observations on the P332 Interim Report. We have combined our answer to your third and fourth questions, given they are related.

¹ Under Section F, Paragraph 2.6.10(b) of the Balancing and Settlement Code

² <https://www.elexon.co.uk/mod-proposal/p332/>

³ Under Section F, Paragraph 2.6.10(c) of the Balancing and Settlement Code

⁴ <https://www.ofgem.gov.uk/publications-and-updates/electricity-settlement-reform-significant-code-review-launch-statement-revised-timetable-and-request-applications-membership-target-operating-model-design-working-group>

First question: *Whether the BSC was the best vehicle to address the issue (e.g. licensing may be an alternative);*

We would need to see a more robust evidence base that the Balancing and Settlement Code (BSC) is the best vehicle to address any issues arising from customer-preferred agents in order to provide an unambiguous answer to this question.

In relation to the licensing of agents, it is worth noting that any decision to license supplier agents would be dependent on the Department for Business, Energy and Industrial Strategy introducing the necessary legislation. While we cannot speak for the Government, we note the general pressure on the legislative timetable in coming years, which might make such a move difficult.

The Interim Report notes that the proposed solution is still under development and there is no clear view from the workgroup on whether the issue is a BSC issue or a commercial issue. There is also limited evidence that the proposed solutions will have the appropriate effect and there is limited information on the measurable benefits of the changes and how they would better facilitate achieving the BSC Objectives.

Second question: *Whether Supplier Agents becoming signatories to the BSC was appropriate (i.e. making a new class of industry participants directly subject to the regulatory framework); and*

Making Supplier Agents signatories to the BSC would require a robust evidence base to underpin any changes. Such an evidence base is not currently provided by the Interim Report.

Third question: *Whether Ofgem has plans for similar work in the short to medium term that may impact, interact and/or influence the development of the proposal.*

Fourth question: *Any specific changes to the rights and responsibilities of Supplier Agents that Ofgem foresees post 2020, both as part of the imminent Significant Code Review on Mandatory Half Hourly Settlement and also more generally across the non-Data Communications Company market.*

While our Electricity Settlement Reform Significant Code Review 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.⁵ 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.⁶ The scope of the Electricity Settlement Reform SCR includes the roles and responsibilities of supplier agents and may cover all settlement processes and systems for Supplier Volume Allocation.⁷

We therefore wish to maintain our discretion to include arrangements in the 'traditional' half-hourly market in our reforms to electricity settlement. We may also decide that revising the rights and obligations of suppliers and agents in the 'traditional' half-hourly market is best done through our SCR on Electricity Settlement Reform. For the avoidance of doubt, we have not come to a view at this stage on whether such changes are to be

⁵https://www.ofgem.gov.uk/system/files/docs/2017/07/electricity_settlement_reform_significant_code_review_launch_statement.pdf

⁶ Under Section F, Paragraph 5.4 of the Balancing and Settlement Code

⁷ Appendix 1D:

https://www.ofgem.gov.uk/system/files/docs/2017/07/appendix_1_significant_code_review_timeline_consultation_feedback_summary_and_scope_0.pdf

considered within the design of the Target Operating Model for half-hourly settlement within our SCR. As such, it is possible that if work continues on P322, in the future it could be subsumed into an Ofgem-led piece of work on settlement reform or the supplier hub more generally.

Our other observations on P332

Cost: Sections 4 and 5 of the Interim Report highlight the significant costs and impacts on BSC Parties relating to P332. When considered in relation to the current evidence base for the modification and the lack of clarity on the viability of the proposed solution (in the report as it stands), we are concerned there is a risk that the cost to be incurred by proceeding with the work stream over a further 25-month period may be disproportionate.

Resource: The number of workgroups, length of the proposed work stream and industry resources requested to input to the development and implementation of P332 coincide with a number of significant reforms to the electricity market, including Faster Switching, Smart Meter rollout and mandatory half-hourly settlement.

In responses to our November 2016 Consultation on mandatory half-hourly settlement many industry participants stated that the extent of complex and transformational concurrent industry change is placing substantial commitment pressures on a limited amount of industry resource. If work on P332 proceeds to revise the supplier hub model in the 'traditional' half-hourly market this would add further demands on industry expertise and has the potential to divert attention away from existing major industry projects. If changes were to proceed, it is likely that we would prefer to manage them within the Electricity Settlement Reform SCR. For the avoidance of doubt, we have not come to a view at this stage on whether such changes are to be considered within the design of the Target Operating Model for half-hourly settlement within our SCR.

Evidence Base: Substantial changes to the market and the BSC require a robust evidence base. The information provided by the workgroup highlights that there are a number of customer-preferred agents operating in the HH market. However, there is limited evidence of the extent to which the supplier hub principle - where suppliers are responsible for and effectively manage their arrangements with agents - is not functioning effectively and the negative impact this results in costs, settlement performance and consumer detriment.

Whilst the data provided in Section 8 and Appendix 5 of the Interim Report is welcome, it provides a snapshot of the customer-preferred market. The evidence for proceeding with P332 would need to be supported by further detail on the extent of the issue to be resolved, where the management of agent performance and delivery of BSC obligations is failing.

Solution: As stated in our response to your first question, the Interim Report notes that the proposed solution is still under development and that there is a lack of agreement within the workgroup on whether the proposed solutions will have the appropriate effect. We also observe that there is limited information on the measurable benefits of the changes related to P332 and how they would better facilitate achieving the BSC Objectives.

Yours sincerely,

Rob Salter-Church

Partner, Consumers and Competition

