

MARKET ARRANGEMENTS CODE CHANGE PROPOSAL

Change Proposal Reference <i>(To be completed by the Panel Secretary)</i>	CPM018	Version No	1
Type of Change Proposal:	Code Change Proposal		
Submission Date	2 September 2019		
Title: of Market Arrangements Code Change Proposal	Treatment of Market Performance Standard Charges and Operational Performance Standard Charges		
Summary: of Market Arrangements Code Change Proposal <i>(40 to 50 Words Maximum)</i>	<p>This proposal advocates a hybrid approach for the treatment of performance standard charges.</p> <p>This involves a default incentive neutral redistribution but with the option to use some or all of the charges to fund other activities where these address market failures that cannot be addressed via more suitable funding mechanisms.</p>		
General Details of the Proposer			
Name of Proposer	Nigel Sisman		
Capacity (on behalf of a Trading Party, as a Panel Member, as the Customer Representative or the Market Operator).	Chair, on behalf of the Market Performance Committee (MPC)		
Contact Email	nigel@sismanenergyconsultancy.co.uk		
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The Proposer recommends that this Change Proposal should: <i>(delete as appropriate)</i>	Proceed to Assessment		
	Proceed to Consultation		
	Proceed to Recommendation		

Related Documents

Reference of any associated Code Panel Market Arrangements Code Change Proposal	CPM008 Revised CPM008
Documents Accompanying Form	<p>Economic Insights Report: Options for the Use of MPS and OPS Charges (v1.0). Available for download at: https://www.mosl.co.uk/download-document/6e554eaedf685f1ea16850625446972c</p> <p>(This is a controlled document; login to MOSL website is required.)</p>

Market Arrangements Code Change Proposal Details

Description of the issue or defect which this Market Arrangements Code Change Proposal seeks to address, as required under the Market Arrangements Code Section 7.1.2(b).

During its first review of the performance standard regime the MPC decided that it would address what it considered to be an inequitable and unintended consequence of the approach to redistribution of MPS charges namely that because Retailer payments were anticipated to be much larger than Wholesaler payments that the provisions would lead to a significant redistribution of monies from Retailers to Wholesalers. To address this, in CPM008 (original CPM008) MPC, and subsequently Panel, recommended separate ‘pots’ for Wholesaler and Retailer to avoid the observed dysfunctionality.

However Ofwat returned the proposal to the Panel for further consideration because of another issue: Ofwat decided the proposal would result in weak incentives for good performance from larger retailers and wholesalers and that this aspect had not been fully considered in the proposal.

MPC, and Panel, subsequently recommended another proposal, Revised CPM008, which featured a performance based attribution algorithm designed to deliver proportionately greater benefits via redistribution to better performers.

After receiving the Revised CPM008 Final Recommendation Report, Ofwat in 4 February 2019 considered that the method of redistribution did not effectively incentivise trading parties to perform against the MPS and could not therefore be considered an appropriate enduring approach.

Although Ofwat approved the Panel and MPC’s recommendation for FY2018/19 and FY2019/20, Ofwat requested the Panel and MPC to develop an enduring solution that would address (i) Ofwat’s concern about diluted incentives; and (ii) potential for non-redistribution of charges to contribute significantly to obviate such diluted incentives.

The consultants, Economic Insight (EI), were commissioned to provide an independent assessment of the CPM008 proposals, the Ofwat decisions and views and to deliver a recommendation on the most appropriate way forward.

The EI report “Options for the use of MPS and OPS charges” contains EI’s analysis, its conclusions and the rationale for EI recommendation of the hybrid model for the treatment of performance standard charges.

The MPC is working with the EI recommendation which it anticipates will provide the substantive framework to be recommended via consultation to the industry. The MPC anticipate making a final recommendation to Panel in October 2019.

Description of the Market Arrangements Code Change Proposal, its nature and purpose and how it is consistent with the Market Arrangements Code Principles and required under the Market Arrangements Code Section 7.1.2(c)

The key features of the proposal are envisaged to include:

- As a default, 100% of the charges should be redistributed to Trading Parties in an incentive neutral way, but there should be an option to use the charges to fund other activities.
- Redistribution of charges in an incentive neutral way involves a Trading Party only receiving a share of the charges paid by other Trading Parties, not the charges it pays. This mechanism avoids incentive dilution because an improvement or degradation in its performance is unlikely to affect the amount of charges other Trading Parties paid, and which it could receive via redistribution.
- There is no ‘requirement’ to use any of the charges to fund other activities as there is a risk that a requirement would encourage inefficient expenditure.
- Notwithstanding this, there should be an established process by which a reasoned decision can be taken when to exercise the option of using the charges for market-enhancing activities.

It is envisaged that the Panel will act as the “decision maker” in respect of the potential allocation of performance standard charges to market enhancing projects. The MAC will define essential criteria that projects would need to satisfy in particular that projects should be market enhancing and address market failures, should be additional to activities that are already planned or which might be more appropriately funded by other routes, and that such projects should not confer any significant competitive advantage or favour to individual or small groups of actors. The precise formulation is being developed and further interpretation may well be defined in an ancillary document that sits outside the code to ensure reasonable flexibility in defining and operating the process as well as any post project selection monitoring or management that might be appropriate.

The processes will require MOSL support some of which might need to be funded via business-as-usual (BAU) activity but higher levels of MOSL (or other specialist) support might need to be funded directly from the performance charges paid.

It is envisaged that the consultation will explore a more detailed proposal of the governance framework and that the MPC will evolve its response, where appropriate, in the context of feedback provided.

The MPC is also aware that some concerns have been raised about the efficacy of EI’s proposed default redistribution approach (CPM008+) and that an alternative modified performance based approach has been suggested. The alternative has been proposed to partially address a transfer issue that CPM008+ may systematically create leakage of

monies from the largest market share actor or actors to the smaller ones, but to date, having heard EI's opinion on the matter MPC has not changed its view although the matter will be consulted upon before MPC makes its final recommendation to Panel.

Principles

Description of the principles affected by the Change Proposal on the items below (if applicable) as detailed under Schedule 1 Market Arrangements Code Principles and Definitions

Principles	Affected (Y/N)	Description
Efficiency	Y	This proposal promotes the efficient operation of the market by removing the incentive dilution effects associated with the previous and current approaches.
Proportionality	N	
Transparency	N	
Barriers to entry	Y	By removing the dilution effect associated with larger Trading Parties the proposal will encourage new entrants.
Non-discrimination	N	
Customer participation	N	
Seamless markets	Y	The proposal to fund projects from retained MPS/OPS charges brings the Market more in line with Scotland where all funds are retained and directed toward projects.
No limit on upstream competition	N	

Description of any consultation carried out in advance of the Market Arrangements Code Change Proposal being made (if any), as required under the Market Arrangements Code Sections 7.1.2(f).

Industry consultation expected to run from 23 September to 7 October 2019.

The consultation will cover principles and processes of the governance around determining how funds are released for projects.

Further Information

N/A

Key

	To be completed by the Market Operator
	To be completed by the Proposer