

Review of the Market Performance Standards and Operational Performance Standards

Consultation overview

The Market Performance Committee (“the Committee”), on behalf of the Panel, has conducted a review of the Market Performance Standards (MPS) and Operational Performance Standards (OPS) set out within the Market Performance Framework (CSD 0002).

Following this review, which included assessment of extensive feedback from Trading Parties¹, the Committee now proposes, on behalf of the Panel, reform of the standards regime.

This consultation document is supported by a suite of documents which provide the proposed changes to the Market Performance Framework, the rationale for these changes and draft market code Change Proposals. The structure of this document suite is shown below.



The Committee notes the concerns from many Trading Parties that the introduction of MPS charging would not be appropriate unless the Committee, Panel, and Ofwat are satisfied as to the accuracy of MPS reporting. MOSL are defining the assurance processes and regular updates will be provided to the relevant stakeholders about progress.

The Committee notes that Trading Parties should also seek their own assurances on the MPS reporting. Trading Parties will have access to test runs of the new performance charging system from 9 January and the Committee encourages joint working with MOSL to ensure that the outputs are robust.

This consultation closes on 19 January 2018 at 12.30.

¹ The Committee conducted a [Consultation on the MPS and OPS](#) in October 2017.

Consultation questions

Form and structure of performance standards

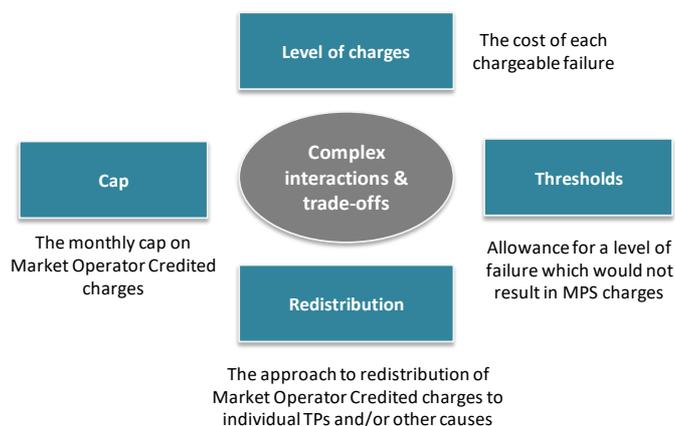
The Committee proposes some changes to the form and structure of the MPS, the removal and replacement of two standards to deliver more appropriate incentives on Wholesalers, the introduction of some new performance metrics outside of the standards regime as well as an additional OPS together with a commitment to investigate whether OPS charging could be introduced on a subset of priority standards during 2018/19. More comprehensive information is provided in the Change Proposal Recommendations Paper.

Question 1. Do you have substantive evidence / rationale for changing the MPC's proposals with regards to the form and structure of the performance standards and the related proposals included in the recommendations document?

Charging

The Committee believes that the present charging system, based on current evidence available, will not incentivise retail behaviours appropriately and therefore is unlikely to be effective at driving market improvement. The interaction between charging levels and the cap, with charges applying to all chargeable performance breaches, creates a narrow active range² over which any incentive to improve performance would apply.

There are four components of the MPS charges which interact with one another to influence the impact of Performance Charges and therefore Trading Party incentives to perform well against these measures. The four components are shown below.



The level of charges

The large volume of tasks carried out by Retailers in comparison to Wholesalers, means that a significant proportion of Retailers are not, nor will they be expected to be, within the active range of the financial incentive (i.e. their charges exceed the cap each month). In contrast, most Wholesalers are, and will be expected to be, in the active range despite currently having a lower level of performance, due to the lower volume of tasks meaning that poorer performance does not necessarily cause charges to

² "Active range" refers to the range over which financial incentives will result in charges being levied on Trading Parties. These incentives are not active beyond the overall cap on charges.

exceed the cap. As a result, the same level of charges for wholesalers and retailers deliver a different level of incentive for each group and are unlikely to be effective for both.

The Committee considered this issue alongside the interactions of the four components outlined above. The current level of performance charges for retailers means that charges often exceed the cap, and whereby there is no financial incentive to improve performance.

For Retailer MPS charges to more effectively drive behaviour, without changing the cap, analysis suggest that the level of charges must be reduced. In determining the new level of charges a key consideration was ensuring that the performance charge for missed meter reads remained high enough that the penalty remains at least as high the cost of an efficient meter read.

The Committee's proposal is a reduction in the level of Retailer charges of slightly more than 50%. Based on analysis, this reduced level of charges is expected to bring significantly more retailers into the active range of the package of incentives whilst maintaining financial incentives for each task. This will ensure that all trading parties are financially incentivised over a wider range of tasks. This should reduce the probability of breaching the cap, and therefore drive better market behaviours.

The Committee is proposing that the level of MPS charges should be reduced for all Retailer standards; such that:

- Level 1 failure – £5
- Level 2 failure – £10 (+£5)
- Level 3 failure – £20 (+£10)

Question 2. Do you have any substantive evidence / rationale that different levels of MPS charges would provide more effective incentives?

Thresholds

The Committee has been presented evidence which suggests that 100% compliance on the current MPS8 (missed meter reads) is unattainable due to access issues and missing or damaged assets. This is compounded by a significant associated charge for failure (level 3). There is therefore a risk that the charging cap could be exceeded in relation to MPS8 alone and so effectively no incentive for delivery of any other Retailer standards would apply.

An attainable target is more likely to drive performance improvement than an unattainable target. The Committee proposes that a threshold is applied for Retailer missing meter reads (MPS8) such that, initially, 5% of the total number of expected tasks in any period may breach the success criteria and not incur a performance charge. For clarity, this means that if 95% of expected meter reads are submitted within a month in line with the success criteria, zero charges will be incurred. This level was based on evidence revealed during the consultation including information about long unread meters. This initial threshold is based on current evidence available and will be subject to review by the Committee with the aim of ensuring that MPS charges as a package provide genuine incentives for Trading Party performance and improvement.

The Committee proposes that all other standards should remain with a 100% rate of success to avoid an MPS charge.

Question 3. Do you have any substantive evidence / rationale to support a different level of threshold for Retailer missed meter reads?

Question 4. Are there other standards that in the future the Market Performance Committee should consider applying a threshold to? If so, please include evidence / rationale.

Redistribution of charges

The current mechanism for redistributing market operator credited MPS charges is that all charges are redistributed across Retailers and Wholesalers at the end of the financial year based on market share.

The significantly higher number of tasks submitted by Retailers than Wholesalers is expected to lead to higher numbers of performance breaches and therefore larger total charges for Retailers. This creates the situation whereby Retailers are contributing significantly more MPS Charges into the “single pot”. Wholesaler This asymmetry in the level of contribution to charges is not reflected in the distribution mechanism and therefore a net cashflow from Retailers to Wholesalers is anticipated.

The Committee proposes that MPS charges are ring-fenced in separate Retailer and Wholesaler pots and redistributed based on market share within the two pots, such that charges paid by Retailers will only be redistributed to Retailers and likewise for Wholesalers. This will greatly increase the incentive properties of the redistribution. Better performing Retailers and Wholesalers will receive a new financial benefit compared with, respectively, poorer performing Retailers and Wholesalers.

Question 5. Do you have any substantive evidence / rationale to support an alternative mechanism for the redistribution of MPS Charges? If so, please supply evidence / rationale and an explanation of your preferred approach to redistribution.

Implementation

The Committee has put forward two code change proposals which are required to bring into effect the outlined changes from April 2018:

- CPM008 - Proposed changes to the Market Arrangements Code covering the mechanism for redistributing MPS charges.
- CPW030 - Proposed change to the Wholesale Retail Code covering changes to the form and structure of performance standards, level of MPS charges and additional standards.

Question 6. The drafting included in the CPM008 and CPW030 proposals has been delivered by MOSL based upon feedback from MPC. Furthermore, the Design Specification and User Manual have been delivered by MOSL in response to requests from MPC.

Please can you provide any feedback about any refinements that might be necessary or desirable to ensure a proper understanding and implementation of the proposed standards regime?

Future work

Areas of the consultation which the MPC has not decided to include in this change proposal, but has put on its forward agenda include;

- To develop a plan for potential introduction of OPS charging.
- The development of data quality performance standards.

Question 7. Which areas in terms of the MPS, OPS or market performance more broadly should the Committee consider or prioritise as part of its forward agenda?