Wholesale Retail Code Change Proposal – Ref CPW129

Modification proposal	Wholesale Retail Code Change Proposal[1] – CPW129 – Review of Post RF Materiality Threshold
Decision	The Authority has decided to reject this Change Proposal
Publication date	12 December 2022
Implementation date	N/A

The Authority rejects this Change Proposal.

The Change Proposal has identified an issue in the market that has potential implications for a number of areas. However, we consider that the proposed solution only deals with the symptoms of the problem that has been identified, rather than the root cause. If implemented, the proposal would relax the conditions for when Unplanned Settlement Runs (USR) are permitted. We do not consider that USRs should be used as standard practice in the market and that increasing their use may lead to unintended (and negative) consequences for customers and could also potentially undermine important improvement programmes in the market.

We agree with suggestions made by the Code Change Committee that there may be a case to review the overall settlement process to consider if it could be simplified and more efficient. We would encourage any review of the settlement process to be undertaken "in the round" and to take account of other market improvement initiatives that may have an impact on settlement. For example, we do not consider that this Change Proposal has sufficiently considered whether the solution could potentially undermine ongoing data improvement activities, including industry's efforts to strengthen incentives for Trading Parties to ensure that accurate data is being submitted into CMOS in a timely manner.

[1] The terms used in this document are those defined in the Wholesale Retail Code.

Background

Section 4.13.4 of the Wholesale Retail Code, Schedule 1, Part 4: Market Terms sets out the materiality thresholds for requesting Post RF settlement runs[2], to be the higher of:

- 0.1% of the sum of the aggregate value of the Primary Charges due to the Contracting Wholesaler from the Contracting Retailer for the relevant Area for each of the relevant consecutive Invoice Periods affected; and
- £3,000.00 x N [number of runs which are proposed to be carried out].

In December 2021, Wave Utilities (the "Proposer") suggested that the current materiality thresholds for raising Post RF settlement run requests are considered high, leading to larger wholesale-retail pairings to be unable to request Post RF runs. This issue results in exposing customers of different wholesale-retail pairings to different levels of back-billing, as well as bringing uncertainty on back-billing timescales and what may or may not be back-billed.

The issue

Generally, Post RF settlement runs are requested in cases where an incorrect data item that materially affects the calculation of Primary Charges has been identified and corrected in the Central Market Operating System (CMOS). In such cases, in order to request a Post RF run, the impacted Trading Parties must show that the difference between the current Primary Charges and what should have been calculated - if data in CMOS was accurate – exceeds the materiality thresholds.

The final recommendation report notes that the current percentage threshold result in some larger Retailers being unable to correctly process changes to customers' bills, exposing customers to billing issues. The Proposer cites examples which results in a patchwork of backdated charges and an inconsistent billing approach across the market.

The report also explains the impact of the high numeric threshold which, in some circumstances (where customers are refunded charges, but the Retailer can't request a Post RF run due to its smaller size) results in Retailers being unable to seek recovery

[2] Post RF settlement runs refers to Primary Charges recalculated for an invoice period outside of the planned schedule of reconciliations. Following RF runs, Wholesalers have eight months in which they can request Post RF runs to issue a positive invoice to Retailers. Retailers have 28 months following RF runs in which they can request Post RF runs, to recoup charges from Wholesalers.

of the corresponding wholesale charges and adds a cashflow burden for the Retailer to manage.

The final recommendation report provides a Post RF Settlement Run analysis to demonstrate that majority of the Unplanned Settlement Runs (USR)[3] – 78.9% (609 out of 635) - undertaken by MOSL in the period 2020 and 2021 - were post RF runs and 56.2% of those Post RF runs were processed by five pairings. The analysis shows that 65.8% of runs assessed (sample set of 199 Post RF runs) were for negative sums (i.e., rebates to Retailers), which would be passed onto customers.

The Change Proposal[4]

This Change Proposal seeks to amend the existing materiality thresholds for requesting Post RF runs by:

a) removing the percentage criteria of 0.1% to address the issue of larger pairings being unable to request Post RF runs; and
b) reducing the numeric value to £1,500 to address the high barrier for smaller pairings to overcome when requesting Post RF runs.

The Proposer noted that both amendments are expected to improve customer billing experiences by providing greater clarity to customers and to Retailers on potential back-bills, in terms of the timing and value. It also highlights that the proposed solution means that settlement is less likely to be unduly impacted by the size of the Retailer, thereby promoting a more consistent customer experience across the market.

The final recommendation report provides total cost estimates for delivering the proposed changes to be up to £30,000 subject to the variability in how/when Post RF runs are requested. The assessment cost for MOSL is estimated as £5,520 and, if the changes are implemented, one Full Time Equivalent to manage processing Post RF runs may be required.

The estimated Trading Party cost to assess the change was £17,550 (£975 cost per 18 responses to the consultation). Respondents stated that impact to their systems and processes will be minimal with ongoing costs increasing in line with the volume of

[3] An Unplanned Settlement Run (USR) is a recalculation of Primary Charges for an invoice period outside of the planned schedule of reconciliations.
[4] The proposal and accompanying documentation are available on the MOSL website at https://www.mosl.co.uk/market-codes/change#scroll-track-a-change

requests for Post RF runs – MOSL's prediction is up to 140 extra runs per year in total for the whole market.

The report also explains that the proposed change is similar to CPW046: Changes to the unplanned settlement process which was implemented in December 2018 amending the materiality threshold for Corrective Settlement Runs, which generally occur before the RF run, to require the reconciliation to exceed either materiality threshold rather than both.

The Change Proposal has been developed by MOSL and the Proposer, consulting upon it with the industry between 24 January 2022 and 11 February 2022 and providing a recommendation to the Panel in April 2022.

Note: The final recommendation report notes that the original solution was to only remove the percentage threshold. The final solution to remove the percentage threshold and to reduce the numeric threshold has been revised following the consultation feedback and further engagement with consultation respondents.

Industry consultation and assessment

There was an industry consultation on this Change Proposal between 24 January 2022 and 11 February 2022. There were 18 responses from 10 Wholesalers, seven Retailers and the Consumer Council for Water (CCW).

Below is a summary of the key consultation response themes and the Proposer’s reply. More details can be found in the final recommendation report.

Recognition of the issue

The majority of respondents (14 respondents – seven Wholesalers, six Retailers and CCW) either identified with the issue outlined in the Change Proposal or agreed that there is an issue with the materiality thresholds for requesting Post RF runs, some noting that a percentage threshold naturally benefits some Retailers over others.

Views on the proposed solution to remove the 0.1% percentage threshold criteria

Five consultation respondents (two Wholesalers and three Retailers) agreed with the proposed solution to remove the 0.1% percentage threshold criteria, noting that it addresses the issue raised and ensures that customers are treated equally regardless of the size of their Retailer. One of the respondents who agreed with the proposed solution also noted an additional suggestion for the numeric threshold to be lowered to ensure fairness for all parties.

Six respondents preferred a version where the percentage criteria is retained but "and" between the two thresholds is amended to "or". One of the respondents who expressed preference for "or" to be added, also suggested lowering the numerical criteria to enable smaller Retailers to also benefit from the lower materiality thresholds.

Three Wholesalers disagreed with the proposed solution. Some noted that the current thresholds provide the right balance between incentivising parties to ensure data is correct and providing a reasonable level of charge recovery for exceptional items. Another reason for disagreement was that the proposed change would add additional demand onto an already overburdened and inefficient Post RF run process. It was suggested that wider improvements to the process are needed. Another respondent also noted that it would have supported the change only if the cost of requesting Post RF runs were removed.

CCW requested further analysis on the number of post RF runs being processed and clarification on the rationale for the current Post RF materiality threshold to be able to provide a response.

Two respondents did not state a preference and one provided no comments.

Views on backlog of runs and increase in Post RF run requests

Five respondents (two Retailers and three Wholesalers) confirmed that they have historically built-up backlogs to meet the Post RF materiality threshold. These respondents represent the largest Trading Parties operating in the market.

Six respondents provided cautious forecasts for their increase in Post RF run requests, which in total may be up to an additional 140 runs per year.

Customer impact

Seven respondents said that the proposed solution will impact their customers. For example, one Retailer noted that its customers will be reimbursed when historical inaccuracies are discovered, while others noted that the change could generate greater confidence in the market by ensuring customers are not disadvantaged by their wholesale-retail pairing and providing greater certainty of the charges being recalculated.

The rest of the respondents were of a view that the change will have limited/no direct impact on customers or state they do not have enough information to understand the true impact on customers. For example, one respondent said that they do not anticipate a significant increase in the number of Post RF runs therefore the impact on customers would be limited. Another respondent suggested an industry settlement workshop to be established so the true impact on customers could be discussed. One Retailer stated that lower numeric criteria will bring indirect benefits to its customers while another Retailer noted that the solution is deigned to benefit larger Retailers.

CCW raised a concern that the change may result in increased complaints to itself and Retailers if there are negative billing implications.

Proposer's reply and evolution of the solution following the consultation

- **Consideration on the design of the solution:** The Proposer noted in the Change Proposal that it considered the option to retain the percentage criteria but to amend "and" between the two thresholds with "or". However, the Proposer considered that this would retain a level of unfairness by introducing a potentially very low threshold for very small pairings.

- **Revised solution:** Following a review of the consultation feedback, the Proposer revised the solution, continuing to remove the percentage threshold but also decreasing the numerical threshold of £3,000 to £1,500. This was to enable the change to also be of benefit to smaller Trading Parties. The Proposer reached out to nine respondents for further comment on this solution, and seven of the nine (four Wholesalers and three Retailers) responded. All apart from one Wholesaler agreed that the revised solution does improve the situation for both large and small Trading Parties, The Wholesaler who disagreed questioned whether the £1,500 flat numeric value would benefit smaller Trading Parties.

- **Current Post RF materiality thresholds:** In response to CCW's request, the Change Proposal now provides an explanation on the current thresholds, noting that originally thresholds of 0.5% of aggregate primary charges and £5,000 were proposed but due to concerns about Retailer's ability to recover charges from a Wholesaler where charges had to be refunded to customers, the materiality threshold was reduced to 0.1% of aggregate charges and £3,000.

- **Further analysis on the number of Post RF runs and impact on customers:** As part of its response to the consultation CCW requested more information on the number of Post RF runs processed to correct under-recovering of Primary Charger, due to concerns that the removal of the percentage threshold has the potential to result in bill shocks to customers. In the final recommendation report, the Proposer provides a breakdown of Post RF runs which showed that 65.8% of the assessed runs were for negative sums which would be passed onto customers. The Proposer also noted that the small percentage of Trading Parties that are currently impacted by the percentage threshold limitations account for a large proportion of the market and therefore the impact on customers would be wide reaching. As part of the Post Implementation Review Plan, the Proposer envisaged to collect 12 months data on the number of Post RF runs processed, grouped by year and a view of whether these runs occurred as a direct result of CPW129's implementation will be outlined.

Code Change Committee recommendation

The Code Change Committee considered this Change Proposal at its meeting on 26 April 2022 and agreed to recommended that the Authority reject this Change Proposal, with three votes in favour of approval and four votes against. The Proposer did not vote to avoid any conflict of interest.

The three Committee members who voted to recommend approval noted that the Change Proposal appeared to be cost-effective and would benefit end customers.

The four Committee members who voted to recommend rejection highlighted that the scale of the issue and its impact on customers had not been clearly articulated and evidenced and questioned whether the issue was significant for Retailers and the market. They also stated that wider issues related to the RF/Post RF process should be considered, noting that this change could be incorporated into that holistic review.

The report details that MOSL would commit to drafting a plan for a holistic review of RF and Post RF issues and will circulate it to the Code Change Committee in due course.

Key comments and questions during the Code Change Committee discussion include:

- The Committee questioned whether the change would benefit customers. The further analysis undertaken by MOSL in response to CCW's request perceived the likelihood of bill shocks arising from this change to be low.
- One Trading Party Committee Member noted that other parts of the Post RF settlements process may not be fit-for-purpose and reiterated the need for a holistic review of Post RF process issues to be considered.
- One Committee Member noted that Retailers' billing systems are separate to CMOS, therefore Retailers should be able to provide billing information to customers regardless of the state of the data in CMOS.
- A Committee Member questioned the need for materiality thresholds altogether, stating that the cost of £350 for Post RF runs could be a natural disincentive. It

was noted that the cost is not necessarily paid by the party requesting the Post RF run. It was also noted that a decrease from 0.1% of aggregate charges (which for large wholesale-retail pairings can exceed £10m) to £350 could increase the number of Post RF run requests to levels that could be unmanageable for MOSL to process.
- Another Committee member considered that clear rationale for decreasing the threshold from £3,000 to £1,500 had not been provided in the recommendation report.

Our decision and reasons for our decision

We have considered the issues raised by the Change Proposal and the supporting documentation and have decided to reject this proposal. We do not think that it has been sufficiently demonstrated or evidenced that there will be customer and market benefit through approval of this change.

We note and agree with the suggestion made at the Code Change Committee (CCC) meeting on 26 April 2022 that the Change Proposal has not sufficiently assessed the impact on customers. We believe that the Change Proposal could have unintended consequences, in particular, when considering the impact on the overall settlement process and the potential for perverse impacts on data improvement activities, which could consequentially negatively impact customers. These implications have not been fully assessed and therefore we cannot be sure that this Change Proposal will satisfy the **Primary Principle** by protecting and promoting the interests of, and participation by, existing and future Non-Household Customers.

- **Impact to the overall settlement process and data quality**

During the April CCC it was noted that the proposed solution could have wider implications on the market, but these issues were not explored or considered in sufficient detail in the final report.

For example, the solution, as presented, would likely increase the use of Unplanned Settlement Runs (USR), in particular, Post RF settlement runs. We note that in the majority of cases USR's are requested as a result of inaccurate data entering the market. We do not consider that USR's were intended to be used as a 'normal' aspect of market functioning, but rather to address unplanned issues as and when they arise.

The increased amount of Post RF runs, likely to result from this Change Proposal, could reduce the incentive on Retailers to obtain and input frequent and accurate meter readings from their customers and could therefore have consequential billing implications. The Change Proposal could also create a perverse incentive on the quality of data that Trading Parties enter into CMOS, which could impact on the overall level of data quality in the market. In addition, the increased use of URSs could create an additional burden in carrying out Post RF runs on MOSL and Trading Parties at the expense of addressing the root of the problem caused by inaccurate market data. In this respect, we cannot be satisfied that the Change Proposal would advance the **Simple, cost effective and secure** principle or **Efficiency** principle.

- **Impact on data improvement initiatives**

We do not think that the proposal has sufficiently considered how the solution may interact with, and take account of, other market initiatives that are intended to improve settlement and overall data quality.

For example, earlier this year, MOSL and the Market Performance Committee (MPC), introduced Holistic Performance reporting which has strengthened incentives for Trading Parties to ensure that accurate data is being submitted to CMOS in a timely manner. We are also aware that, as part of its Strategic Priorities published in September 2022, the Strategic Panel instructed MPC to commence work on setting clear targets and holding market participants to account for Settlement Accuracy.

During the April CCC discussion, it was suggested that the proposed solution could have a perverse impact on data improvement activities in the market. We share these concerns and question whether the proposed solution would act against the incentives that are being introduced and monitored by the MPC.

- **Holistic review**

During the April CCC, there was also a discussion about the complexity of the current settlement process and whether it could be made more efficient or extended to negate the need for USRs. The consultation responses also highlighted a number of concerns with the proposal, including that the solution would add additional demand onto an already inefficient Post RF process. It was proposed that wider improvements to the Post RF process are needed, including a suggestion for removing the cost associated with requesting Post RF runs.

In light of the above, we further consider that the **Proportionality** principle has not been met as the Change Proposal addresses a problem which has not been sufficiently quantified, nor is it evident from the final report why bills cannot be accurately calculated during the standard Settlement process by parties collecting timely and accurate meter readings.

We acknowledge that there may be a case for looking at improving the settlement process, although we consider that such work should be carried out "in the round" to take account of other activities which are intended to improve Settlement Accuracy.

Decision notice

In accordance with section 6.3.7 of the Wholesale Retail Code, the Authority rejects this Change Proposal.

Dan Mason
Head of Market Governance & Design