



98 Aketon Road
Castleford
WF10 5DS

John.barnett@northernpowergrid.com

Will Fletcher
Project Manager
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

By email to EnergyMarket@cma.gsi.gov.uk

5 August 2015

Dear Mr Fletcher

Energy Market Investigation - Northern Powergrid response

Northern Powergrid is the electricity distribution (DNO) business for the Northeast, Yorkshire and parts of northern Lincolnshire, operating through its two licensed subsidiaries, Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) plc. We welcome the opportunity to comment on the Competition Markets Authority's (CMA) provisional findings and its notice of possible remedies.

If we can be of any assistance in addition to this response we would welcome a meeting with you to discuss the background to our views and any specifics that you would like to explore further. We would highlight that our interest in the operation of the electricity market naturally extends beyond our obligations to facilitate competition in the supply and generation of electricity but we have restricted our comments to those conclusions and remedies where we have expert insight to offer.

Areas of interest for Northern Powergrid

For the key areas of interest and relevance to a DNO we are broadly in agreement with the provisional conclusions and remedies proposed. There are a limited number of areas where we do not agree with the proposals and we make clear in this response the reasons for our alternative view.

Our main points are as follows:

- Half hourly (HH) settlement will be an important step for domestic and small business customers to realise the benefits from smart meters and the wider implementation of smart grids;
- Time of use (TOU) tariffs may be used to influence customer energy use for their benefit, particularly around peak system demand;

NORTHERN POWERGRID

is the trading name of Northern Powergrid (Northeast) Ltd (Registered No: 2906593) and Northern Powergrid (Yorkshire) plc (Registered No: 4112320)

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne NE1 6AF. Registered in England and Wales.

If you would like an audio copy of this letter or a copy in large type, Braille or another language, please call 0800 169 7602

www.northernpowergrid.com

- Using locational price signals is an important method to minimise electrical losses and electricity distribution charging methodologies already include this concept where it is net beneficial - there is no case to introduce changes and new obligations in electricity distribution;
- We would welcome further discussion on the DNO's role in communicating aspects of industry change to customers as we continue to move to a more active engagement with our customers;
- Improvements need to put customers in control of their energy use and their bills, while avoiding unnecessary complication;
- Some customers, including the vulnerable, may always need simpler and more easily understood tariffs;
- Improvements should be made to the processes for development and implementation of industry code changes by Ofgem engaging more in the process - this option (remedy 18b) is both proportionate and cost effective;
- Centralisation of meter point registration services should drive faster switching of energy suppliers and we need to ensure an appropriate Target Operating Model (TOM) to determine the scope of the centralised service; and
- Reviewing, clarifying and delineating responsibilities for setting policy and operating regulatory frameworks between Ofgem and DECC should aid better overall outcomes for customers.

Our responses to the possible remedies

We note that while many of the possible remedies would directly affect energy suppliers, some would involve both supply and distribution licensees and some remedies, including on code governance, could affect all parties including the wider energy stakeholders and customers. Our response is focussed on eight of the 31 remedies which are of most relevance to electricity distribution. Appendix 1 sets out our views on eight of the proposed remedies - 1, 13, 15, 16, 17, and 18a, b and c.

We hope you find our response to be a useful contribution to the CMA's investigation and please contact me if you require any further information on the points we make in our response or for input on any other aspect of the enquiry.

Yours sincerely

John Barnett
Policy & Markets Director

Appendix 1 - Northern Powergrid's response to possible remedies

Remedy 1 - Introduction of a new standard condition to electricity generators', suppliers', interconnectors', transmission, and distribution licences to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency.

1. We note the CMA's analysis in its provisional findings report on page 151 onwards and we support the general principle of locational signals in respect of network use charges and losses, especially for extra high voltages where the benefits are greatest and compare most favourably to the costs of the extra market sophistication and complexity.
2. Cost-reflective charges are a fundamental precept of an effective market. Locational price signals are important to incentivise economical system development and we should only accept socialisation of costs where there are merits for policy makers (e.g. not increasing the burden on the fuel poor). Socialisation of costs inhibits the right economic decisions being made on least cost solutions.
3. We are pleased that the CMA has noted the existing locational nature of distribution charging and losses. We would add that the Balancing and Settlements Code (BSC) (Section K) already places obligations on distributors to calculate losses via methodologies that must align to prescribed principles, with those principles requiring calculation on a locational basis.
4. Should the CMA conclude that changes are required to the current arrangements any new licence conditions should only be considered for transmission licensees as distributors already have obligations regarding locational signals in losses. Appendix 1, Part A of our licence requires us to publish a schedule of adjustment factors to be made for Distribution Losses within our Use of System Charging Statement, with those adjustment factors having locational signals as a requirement of the BSC as highlighted above. In addition, standard condition 49.1 of our distribution licence requires DNOs to ensure that distribution losses from the system are as low as reasonably practicable, and to maintain and act in accordance with a published distribution losses strategy.
5. We therefore see no reason to modify the licences of distributors where the CMA has recognised that there is no change necessary to the locational price signals that exist in distribution losses and use of system charges today. The existing obligations and practices in distribution already contribute appropriately to the objective of minimising electrical losses.

Remedy 13 - Requirement that domestic and SME electricity suppliers and relevant network firms agree a binding plan for the introduction of a cost-effective option to use half-hourly consumption data in the settlement of domestic electricity meters.

6. We note the analysis in Appendix 8.6 in relation to half hourly (HH) electricity settlement and we are generally supportive of the principles behind the finding and the action proposed. Settling electricity in line with the measurement and recording capability of smart meters is an important step in realising the benefits from the customers' investment in the smart meter programme.
7. We agree that HH settlement can facilitate more innovative time of use (TOU) tariffs and our own smart grid low carbon network fund project the Customer-Led Network Revolution

(CLNR) confirmed the benefits of static time of use (TOU) tariffs in modifying customer behaviour, particularly around minimising usage at peak network demand.

8. In our project, we developed a tariff with British Gas where trial participants paid double in the four-hour peak period (4pm to 8pm) and a much reduced rate through the night period. Over 600 customers participated for more than one year with a safety net (they knew that overall they would pay no more and they could only benefit from the trial tariff).
9. Our results demonstrated that an average 10% peak load shift was possible and there were indications of customers using less electricity overall although these differences were not statistically significant compared to the control group. Around 60% of trial participants saved money on their bills (with savings ranging from £31 to £376 per annum). This value of cost saving by switching tariff may put domestic DSR in a similar category to that of switching energy supplier where typical savings of £312 (dual fuel) are identified by DECC¹.
10. Social surveys concluded that it was household chores (particularly laundry and dish washing) were the most common methods to move electricity consumption. Significantly, it was families containing younger children or older people who reported more difficulty with shifting demand.
11. We support suppliers offering customers optional TOU tariffs. But more accurate settlements arrangements should not be allowed to lead automatically to non-optional complex TOU retail tariffs as some customers, including some vulnerable groups will always need access to simpler and more easily understood tariffs.
12. We are offering electricity suppliers a time of use smart meter distribution use of system charge from November 2015. It will be up to suppliers how they take advantage of that tariff that has been designed to offer domestic customers the red/amber/green price signals that are already available to larger customers connected to our networks whilst being cognisant of the necessary smart metering functionality.
13. Another conclusion from the CLNR project was that the introduction of peak charging in the HH DUoS charges in 2010 had no noticeable effect on customers' use. Enquiries with energy suppliers identified that only around 5% of suppliers passed on this price signal to end customers. This demonstrates the key part that suppliers will have to play in providing cost reflective tariffs to end customers.
14. Changes should be proportionate and practical; more accurate settlements arrangements should not automatically create the consequence of more complicated tariffs for network use. A clear cost benefit analysis would need to be undertaken to understand the balance between any further cost reflective network tariffs; additional billing system cost for parties and the ability/willingness of end users to react to the signals if suppliers decide to pass them on to consumers.
15. HH settlement should bring clear market benefits; however, Ofgem, code panels, code administrators and industry parties need to introduce further HH settlement in a way that minimises consequential impacts on wider IT systems, otherwise benefits gained through HH settlement could be compromised by additional costs to customers in the long run.
16. We also note the CMA's reference to P272 for the HH settlement of larger business customers in profile class 5 to 8 where we are already supporting this change through working closely with other industry parties on implementation. (We provide additional

¹ Average dual-fuel saving reported on the DECC website (March 2015)

- commentary on P272 under remedy 18b as relevant evidence of operation of current industry code governance arrangements.)
17. We believe any requirement for a binding plan on HH settlement can be achieved through well-designed, well-managed and well-publicised industry code changes. We would also welcome fixed deadlines or backstop dates in order to provide clarity, including on the timing of any required IT changes. However, binding plans and deadlines should not prevent the phased movement of customers to HH settlement if 'big-bang' data traffic is forecast to cause problems and unnecessary costs for industry data systems. In addition, any phased movement of customers should be completed over as short and as practical a period as possible in order to assist the prompt decommissioning of legacy systems.
 18. We believe that introducing the HH settlement mandate should be post 2017 as this should allow for initial problems with the smart rollout to be resolved and allows for the 'bedding in' of profile class 5 to 8 customers moving to be HH settled (under P272).
 19. Unmetered customers appear out of scope of the CMA proposed remedies. We consider that they should not be necessarily moved to HH settlement since customers in this market appear to access competitive supply contracts and switch suppliers as necessary to access the best deals. However, we would highlight that some unmetered customers are already settled HH and some are settled non-HH, so under remedy 13 there would only be one sub-set of unmetered customers still settled non-HH with the potential to retain supporting systems for this sub-set only.
 20. We will continue to work with Ofgem and Elexon in the area of smarter markets and HH settlement through the implementation for medium-sized business customers and in future to develop and implement arrangements for domestic customers and smaller businesses.

Remedy 15 - More effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills.

21. We agree that this is a desirable outcome of any revised arrangements.
22. An independent regulator has a part to play in this as does DECC - a confirmation of statutory duties should make this clear as to who has the primary role to provide customers with an accurate and informative view of the energy bill breakdown.
23. We are conscious of the effects of policy changes on prices and bills not just on competition, but especially also on vulnerable customers. Not all customer groups are equally impacted by changes - policy makers and companies need to consider disproportionate effects on the most vulnerable.

Remedy 16 - Revision of Ofgem's statutory objectives and duties in order to increase its ability to promote effective competition.

24. The current hierarchy of duties does not preclude Ofgem from designing and deploying solutions that support a competitive market.
25. We do not think that the role of promoting competition has been materially diminished by Ofgem's duties being previously revised.
26. However we appreciate the potential dilemmas faced by Ofgem when it must balance a number of considerations and sometimes these push in different directions.

27. We welcome any further necessary clarification of objectives and roles for both Ofgem and DECC.

Remedy 17 - Introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently.

28. We do not support the introduction of a mechanism to manage disagreements between DECC and Ofgem.
29. We believe it would be a mistake to introduce any arrangements that would suggest that Ofgem needed to be mindful of political sensitivities when making decisions.
30. Rather, we believe that the duties of both parties should be confirmed or clarified as necessary in order that Ofgem maintains its duty to function independently and at arms-length from Government.
31. In the presence of such clarity, if an independent regulator considered that it was unable to behave independently, it is not clear to us that there are any procedural arrangements that would give it the necessary confidence to do so. Indeed, introducing a forum in which the differences of opinion between DECC and Ofgem could be aired and resolved could make a problem worse as the staff from each side could strive to resolve any conflict by some kind of compromise which risks outcomes that are inconsistent with the remit of an independent regulator.

Remedy 18a - Recommendation to DECC to make code administration and/or implementation of code changes a licensable activity.

32. We are uncomfortable with licensing of code administration on the grounds that the benefits from this solution may not outweigh the additional costs.
33. We would suggest further work on applying best practice across the 11 industry codes could be more cost effective than licensing. We would highlight, for example, that different codes have different arrangements for forming recommendations to Ofgem on whether a change should be accepted or rejected; some codes use party voting to establish the recommendation and some use a panel of experts. Ofgem's further review of code governance should be allowed to run its course, including identifying optimal solutions for governance without resorting to licensing.
34. We would highlight that through Ofgem's Further Review of Industry Code Governance and its workshop on 22 July 2015 the smaller parties have been complimentary on some aspects of some codes. For example, Elexon have been praised for supporting parties in respect of the Balancing and Settlement Code (BSC).
35. In addition, we would highlight that some codes, including the DCUSA, SPAA and the BSC offer free code education days to code parties. So support does exist for all parties to engage effectively.
36. Existing code administration on change proposals can work well when parties to the codes engage appropriately with the process. Despite clearly accessible industry code arrangements it remains unclear why some parties choose to engage fully with industry change, why some parties engage more than others, why some parties engage on some change proposals and not on others and why some parties appear to engage very little on any changes.

37. In this area of 'patchy' party engagement with code changes there are notable examples we can highlight where there has been insufficient effective early engagement. Insufficient engagement by parties is not necessarily due to flaws in code administration arrangements. Overall, code governance arrangements at code panel or board level are unlikely to have a direct influence on party engagement with the code's change administration processes. Examples of insufficient early engagement include, significant code changes that have drawn noticeable low participation in terms of responses to consultations and voting and then there have been concerns expressed by parties about specific changes post approval (even though the change development processes has been lengthy and fully transparent). There have also been recent change proposals to extend implementation dates in relation to well publicised changes (including for example BSC P272 where the implementation process and deadline were subsequently amended by BSC P322 following supplier raising additional concerns post the initial decision).
38. We would note that even code changes directly affecting the parties themselves can have low participation; to take one example DCUSA DCP178 - '15 month notice for Distribution Use of System charges' where only four of the 'big six' suppliers voted and only three of the other suppliers.
39. Given that it is unclear what is causing patchy participation in code changes at present we believe Ofgem's work on its further review of code governance should be allowed to run its course, including the factoring in of the suggestions from smaller parties, prior to any further consideration of the licensing of code administration.
40. Licensing code administration seems disproportionate to the issues and a little like resorting to 'special measures' when most of the code governance arrangements are well developed and are effective when stakeholders, including code parties and Ofgem provide the necessary input to the development of changes.
41. We object to introducing extra complexity and costs on to customers' bills (ultimately) when we consider that the need for and benefit from creation of a licensable activity is unproven.

Remedy 18b - Granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes.

42. We believe this remedy has clear merits provided that Ofgem consults industry parties thoroughly on the scoping of such projects on code changes and prior to determining timetables. Code administration can work well when code parties and Ofgem engage appropriately in change development. Effective code governance supports outcomes may be delivered that are good for consumers as a whole and not benefit one sector at the expense of material downside to another.
43. The most effective development and implementation of code changes has taken place when Ofgem has engaged actively and early on in the process to clearly communicate policy and desired outcomes.
44. This is why we favour this option that avoids the increased cost of new parties but engages Ofgem early and throughout the change development. As such this is our preferred option under remedy 18.

Remedy 18c - Appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute.

45. We believe the introduction of a third party is inappropriate. The increased costs would outweigh the benefits.
46. We believe that an independent code adjudicator is unnecessary if Ofgem and DECC's objectives can be further refined and delineated such that decision making takes place against fewer conflicting policy priorities.
47. Ofgem as an independent regulator should continue to take the lead role in determining which code changes should be adopted and a confirmation of its statutory duties should help Ofgem make appropriate decisions, including in the event of non-unanimous party support or disputes between parties.