Consultation

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Price Cap – May 2022 consultation on credit and PPM SMNCC allowances

Subject	Details
Publication date:	03 May 2022
Response deadline:	01 June 2022
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This is our final consultation on updating the smart metering allowances (the Smart Metering Net Cost Change (SMNCC) allowances) for credit and prepayment (PPM) meters in the default tariff cap in time for Winter 2022-23. We would like views from stakeholders with an interest in the level of the default tariff cap. We particularly welcome responses from domestic energy suppliers, consumer groups and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at Ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

The default tariff cap ('cap') protects domestic customers on default tariffs. We conduct Annual Reviews of the Smart Metering Net Cost Change (SMNCC) allowances in the cap for credit and prepayment meters (PPM). These allowances reflect the change in smart metering costs since 2017. As part of this Annual Review we will set the SMNCC allowances for cap period nine (October 2022 – March 2023) and cap period ten (April 2023 – September 2023). We will also update the value for cap period eleven (October 2023 – December 2023), although this value is subject to revision through a potential 2023 Annual Review.

We are proposing a relatively modest set of changes and updates as part of this 2022 Annual Review. This reflects that our approach to modelling the change in smart metering costs is mature, following extensive engagement with industry since we first set out our SMNCC allowance. Given this maturity, changes to our methodology are likely to generate increasingly smaller gains in accuracy at the expense of increased complexity. As a result, in a few instances where changes would be disproportionately complex to make, and would result in relatively minor effect on the end result, we do not propose that they are made. Summaries of our proposed updates and changes are given in the sections below.

COVID-19 and installation costs

COVID-19 affected suppliers' ability to install smart meters which resulted in them incurring costs which did not result in installations (sunk installation costs). We included an estimate of sunk installation costs for 2020 and 2021 in our August 2021 decisions. We have now been able to gather data on installation costs in 2021, including sunk installation costs.

We propose to update our 2021 estimates of sunk installation costs using an average of values from two methods, in line with our approach to 2020. We also propose not to include sunk installation costs for the years beyond 2021, reflecting our expectations that the impact of COVID-19 on sunk installation costs beyond 2021 are likely to be small.

Setting the rollout profile

We considered the impact of the Supplier of Last Resort (SoLR) process on the smart meter rollout for those suppliers who took on SoLR customers. We concluded from relevant supplier data, related to the market leader rollout profile we use for credit, that the SoLR process reduced their smart meter rollout by less than one percentage point at the end of 2021. We therefore propose not to make an adjustment for SoLR impacts at this stage as doing so would be disproportionate given the low impact on rollout and complexity of implementing the adjustment.

We also considered whether to update the fuel-specific rollout adjustments from our August 2021 decisions. These adjustments, based on historical data from large suppliers, are used to generate separate rollout profiles for each fuel type. Calculating the impact of updating these adjustments with 2021 data showed it had an immaterial impact. We therefore propose to maintain the existing fuel-specific rollout adjustments.

Updating general economic inputs

We propose to update several inputs into the SMNCC model so that they are more reflective of recent data. This includes the Gross Domestic Product (GDP) deflator measure of inflation used to adjust inputs and outputs of the model, the headline rate of corporation tax used as part of the cost of capital estimate and the Long-Run Variable Cost (LRVC) of energy estimates used in the calculation of debt management benefits.

Other areas

We propose to introduce a positive uplift adjustment to the modelled costs of traditional PPM electricity meters so they better align with measured costs. We also correct our implementation of a previous decision related to the calculation of advanced payments for PPM meters. In the event we are not able to complete our 2022 Annual Review in time we propose to use the updated SMNCC model as a starting point to set any contingency value. If no weight can be placed on the updated SMNCC model, we propose to use the SMNCC values calculated for cap period nine in our February 2022 decision.

Proposed credit and PPM SMNCC values

For cap period nine, we propose to set the credit SMNCC at £9.43 per typical dual fuel customer and set the net PPM SMNCC at -£12.68 per typical dual fuel customer (ie post expected PPM offset). These values are higher for credit (+£1.41) and lower for PPM (-£2.85) than the values we calculated for cap period nine when we set the credit and PPM SMNCC in February 2022.

Appendices 1 and 2 show the detail on proposed credit and PPM SMNCC values for individual fuels, as well as the proposed values for subsequent cap periods.

Next steps

We are seeking views by 1 June 2022. We intend to take a decision in early August 2022, ahead of the next cap update. This would take effect from cap period nine, which begins on 1 October 2022.

1. Introduction

Subject of this consultation

1.1. The default tariff cap ('cap') protects approximately 22 million domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that they pay a fair price for their energy, reflecting its underlying costs. The cap is one of the key activities which fall within the outcome "consumers pay a fair price for energy and benefit from rights and protections" within our Forward Work Programme for 2022-23.[1] We set the cap by considering the different costs suppliers face. The cap is made up of a number of allowances which reflect these different costs.

1.2. One cost to suppliers is the net cost of installing and operating smart meters. We reflect this in the cap through two allowances. The operating cost allowance includes the cost of smart metering in the 2017 baseline year (alongside other operating costs).[2] The Smart Metering Net Cost Change (SMNCC) allowance reflects the change in smart metering costs since 2017.

1.3. The SMNCC allowance comprises a 'pass-through' element covering industry charges relating to smart metering and a 'non-pass-through' element covering suppliers' smart metering costs.

- We update the pass-through element as part of the six-monthly cap updates. This element is not the focus of this consultation.

- We use a forward-looking modelled approach to set the non-pass-through element for future cap periods. This consultation focuses on the non-pass-through SMNCC allowances (which we refer to as 'the SMNCC' for the remainder of this document).

[1] Ofgem (2021), Forward work programme 2022/23
https://www.ofgem.gov.uk/publications/202223-ofgem-forward-work-programme
[2] We index this allowance with inflation as part of the six-monthly cap update.

1.4. This consultation covers the SMNCC allowances for both credit meters and prepayment meters (PPM). We have produced one document given the similarities between our proposals for these areas. We indicate where a proposal only applies to one meter type.

2022 Annual Review

1.5. We set the SMNCC allowances in the cap for the duration of the cap.

1.6. We review the SMNCC annually and update all future values of the cap when we conclude an Annual Review.[3,4] These are the final SMNCC allowances for the next year (ie cap periods nine and ten). The SMNCC allowances for the remaining cap periods beyond next year (ie cap period eleven) could be subject to revision through a subsequent Annual Review.

1.7. Table 1.1 below provides a simplified illustration of this Annual Review process.

Table 1.1: Simplified illustration of Annual Review process

<table>
<tr><th></th><th>Annual review Y</th><th>Annual review Y+1</th><th>Annual review Y+2</th></tr>
<tr><td>Cap period X</td><td rowspan="2">Annual review sets final SMNCC for these cap periods</td><td rowspan="2">N/A (historical cap period)</td><td rowspan="3">N/A (historical cap period)</td></tr>
<tr><td>Cap period X+1</td></tr>
<tr><td>Cap period X+2</td><td rowspan="4">Annual review updates SMNCC for these cap periods (but subject to later Annual Review)</td><td rowspan="2">Annual review sets final SMNCC for these cap periods</td></tr>
<tr><td>Cap period X+3</td></tr>
<tr><td>Cap period X+4</td><td rowspan="2">Annual review updates SMNCC for these cap periods (but subject to later Annual Review)</td><td rowspan="2">Annual review sets final SMNCC for these cap periods</td></tr>
<tr><td>Cap period X+5</td></tr>
</table>

[3] When we are unable to conclude our Annual Review and have to set a contingency allowance, we only update the SMNCC for the next cap period.
[4] We normally announce the conclusions of our review ahead of our August cap announcement.

1.8. The 2022 Annual Review will determine the final SMNCC allowances for cap periods nine (October 2022 to March 2023) and ten (April to September 2023). These values will replace those set previously. It will also set the SMNCC allowance for the remaining cap period (cap period eleven, which runs from October to December 2023), although this may be updated as part of a potential 2023 Annual Review.

1.9. In October 2021 we published a working paper ('SMNCC WP5') setting out the intended scope of the 2022 Annual Review and reiterated our position from our August 2020 decisions that we do not expect to carry out future Annual Reviews (including this one) with the same level of detail as our May 2020 credit consultation, as we consider this would be disproportionate.[5,6]

1.10. As a result, this consultation proposes a relatively modest set of changes and updates to the SMNCC model. The document contains four sections related to changes, starting from chapter three, which are listed and summarised below.

Chapter 3: COVID-19 and installation costs

1.11. In this chapter we set out proposals to update our estimates of sunk and productive installation costs for 2021 using an average of two methods. We also propose to not include sunk costs for years beyond 2021.

Chapter 4: Rollout

1.12. In this chapter we set out proposals to not adjust the market leader rollout profile at this stage to take account of Supplier of Last Resort impacts and to not update our existing fuel specific rollout adjustments. We also propose to update our rollout calculations using the latest Annual Supplier Return data and discuss BEIS's proposed adjustment to the way that supplier smart meter installation requirements are calculated.

[5] Ofgem (2022), Working paper on 2022 annual review of SMNCC allowances, paragraph 27: https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

[6] Ofgem (2020), Reviewing smart metering costs in the default tariff cap: August 2020 decision, paragraph 5.39: https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap

Chapter 5: Updates to general economic inputs

1.13. In this section we propose updates to three cross-cutting inputs into the SMNCC model, the GDP deflator, the rate of corporation tax and the Long-Run Variable Cost of Energy (LRVC) estimates.

Chapter 6: Other areas

1.14. In this final section we summarise the data updates that we propose to make, including the introduction of a non-zero meter rental uplift value for traditional PPM electricity meters. We also set out an adjustment to the advance payments calculation for PPM to accurately implement a previous decision. Finally, we provide an updated review of model uncertainty, as well as set out our contingency approach and discuss the impact of current market developments on the SMNCC.

2. Consultation process

Consultation stages

Process to date

2.1. In October 2021 we published our final consultation as part of the 2021 SMNCC Annual Review, setting out the proposed credit and PPM SMNCC values for cap period eight.[7] Following this, in February 2022, we published our decision on credit and PPM SMNCC allowances for cap periods eight and beyond.[8] These values came into effect as part of the Default Tariff Cap on 1 April 2022.

2.2. In parallel to the final consultation on the 2021 Annual Review we published SMNCC WP5 setting out the proposed scope of the 2022 Annual Review, to which this consultation refers.

Disclosure

2.3. Alongside this consultation, we are carrying out a similar disclosure process as for our previous final consultations. This allows stakeholders to inspect the SMNCC model, and their advisers to inspect certain other pieces of analysis, in each case subject to confidentiality restrictions. We have published information about this disclosure process on our website.[9]

2.4. If you would like to participate in the disclosure process and have not yet registered your interest, please contact us as soon as possible at: RetailPriceRegulation@ofgem.gov.uk.

Future publications

2.5. We will consider feedback from this consultation before deciding on any changes to the SMNCC allowances as part of our 2022 Annual Review. There are already credit and PPM SMNCC allowances defined for the remaining cap periods, so we will need to decide whether

[7] Ofgem (2021), October 2021 consultation on credit and PPM SMNCC allowances: https://www.ofgem.gov.uk/publications/price-cap-october-2021-consultation-credit-and-ppm-smncc-allowances
[8] Ofgem (2022), February 2022 decision on credit and PPM SMNCC allowances: https://www.ofgem.gov.uk/publications/price-cap-february-2022-decision-credit-and-ppm-smncc-allowances
[9] Ofgem (2021), Price Cap – Disclosure arrangements for Spring 2022 consultations. https://www.ofgem.gov.uk/publications/price-cap-disclosure-arrangements-spring-2022-consultations

to amend any of these values. For both credit and PPM, we intend to set SMNCC allowances for all remaining cap periods, but if we had to set a contingency allowance then we would only update the SMNCC for the upcoming cap period nine.

2.6. We intend to publish a decision in early August 2022, ahead of announcing the cap level for cap period nine. Any changes would take effect from 1 October 2022.

2.7. Table 2.1 below shows how we expect the Annual Review process to operate. Given the maturity of the SMNCC modelling we expect each update to involve increasingly smaller changes. As a result there is a case for less regular model reviews. Any change to the Annual Review process, as summarised below, would be subject to consultation. We are not proposing a change as part of this Annual Review.

Table 2.1: Expected timings for Annual Review process

<table>
<tr><th></th><th>2021 Annual Review (decision published February 2022)</th><th>2022 Annual Review (expect decision in August 2022)</th><th>2023 Annual Review (expect decision in August 2023)</th></tr>
<tr><td>Cap period eight (April to September 2022)</td><td>Set final SMNCC</td><td>N/A (historical cap period)</td><td rowspan="3">N/A (historical cap period)</td></tr>
<tr><td>Cap period nine (October 2022 to March 2023)</td><td rowspan="3">Updates SMNCC (but subject to later Annual Review)</td><td rowspan="2">Sets final SMNCC</td></tr>
<tr><td>Cap period ten (April to September 2023)</td></tr>
<tr><td>Cap period eleven (October to December 2023)</td><td>Updates SMNCC (but subject to later Annual Review)</td><td>Sets final SMNCC</td></tr>
</table>

Related publications

2.8. Key related publications:

- October 2022 working paper on 2022 Annual Review of SMNCC allowances: https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

- February 2022 decision on credit and PPM SMNCC allowances: https://www.ofgem.gov.uk/publications/price-cap-february-2022-decision-credit-and-ppm-smncc-allowances

How to respond

2.9. We want to hear from anyone interested in this consultation. Please send your response to the Retail Price Regulation team (Retailpriceregulation@ofgem.gov.uk).

2.10. We do not ask specific question in this document. Rather, we welcome views on any of the matters discussed in this consultation.

2.11. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

2.12. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

2.13. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

2.14. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 8.

General feedback

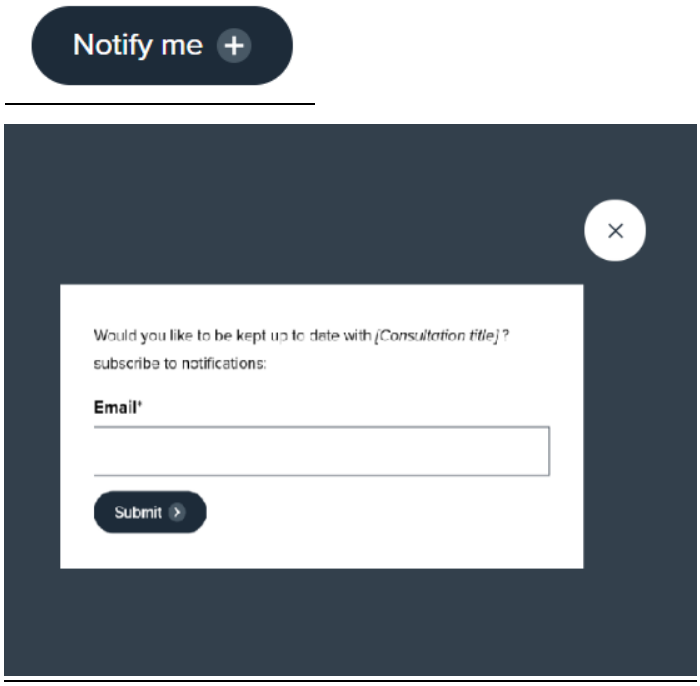
2.15. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

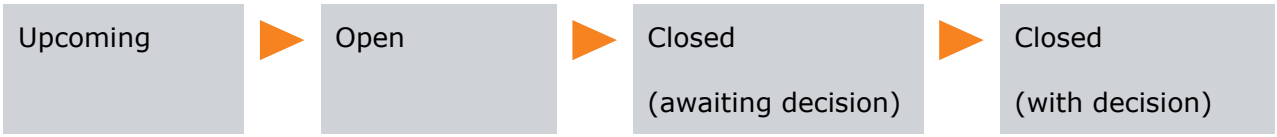
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



3. COVID-19 and installation costs

Section summary

This chapter discusses how we propose to update our estimates of sunk installation costs in 2021 and years beyond 2021. We then similarly consider the consequences for our estimates of productive installation costs in 2021.

Summary of main proposals

3.1. Our approach to considering the impact of COVID-19 on installation costs involves three main proposals on sunk installation costs and the cost per installation for 2021. As these decisions are inter-related, we summarise them at the start of this chapter. This provides context for the discussions on each issue that follows.

3.2. We propose to calculate sunk installation costs in 2021 using the average of the two methods we set out in our August 2021 decisions. Our estimate of sunk installation costs in 2021 is lower than our sunk installation cost estimates in 2020.

3.3. We propose not to include sunk installation costs for the years beyond 2021, reflecting our expectations that the impacts of COVID-19 on sunk installation costs beyond 2021 are likely to be small.

3.4. We propose to calculate the cost per installation in 2021 using an average of the two methods we set out in our August 2021 decisions for calculating cost per installation in 2020. This also aligns with the two methods associated with our proposed estimation approach for sunk installation costs in 2021.

Background on installation costs and sunk installation costs

Normal approach to installation costs

3.5. As set out in the November 2020 first credit SMNCC working paper ('SMNCC WP1'),[10] data on installation costs is available in arrears through the Annual Supplier Return data (ASR) – previously called Smart Meters Annual Information Request (SMAIR). For the years where we have actual data, our normal approach is to calculate the average cost per smart meter installation using this data. We divide the total installation costs by the total number of installations. We then amortise the average cost (to spread it over a number of years) and apply the meter rental uplift. The meter rental uplift reflects that the rental payments suppliers pay to Meter Asset Providers (MAPs) may not correspond to the way we model the costs of smart meter assets and installations.[11] We use this uplifted cost per installation in the SMNCC model. The total installation costs then depend on rollout in that year.

3.6. For future cap periods, we estimate the installation cost by taking the latest historical average installation cost and adjusting it based on expected future changes in productivity. We then amortise this value and apply the meter rental uplift. The total installation costs are the uplifted average cost multiplied by the number of smart meters that we expect will be rolled out in that year (according to the rollout profile used).[12]

Assessing the impact of COVID-19 on installation costs

3.7. Where suppliers were unable to install as many smart meters as expected due to COVID-19, they may have been unable to scale down their cost bases accordingly. Costs

[10] Ofgem (2020), Updating the allowance for smart metering costs in the default tariff cap: working paper. https://www.ofgem.gov.uk/publications/updating-allowance-smart-metering-costs-default-tariff-cap-working-paper

[11] We discussed the meter rental uplift in our previous documents. See for example Ofgem (2020), Technical annex to reviewing smart metering costs in the default tariff cap: August 2020 decision, paragraphs 3.29 to 3.42. https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap

[12] Ofgem (2020), Updating allowance for smart metering costs in the default tariff cap: working paper, paragraphs 3.1 and 3.2. https://www.ofgem.gov.uk/publications/updating-allowance-smart-metering-costs-default-tariff-cap-working-paper

incurred in relation to meters which could not be installed would be an immediate (sunk) cost to suppliers.[13]

3.8. In our August 2021 decisions, we previously used a bottom-up approach to estimate sunk installation costs in 2021. This approach involved us selecting values for three parameters: the proportion of normal rollout which is not achieved, the proportion of costs which are sunk when an installation does not occur, and the cost per installation in a normal year.[14] Using these assumptions, we estimated sunk installation costs in 2021 to be around £47.5m (in 2020 prices).

Updating sunk installation costs for 2021

Context

3.9. In our August 2021 decisions, we decided to calculate sunk installation costs in 2020 and 2021, reflecting that COVID-19 had impacted smart meter installations up to that point.

3.10. Our estimates of sunk installation costs for 2020 were based on our 2021 Request for Information (RFI). They were calculated by using an average of the values from two methods[15]:

- Method one: by gathering information directly on sunk costs.
- Method two: estimating sunk costs as a residual, starting with the total installation costs and subtracting the estimated cost for the meters which were installed.

3.11. At the time of our August 2021 decisions, we had not collected data to estimate sunk installation costs in 2021. Instead, we used a bottom-up approach as described above.

[13] Ofgem (2020), Updating allowance for smart metering costs in the default tariff cap: working paper, paragraphs 3.3 and 3.4. https://www.ofgem.gov.uk/publications/updating-allowance-smart-metering-costs-default-tariff-cap-working-paper
[14] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 3.48. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
[15] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 3.15. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 2.92. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

3.12. We stated that we would update our 2021 sunk installation costs figure with actual data in our next Annual Review, by gathering data on sunk installation costs in 2021. We would account for any difference in our revised estimates through advanced payments.

Proposal

3.13. We have now gathered data on sunk installation costs in 2021, having issued an RFI in February 2022.[16] We propose to update our estimates of sunk installation costs in 2021 by using an average of the values calculated using methods one and two. We consider that the average will be a better reflection of suppliers' aggregate costs than either of the two methods.

3.14. This is in line with our approach to estimating sunk installation costs in 2020.

Considerations

Results

Table 3.1 - Sunk installation costs by payment method in 2021 and 2020[17]

Payment method	2021	2020
Credit (£m, 2021 prices)	37.2	107
PPM (£m, 2021 prices)	10.9	8.5
Total (£m, 2021 prices)	48.1	115.5

Notes: All values are totals across single and dual fuel and averages between method one and two. The figures for methods one and two include an adjustment to scale up the data from the suppliers included in the analysis to a representation of the full market. This adjustment assumes that the suppliers outside our data had the same per customer sunk installation costs as those included. The 2020 figures have been expressed in 2021 prices using an updated GDP deflator in line with chapter 5 of this document and updated in line with Appendix 6 of this document. They therefore will not match 2020 figures previously published in our August 2021 decisions.

3.15. Table 3.1 shows that in 2021 total sunk installation costs across payment methods have fallen. This matches our expectations that COVID-19 would have a lesser impact on smart meter rollout in 2021 than in 2020. This is because societal restrictions in response to

[16] We issued the RFI to suppliers with at least a 1% domestic supply market share.
[17] The data used for 2020 reflects an update to our estimates of 2020 sunk installation costs, in line with Appendix 6.

the pandemic were reduced. Suppliers may have also been able to include more flexibility in their plans over time to reduce the risk of sunk installation costs.

3.16. Table 3.1 also shows that PPM sunk installation costs have increased in 2021 compared to 2020. However, the share that PPM sunk installation costs accounted for in the total PPM installation costs in 2021 decreased by approximately 1 percentage point relative to 2020.[18] Whilst this matches our expectations for COVID-19, the decrease in the proportion of PPM installation costs that were sunk was smaller than we would have expected, when considering that COVID-19 may have impacted roll out in 2021 to a much lesser extent than in 2020.

3.17. Our current proposals for 2021 sunk installation costs will reflect this trend in PPM sunk installation costs. An alternative option we have not proposed is to adjust the 2021 allowance to cap the increase in PPM sunk installation costs. **We would like to invite stakeholders to comment on potential explanations for why the decrease in the proportion of PPM installation costs that are sunk may have been small in 2021 and whether we should cap the absolute level of sunk costs at their 2020 value.**

Selected methodology

3.18. In our August 2021 SMNCC decisions, our rationale for taking an average between methods one and two for 2020 sunk installation costs was to reflect suppliers having different contractual situations, meaning that different methods would be suitable for different suppliers. We considered that the average would be a better reflection of suppliers' aggregate costs than either of the two methods alone.[19]

3.19. Method one is the simplest and most direct way of estimating sunk installation costs, as it uses the data provided by suppliers through our RFI. However, method one would not be appropriate where the supplier's cost per installation increased, but its meter rental charges did not increase accordingly (ie to reflect an increase in the payment per installation by MAPs

[18] We define total PPM installation costs as both sunk installation costs due to COVID-19 and productive installation costs in cases where suppliers were able to install smart meters. We gathered data on this in our February 2022 RFI.
[19] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 3.25 – 3.33. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 2.109 – 2.113. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

to suppliers). This affected one supplier in our sample for 2021, though it represents a material number of customer accounts covered in our supplier sample.

3.20. Using method two alone to calculate sunk installation costs would overestimate suppliers' sunk installation costs in aggregate because it relies on an assumption that the installation cost per meter for meters which were installed was unchanged despite COVID-19. Therefore, by holding the costs per installation constant from 2019 (in real terms), any increase in the cost per installation amongst suppliers results in sunk installation costs under method two.

3.21. We therefore consider that taking the average of both methods for 2021, as we did for sunk installation costs in 2020, remains the most appropriate approach rather than using method one or two alone. Our proposals result in a sunk installation cost of £48.1m in 2021. In our August 2021 decisions, the previous estimates of sunk installation costs in 2021 using a bottom-up approach were around £47.5m (in 2020 prices, approximately £48m in 2021 prices used the GDP deflator). Appendix 6 provides notes on how we calculate sunk installation costs in 2021.

2020 sunk installation cost update

3.22. In correspondence during the 2022 RFI, one supplier stated that part of its previous 2021 RFI submission should have been a nil return. We propose to revise our estimates of 2020 sunk installation costs to reflect the exclusion of this data. We outline this further in Appendix 6, noting that for future SMNCC allowances, we will account for this difference in estimates of 2020 sunk installation costs through advanced payments.

Sunk installation costs beyond 2021

Context

3.23. In principle, there could also be sunk installation costs due to COVID-19 in 2022 (or 2023).

3.24. In our August 2021 decisions, we decided that we would not include sunk installation costs for 2022. However, given the uncertainty around COVID-19, we stated that we could

not rule out the possibility that we may need to revisit this position as part of a future review.[20]

Proposal

3.25. We propose not to include sunk installation costs for the years beyond 2021. This reflects that, while the impacts of COVID-19 are uncertain, it is expected that they will decrease as the societal restrictions in response to the pandemic are removed. It also reflects that suppliers may be able to include more flexibility in their plans over time to reduce the risk of sunk installation costs.

3.26. This position is unchanged from our August 2021 decisions.

Considerations

3.27. As set out in SMNCC WP1, the impacts of COVID-19 are uncertain, meaning that we would have no confidence that making a sunk installation cost adjustment for 2022 would increase the accuracy of our SMNCC allowance.[21]

3.28. At the time of publishing this document on 3 May 2022, the majority of UK societal restrictions in response to COVID-19 have been removed and the rollout of vaccines has progressed. Furthermore, to the extent that suppliers are able to include more flexibility in their plans when they have more time to do so, this would apply to a greater extent by 2022. This is supported by the fact that the overall share (across credit and PPM) that sunk installation costs accounted for of total installation costs fell in 2021 relative to 2020.

3.29. We do not consider that we should include sunk installation costs for 2022 as part of this review – or that sunk installation costs are currently likely in 2022 for the reasons set out above.

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[20] Ofgem (2021), Price Cap – Decision on credit SMNCC allowance, paragraphs 3.55, 3.62. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap – Decision on PPM SMNCC allowance, paragraphs 2.116 – 2.118. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

[21] Ofgem (2020), Updating allowance for smart metering costs in the default tariff cap: working paper, paragraph 3.39. https://www.ofgem.gov.uk/publications/updating-allowance-smart-metering-costs-default-tariff-cap-working-paper

Updating cost per installation for 2021

Context

3.30. Our earlier considerations of accounting for sunk installation costs in 2021 discuss the cases where suppliers were unable to install smart meters in 2021 due to COVID-19. However, there were many cases where suppliers were able to install smart meters in 2021, and where installation costs were therefore productive. We need to consider what cost per installation to use for 2021 for where installation costs are productive.

3.31. In our August 2021 decisions, we decided to use the same bottom-up approach for estimating cost per installation in 2021 as we previously used for estimating sunk installation costs for 2021.[22,23]

Proposal

3.32. We propose to estimate the cost per installation achieved (ie where suppliers were able to install smart meters) for 2021 using an average of the costs per installation associated with the two methods that we are proposing to use for calculating sunk installation costs in 2021. This is to ensure that our approach is coherent, by using the same data source as for sunk installation costs. This aligns with our approach for estimating 2020 cost per installation in our August 2021 decisions.

Considerations

Data source

3.33. As set out previously in the April 2021 consultation, we stated that we should estimate the cost per installation achieved in 2020 using the same data source as for sunk installation costs. This is to ensure that our approach is coherent to these related items, which together

[22] This was the same projected cost per installation as we used for 2020 in our August 2020 decision
[23] Ofgem (2021), Price Cap – Decision on credit SMNCC allowance, paragraph 3.75 https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap – Decision on PPM SMNCC allowance, paragraphs 2.122– 2.124. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

make up installation costs.[24] We consider this approach should apply to the cost per installation in 2021 as well.

3.34. Given our proposals, detailed earlier, to estimate sunk installation costs in 2021 using an average of two methods, we should similarly use an average of the costs per installation achieved, associated with each method. For method one, this is based on data gathered from suppliers.[25] We gathered data from suppliers on both sunk and productive installation costs, with the sum of the two representing suppliers' overall installation costs. We can therefore calculate the cost per installation achieved as the productive installation cost divided by the number of actual installations. For method two, this is the cost per installation from 2019 (adjusted for inflation), which we use to estimate sunk installation costs.

3.35. The updated 2021 cost per productive installation values are lower than the 2020 cost per productive installation values.[26] This may be reflecting our expectations of COVID-19 generally having less of an impact on rollout in 2021, particularly in relation to lower direct costs for personal protective equipment or additional pre-installation contact centre costs. Part of the decrease may also reflect natural variation in costs between years for other (non-COVID-19) reasons.

[24] Ofgem (2021), Price Cap: final consultation on updating the credit SMNCC allowance, paragraph 4.47. https://www.ofgem.gov.uk/publications/price-cap-final-consultation-updating-credit-smncc-allowance
[25] The cost per installation achieved is the productive installation cost divided by the number of actual installations.
[26] Despite a fall in the cost per productive installation, total productive installation costs as reported by suppliers in response to our RFIs rose between 2020 and 2021. This partly reflects an increase in the number of productive installs offsetting any fall in per install costs. This is why despite sunk installation costs rising for PPM (see table 3.1), as a proportion of total installation costs they fell by approximately 1ppt (see para 3.19).

4. Rollout

Section summary

This chapter sets out our proposals related to rollout. These cover the impact of the Supplier of Last Resort (SoLR) process and of BEIS's proposals on accounting for customer churn on our rollout profiles. They also cover updates using rollout data, including fuel-specific rollout.

4.1. The number of smart meter installations drives the majority of costs and benefits in the SMNCC. It affects the costs in the year of the installations and the costs in future. We model the cumulative profile of installations over time – referred to as the rollout profile.

4.2. BEIS's new rollout framework ('the Framework') started on 1st January 2022. The Framework sets not only rollout targets for suppliers, but also places minimum installation requirements on suppliers after applying a tolerance level (we refer to this as 'tolerance level'). In our August 2021 decisions, we decided to set the future portion of our rollout profiles using the tolerance levels rather than the target levels.

SoLR impact on the market leader rollout profile

Context

4.3. We decided to use different rollout profiles for credit and PPM in our August 2021 PPM SMNCC decision.[27] We decided to use the market leader rollout profile for credit and the market average rollout profile for PPM.[28]

[27] Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 4.8. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance
[28] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 2.21. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 5.48. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

4.4. The rollout profiles are used to set the SMNCC allowances in future cap periods and calculate the discrepancies between historical SMNCC allowances and suppliers' actual costs. These discrepancies are then corrected through the advanced payments adjustment.

4.5. Following the recent increase in wholesale prices, there have been numerous supplier exits in a short period of time. This has meant that some of the suppliers remaining in the market have taken on customers from the suppliers who exited the market through the SoLR process.

Overview of responses

4.6. In response to our October 2021 consultation, one supplier's economic adviser said that taking on customers through the SoLR process would likely have reduced the smart meter rollout for the market leader, and therefore affected our calculation of advanced payments.

Proposal

4.7. Having considered the position carefully, we propose not to make an adjustment for SoLR impacts at this stage and to continue using the same rollout profile to calculate advanced payments as we use to calculate forward-looking smart metering costs.

Considerations

4.8. In response to the October 2021 consultation, one supplier's economic adviser stated that any advanced payments to suppliers that recently exited the market are effectively lost at industry level. It stated that, as a result, financially sound and efficient suppliers, who have complied with their smart meter rollout obligations, will receive less favourable treatment than suppliers which benefitted from the full level of the SMNCC allowance before entering the SoLR scheme.

4.9. We did not need to reach a position on this issue in our February 2022 decision, as we were not updating the rollout profiles. However, we said that we would consider the issue for cap period nine.[29]

4.10. This issue is specific to advanced payments. It does not affect the rollout profiles we use to set the SMNCC allowances in future cap periods. Suppliers who took on SoLR customers will have more smart meters left to install. The rollout profiles will reflect this for future cap periods. Therefore, the SMNCC will reflect that suppliers will have increased costs for credit in future cap periods.

4.11. This issue is also specific to credit because we use a market leader rollout profile for credit calculations, which will directly reflect any impact SoLR has on the rollout of the market leading suppliers. As exiting suppliers are likely to be further behind in their smart meter rollout when compared to suppliers who are the market leaders, we would expect the impact of SoLR on market leaders to be negative. In contrast we use a weighted average rollout profile for PPM which is less impacted by the movement of customers between suppliers and so we would expect a negligible impact of SoLR on our PPM rollout values.

4.12. In order to consider how SoLR impacted market leaders rollout, we asked the suppliers who could potentially be the market leader for data on their rollout at the end of 2021. We asked for this to be split between their existing customer base and customers gained through the SoLR process.

4.13. In each case, the rollout percentage for the credit customers gained through the SoLR process was lower than for their existing customer base. However, as the customers gained represented a small proportion of their customer bases, the overall impact of taking on customers through the SoLR process was on their overall smart meter rollout for credit customers was to reduce it by less than 1ppt.

4.14. Making an adjustment to remove the impact of SoLRs would increase the complexity of calculating the SMNCC. We would need to develop a specific rollout profile for advanced payments (for both the market leading suppliers). We would then need to calculate the

[29] Ofgem (2022), Price Cap - February 2022 decision on credit and PPM SMNCC allowances, Appendix 13, paragraphs 1.10 to 1.12.
https://www.ofgem.gov.uk/publications/price-cap-february-2022-decision-credit-and-ppm-smncc-allowances

SMNCC with this rollout profile, and feed this back into the SMNCC model as an additional input to help us calculate advanced payments.

4.15. We do not consider that making this adjustment would be proportionate at this stage, given the low impact of SoLR customers on these suppliers' rollouts and the complexity of implementing an adjustment when calculating the SMNCC.

Using ASR data to update 2021 rollout

4.16. Suppliers submit Annual Supplier Returns (ASR) data to BEIS each year. This data provides information on costs related to smart and traditional metering that they have incurred in the previous year.

4.17. The latest ASR includes data on the rollout progress of suppliers by the end of 2021. We propose to update smart meter roll out percentages for 2021 using this ASR data. We discuss using this to update the rollout profiles used to set the SMNCC in Appendix 4, along with the other proposals on data updates.

Updating fuel specific rollout with 2021 values

Context

4.18. In our August 2020 decision, our ASR main rollout data was not split by fuel, so we did not calculate separate rollout profiles for each fuel. We maintained the same approach in our April 2021 consultation.

4.19. In response to the April 2021 consultation, one supplier said that we must return to our approach of separate rollout profiles for gas and electricity. We agreed with the supplier that gas and electricity smart meters have different costs, and that, therefore, the rollout profiles used for each fuel will affect the total costs. We also agreed that the rollout profiles for each fuel will also have some impact on costs through the number of dual fuel and single

fuel installations. Therefore, in our August 2021 decision, we included adjustments from a separate data source to create separate rollout profiles for each fuel.[30]

4.20. We estimated these by looking at historical data for rollout up to 2020 across large energy suppliers. We used this data to calculate the ratio between the rollout achieved for a given fuel and the combined dual fuel rollout. We then applied this ratio to the rollout profiles in the SMNCC model.

Proposal

4.21. We propose to maintain the existing fuel-specific rollout adjustments from August 2021 decisions, which uses historical rollout data up to 2020 across large energy suppliers.

Considerations

4.22. We calculated the impact of updating the fuel-specific rollout adjustments with 2021 data. This would affect the values for 2021 and beyond.

4.23. Given there was an immaterial impact from this, we are not proposing to update the existing fuel-specific rollout adjustment with 2021 data. The scaling factors would be unchanged (to two decimal places) from the 2020 values.

4.24. We do not consider it necessary to make all possible minor updates as part of this Annual Review. As set out in SMNCC WP5, "we do not expect to carry out future Annual Reviews (including this one) with the same level of detail as our May 2020 credit consultation, as we consider this would be disproportionate".[31]

[30] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 2.23. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 4.30. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance
[31] Ofgem (2021), Price Cap - Working paper on 2022 Annual Review of SMNCC allowances, paragraph 27. https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

BEIS's proposed changes to rollout framework in relation to customer driven churn

4.25. Customer churn is when customers leave suppliers (and subsequently move to other suppliers). BEIS consulted on proposals to mitigate the impact of customer driven churn[32] on energy suppliers' tolerance rollout levels for the second year of the Framework. The consultation closed on 20 January 2022, and BEIS is currently considering the responses.[33]

4.26. They proposed an adjustment to the way that supplier smart meter installation requirements are calculated, to reduce the impact of customer driven churn on the requirements in Year 2 of the Framework (2023). This aims to ensure that suppliers receive recognition for the smart meters they install, even where customers subsequently move to a different supplier.

4.27. The changes currently being consulted by BEIS will not impact the SMNCC as part of our 2022 Annual Review. This is because it would not affect the projected rollout of smart meters in 2023 that we currently use in our model. We can consider whether there is any impact from the changes being consulted by BEIS in a future annual review.

[32] We refer to customer driven churn as customers choosing to switch between suppliers, rather than moving to a supplier due to SoLR processes.
[33] BEIS (2021), Smart meter targets framework: churn adjustment.
https://www.gov.uk/government/consultations/smart-meter-targets-framework-churn-adjustment

5. Updates to general economic inputs

Section summary

This chapter sets out proposals to update several general economic inputs into the SMNCC model. This includes the GDP deflator measure of inflation, the headline rate of corporation tax and the Long-Run Variable Cost of energy supply estimates.

5.1. The SMNCC model uses several externally determined general economic inputs. In this section we consider proposals to update those inputs we have identified as having newer estimates or as having changed in response to changes in policy.

GDP deflator

Context

5.2. The GDP deflator is the measure of price inflation used in the SMNCC model to convert real to nominal figures (and vice versa). The GDP deflator values currently used in the SMNCC model are taken from the HM Treasury (HMT) Green Book supplementary guidance as published on 11 April 2019.[34]

5.3. On 15 July 2021 the HMT Green Book supplementary guidance was updated, including the GDP deflator values included in the associated data tables.[35] This newer data reflects the Office for National Statistics (ONS) estimates of the GDP deflator up to 2020 as published

[34]Green Book supplementary guidance: valuation of energy use and greenhouse gas emissions for appraisal. Table 19 of: https://web.archive.org/web/20200522003020/https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/793632/data-tables-1-19.xlsx

[35] Green Book supplementary guidance: valuation of energy use and greenhouse gas emissions for appraisal. Table 19 of: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1024043/data-tables-1-19.xlsx

alongside the first estimate of Q4 2020 GDP and the Office for Budget responsibility (OBR) forecasts of the GDP deflator published in its March 2021 Economic and fiscal outlook.[36,37]

Proposal

5.4. We propose to maintain the GDP deflator as our measure of price inflation within the SMNCC model. We also propose to update the GDP deflator values used in the SMNCC model to those published in the latest version of the HMT Green Book supplementary guidance.

Considerations

Data source

5.5. As the HMT Green Book supplementary guidance is not published as regularly as the underlying ONS and OBR publications, from which it sources its GDP deflator values, it will not always reflect the very latest estimates and forecasts by the ONS and OBR.

5.6. Subsequent updates to the HMT Green Book supplementary guidance will inevitably reflect these newer estimates, and in turn those estimates will be used in future versions of the SMNCC model. As such any difference between the deflator values used now and the newer estimates will affect the advanced payments calculation in future SMNCC updates. The impact of using estimates from the HMT Green Book supplementary guidance rather than directly from the latest ONS and OBR sources will therefore be temporary.

5.7. We therefore consider it proportionate to maintain the current source.

[36]ONS GDP first quarterly estimate Q4 2020: https://www.ons.gov.uk/file?uri=%2feconomy%2fgrossdomesticproductgdp%2fdatasets%2fuksecondestimateofgdpdatatables%2fquarter4octtodec2020firstestimate/firstquarterlyestimateofgdpdatatables.xls

[37] OBR March 2021 Economic and Fiscal Outlook: Economy supplementary tables. Table 1.7: https://obr.uk/download/march-2021-economic-and-fiscal-outlook-supplementary-economy-tables/

Impact of COVID-19 on GDP deflator

5.8. The impact of the pandemic on ONS measurement of government output has resulted in known issues with the GDP deflator values for 2020 and 2021.[38,39] The GDP deflator shows higher levels of inflation in 2020 and lower levels in 2021 compared to other measures of inflation such as the Consumer Prices Index including owner occupiers' housing costs (CPIH).

5.9. As these trends have been driven by measured changes in government consumption they are unlikely to be reflective of the change in prices suppliers and consumers experienced in 2020 and 2021.

5.10. We considered two potential responses to this:

- Change to using a deflator implied from market GDP only. This would require using an unpublished series, reducing the transparency of our approach, and would make historical values inconsistent with the GDP deflator values used for 2022 and 2023 which are taken from OBR forecasts.

- Change to using a market-based measure of inflation such as CPIH. This is a change we have considered making previously, prior to taking our August 2020 decision.[40] We concluded then that we did not consider it necessary to use market-based measures as the GDP deflator is an official source and any forecast will be subject to uncertainty. We maintain that position now.

5.11. As the GDP deflator appears to give a higher inflation estimate in 2020 and lower inflation estimate in 2021, when compared other measures of inflation such as CPIH, we expect these differences to be at least partially offsetting. As a result, and for the reasons

[38] The ONS uses volume estimates of UK government consumption when estimating GDP. During the pandemic this volume estimate fell, for example due to fewer elective care episodes. However, spending (or "current price") estimates of government consumption rose, reflecting the increased expenditure due to the pandemic. These movements resulted in a rise in the implied inflation faced by government, influencing the overall GDP deflator estimates.
[39] ONS International comparisons of GDP during the coronavirus (COVID-19) pandemic: https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/internationalcomparisonsofgdpduringthecoronaviruscovid19pandemic/2021-02-01#government-consumption-expenditure
[40] Ofgem (2020), Technical annex to reviewing smart metering costs in the default tariff cap: August 2020 decision: https://www.ofgem.gov.uk/sites/default/files/docs/2020/08/technical_annex_to_reviewing_smart_metering_costs_in_the_default_tariff_cap_-_august_2020_decision.pdf

already listed above, we propose not to change inflation measures and to update GDP deflator values as sourced from the HMT Green Book guidance.

5.12. The impact of the revised GDP deflator values have on historical cap periods will be accounted for through the advanced payments calculation.

Corporation tax

Context

5.13. The headline rate of corporation tax is used in the SMNCC model to convert the 2019 CBA post-tax cost of capital estimate into a pre-tax figure. This is done as the SMNCC allowance ultimately needs to provide suppliers with pre-tax revenue.

5.14. The pre-tax cost of capital figure is primarily used in the SMNCC model to amortise the cost of buying and installing smart metering equipment.

5.15. Currently the same rate of corporation tax (19%) is used for every year of the model, reflecting the current headline rate. From 1 April 2023 the main rate is rising to 25%.[41]

Proposal

5.16. We propose to use the average rate of corporation tax weighted by the modelled profile of smart meter installations between the start of smart meter rollout in 2012 and the end of the SMNCC modelling period in 2023.

5.17. This generates a corporation tax rate of 20%.

Considerations

5.18. Maintaining a 19% value or moving straight to using a 25% value would, respectively, under and overestimate the impact of corporation tax on the pre-tax cost of capital that

[41]HM Revenue & Customers (2021), Corporation Tax charge and rates from 1 April 2022 and Small Profits Rate and Marginal Relief from 1 April 2023: https://www.gov.uk/government/publications/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023

suppliers face. Our proposal means we are able to reflect the average rate of corporation tax suppliers have faced over the period they have been installing smart meters. Using the number of smart meter installations in each year to weight the importance of each years corporation tax rate ensures the average reflects the profile of supplier activity over time. This approach offers accuracy benefits compared to choosing one of the headline rates while avoiding the proportionality concerns of other methods, such as those discussed below.

5.19. A potential alternative approach would be to expand the model so that it could take as inputs the relevant headline rate for each year of the model. Adjusting the model to be able to take a profile of corporation tax rates, and therefore cost of capital estimates, would add complexity to the calculations and the impact on accuracy would be ambiguous. Corporation tax is just one component of the cost of capital calculation and it may change over time in a way that is uncorrelated with other underlying cost of capital components, such as the cost of equity. As such we cannot be sure that incorporating changes in corporation tax alone would generate more appropriate cost of capital estimates.

5.20. Estimating how the average cost of capital across suppliers has changed over time and forecasting this into the future would also be an extremely complex analytical task and any output would be subject to considerable uncertainty. We would consider such an exercise disproportionate given the unclear gains in accuracy.

5.21. For these reasons we propose maintaining a single cost of capital estimate and therefore a single corporation tax rate.

Long-Run Variable Cost of energy

Context

5.22. The Long-Run Variable Costs of energy supply estimates (LRVC) are a set of figures published as part of HMT's Green Book supplementary guidance.[42] They attempt to isolate the parts of the retail price that vary according to the level of consumption. They are used as an input when estimating the value to suppliers of being able to better manage customer debt

[42] Green Book supplementary guidance: valuation of energy use and greenhouse gas emissions for appraisal. Table 9 and 10 of: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1024043/data-tables-1-19.xlsx

because of smart metering. Given the reduced ability of PPM customers to build up debt, these benefits apply to credit customers only.

5.23. The SMNCC model uses the change in LRVC values, compared to the equivalent 2021 values, to adjust the portion of the average 2021 retail bill which is related to variable costs, in order to produce a modelled time series of average retail bills. This series of average retails bills is then used to scale the estimated debt management benefits to suppliers.

5.24. As with the GDP deflator, the LRVC values currently used in the SMNCC model are taken from the HMT Green Book supplementary guidance as published on 11 April 2019.[43] On 15 July 2021 the HMT Green Book supplementary guidance was updated, including new LRVC estimates. However subsequently we have seen significant price increases in wholesale energy markets, which are not reflected in the latest published LRVC values.

Proposal

5.25. We propose to update the LRVC values used in the SMNCC model to the "central" estimates published in the latest HMT Green Book supplementary guidance.

Considerations

5.26. Using the latest "central" LRVC estimates allows us to reflect the newest estimates while avoiding introducing additional complexity.

5.27. We considered whether to make changes to the LRVC estimates so they better reflect current wholesale prices. However, we do not consider this proportionate because of the low materiality of the issue and the additional complexity that it would entail.

5.28. We explored two potential ways to better reflect changes in wholesale energy prices. The first was to use the "high" LRVC estimates for 2021 to 2023 and the second was to

[43] Green Book supplementary guidance: valuation of energy use and greenhouse gas emissions for appraisal. Table 9 and 10 of: https://web.archive.org/web/20200522003020/https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/793632/data-tables-1-19.xlsx

uprate the 2021 and 2022 "central" LRVC estimates by the change in the wholesale component of the price cap.

5.29. The first of these approaches involves constructing a new data series from two separate published data series, the "central" and "high" LRVC estimates. The second involves adjusting a published data series through a set of calculations conducted outside of the main SMNCC model. In both cases this adds complexity and reduces the transparency of our modelling.

5.30. The impact of both approaches was a small increase in the estimated debt management benefits to suppliers, as these scale in proportion to average bills, but an immaterial impact on the final credit SMNCC values.[44]

5.31. This is because debt management benefits are only a very small component of the final credit SMNCC value. For example, debt management benefits added only around -£0.15 to the final cap period eight credit SMNCC value.

5.32. When weighing this additional complexity against the low materiality, we consider our proposed approach proportionate.

5.33. Any impact revised LRVC estimates have on historical cap periods will be accounted for through the advanced payments calculation.

[44] Only credit SMNCC values are impacted by changes in debt management benefits as it is assumed that there are no such benefits from switching PPM customers to smart meters given the reduced ability of PPM customers to build up debt.

6. Other areas

Section summary

In this chapter, we summarise our proposal to update the SMNCC model using 2021 Annual Supplier Return data and set out where in the appendices further information can be found on data updates and our review of uncertainty. We also cover the contingency approach that we have adopted for this review and detail an adjustment to the advanced payments calculation needed to align the model with a previous decision.

Data updates

6.1. Suppliers submit Annual Supplier Return (ASR) data to BEIS each year. This data provides information on costs related to smart and traditional metering that they have incurred in the previous year.

6.2. We discussed this data in SMNCC WP5. We said that we intended to update the SMNCC model using ASR data in certain areas. A detailed description of our proposal, considerations, and a summary of supplier responses to the WP5 proposal are set out in Appendix 4.

6.3. Table 6.1 below briefly summarises the areas of the SMNCC model we intended to update using the 2021 ASR data.

Table 6.1 – Proposed updates to the SMNCC model using ASR 2021 data

Area	Components
Costs	• the costs of smart meters • the costs of communication hubs • the costs of In-Home Displays (IHDs).
Benefits	• the number and cost of avoided site visits • change of supplier benefits (credit only) • benefits of reduced inbound enquires (credit only) • improved debt management (credit only) • benefits of remote change of tariff (credit only)
Rollout	• data on actual customer numbers by metering type to update smart meter roll out percentages for 2021

6.4. In Appendix 4 we also set out minor updates from our August 2021 decisions and additional model updates that we have decided to carry out in other areas.

6.5. Finally in Appendix 4 we also set out our proposal to introduce a non-zero meter rental uplift adjustment for traditional PPM electricity meters. We decided not to make this change as part of the February 2022 decision because stakeholders had not had the opportunity to comment on it. We stated it was our intention to consult on applying a non-zero meter rental uplift for electricity PPM as part of our next Annual Review.

Review of uncertainty

6.6. In Appendix 7, we set out our view that we should continue to assess the uncertainty around our calculated SMNCC values qualitatively. We explain our view that the net effect of the uncertainty is roughly neutral, and that we have therefore decided not to make a numerical uncertainty adjustment.

Contingency allowance

6.7. We must set an SMNCC allowance for cap period nine, regardless of whether we are able to complete our 2022 Annual Review by early August 2022. This means that we need a contingency allowance proposal, in case there is a situation where we are not able to complete our 2022 Annual Review within the deadline.

6.8. We propose to use the updated SMNCC model as a starting point to set any contingency value. This is the same contingency approach that we proposed in previous consultations. Unlike the other options, it would allow us to incorporate the most recent information.

6.9. In the event that we can place limited or no weight on the updated SMNCC model to set the contingency allowance, we propose to use the SMNCC values we calculated for cap period nine in our February 2022 decision, the current values. For dual fuel these values are £8.02 for Credit and -£22 for PPM (before PPM cost offset).[45] Given we are using SMNCC

[45] Ofgem (2021), Price Cap – February 2022 decision on credit and PPM SMNCC allowances, Appendix 1 and 2. https://www.ofgem.gov.uk/publications/price-cap-february-2022-decision-credit-and-ppm-smncc-allowances

values which relate to the correct cap period and that we have reset the cap period nine values recently in our February 2022 decision, this should support accuracy.

Advanced payments calculation

6.10. Advanced payments reflect when suppliers have received payment in advance for smart metering costs they have not incurred, or when they have not received payment for efficient costs that they should have been funded for. We calculate the SMNCC allowance in a given historical cap period using the latest version of the SMNCC model, and compare it against the SMNCC allowance we provided in that cap period.

6.11. In our August 2021 decision, we decided to calculate advanced payments using the net SMNCC for PPM (ie after we had applied the offset), rather than the SMNCC determined by the model.[46]

6.12. We have noted a change is needed to the model calculations to give accurate effect to this decision as part of our quality assurance of the SMNCC model during this Annual Review. This is because the current model compares the revised net SMNNC values with the gross published values (ie the PPM allowance before applying the PPM offset) rather than the net published values when calculating PPM advanced payments.

6.13. This did not affect cap period seven (October 2021 – March 2022) as there was no difference between the gross and net PPM SMNCC for cap periods five or six, as the gross values for those periods were already at their maximum of zero.

6.14. In cap period eight this had the effect of increasing the gross PPM SMNCC value by +£0.75 for electricity, and +£2.82 for gas. Therefore, had this change to the model's calculation happened ahead of the February 2022 decision, the cap 8 net SMNCC value for PPM electricity meters would have been unchanged at £0.00, while the net SMNCC value for PPM gas meters would have been -£10.29 instead of -£7.47.

[46] Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance paragraph 6.7 page 97: https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

6.15. These revised values for cap period eight will now feed into the adjusted advanced payments calculation in the latest SMNCC model and influence the PPM SMNCC values from cap period nine onwards.

Other impacts of current market developments on the SMNCC

6.16. We do not presently intend to make other changes to our SMNCC modelling approach as part of our 2022 Annual Review. This reflects the fact that we consider that the existing approach, which we have developed through significant previous engagement with stakeholders, remains appropriate.

6.17. We stated previously that if stakeholders considered that there are other areas we should consider as part of our 2022 Annual review, they should raise this in response to the October 2021 working paper.[47] This current document is our final consultation before deciding on any changes to the SMNCC allowances as part of our 2022 Annual Review. We would therefore need to consider whether it was practical and proportionate to address any new issues raised in response to this consultation as part of the 2022 Annual Review, rather than in a subsequent annual review.

[47] Ofgem (2021), Price Cap - Working paper on 2022 annual review of SMNCC allowances, paragraph 30 and 31. https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

Appendices

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Appendix 1 – Proposed Credit SMNCC values

1.1. We propose to make the changes to the credit SMNCC (as set out in this consultation) in the document 'Annex 5 – Methodology for determining the Smart Metering Net Cost Change' referred to in standard condition 28AD of the electricity and gas supply licences.

1.2. Within that document, we propose to make changes to sheet '2a Non pass-through costs', cells Q7:S8.

1.3. The values we currently propose to insert are set out in the table below. These are the output values from the SMNCC model we have disclosed. At the decision stage, we intend to use the output values from the SMNCC model at that stage, including any revisions.

Table A1.1: Values to insert into Annex 5 of SLC28AD

Fuel	Cap period nine	Cap period ten	Cap period eleven
Electricity	10.05	10.34	10.34
Gas	-0.61	-0.69	-0.69

Notes: All values are £/customer, nominal.

Appendix 2 – Proposed PPM SMNCC values

1.1. We propose to make the changes to the PPM SMNCC (as set out in this consultation) in the document 'Annex 5 – Methodology for determining the Smart Metering Net Cost Change' referred to in standard condition 28AD of the electricity and gas supply licences.

1.2. Within that document, we propose to make changes to sheet '2a Non pass-through costs', cells Q9:S10.

1.3. The values we currently propose to insert are set out in the table below. These are the output values from the SMNCC model we have disclosed. At the decision stage, we intend to use the output values from the SMNCC model at that stage, including any revisions.

1.4. The values in the table are before the PPM cost offset has been applied. The PPM cost offset is only applied to these values once they have been inserted into Annex 5.

Table A2.1: Values to insert into Annex 5 of SLC28AD

Fuel	Cap period nine	Cap period ten	Cap period eleven
Electricity	-5.21	-6.16	-6.16
Gas	-22.99	-25.67	-25.67

Notes: All values are £/customer, nominal. These SMNCC values are before the PPM cost offset has been applied.

Appendix 3 – October 2021 working paper stakeholder comments

1.1. This appendix contains our consideration of stakeholder comments provided in response to SMNCC WP5 which set out the intended scope of the 2022 Annual Review.

1.2. There were a limited number of responses to this working paper. A small number of points were raised which we address below.

1.3. One supplier questioned the working papers proposal to use the latest ASR data to update a list of named cost and benefits only. This comment is addressed in Appendix 4 below.

Disclosure

1.4. One supplier commented on the lack of a model disclosure process alongside the publication of the working paper. It said that as a minimum Ofgem should fully disclose all relevant versions of the SMNCC model as part of any final consultation and allow adequate time for stakeholders to review the disclosed models.

1.5. We disclosed the model as part of our October 2021 consultation.[48] We are also disclosing the relevant models at the same time as publishing this consultation document.[49] We consider that this provides adequate time for consideration of the model.

1.6. As normal practice, we do not disclose the model at the working paper stage as we do not consider it valuable for stakeholders. This is because we typically have not implemented the proposed changes to the model at the point we publish working papers. Stakeholders will therefore not be able to scrutinise the practical implementation of the proposed changes by having access to the models.

[48] Ofgem (2021), Disclosure arrangements for autumn 2021 consultations: https://www.ofgem.gov.uk/publications/price-cap-disclosure-arrangements-autumn-2021-consultations
[49] Ofgem (2022), Disclosure arrangements for Spring 2022 consultations: https://www.ofgem.gov.uk/publications/price-cap-disclosure-arrangements-spring-2022-consultations

Installation costs

1.7. One stakeholder commented that they did not think the costs of installing smart meters should be included in the SMNCC allowances and therefore they should not be reflected in the default tariff cap. They highlighted alternative options for monitoring household energy which they considered would be more effective.

1.8. Smart meters are an important feature for modernising the retail energy market. They help decarbonise the energy sector, enable energy supplier to offer new products and services to customers, and allow consumers to take control of their energy consumption.

1.9. Ultimately smart metering policy is set by the Department for Business, Energy & Industrial Strategy (BEIS). This policy generates a set of cost obligations on suppliers, as well as a number of benefits to suppliers. The purpose of the SMNCC allowance is to enable suppliers to recover the efficient costs related to this required activity while maintaining price protection for customers.

Appendix 4 – Data updates

1.1. This appendix contains our decisions to update certain inputs using data that suppliers provide to BEIS and to carry out minor updates in other areas.

Annual Supplier Return (ASR) data

Context

1.2. Suppliers submit ASR data to BEIS each year. This data provides information on costs related to smart and traditional metering that they have incurred in the previous year.

1.3. We discussed this data in SMNCC WP5.[50] We said that we intended to update the SMNCC model using ASR data in certain areas. We did not intend to update the other areas included in the ASR.

Proposal

1.4. In line with SMNCC WP5, we propose to update the SMNCC model using ASR data in the following areas:

- costs: the costs of smart meters, communication hubs and In-Home Displays (IHDs).
- benefits: the number and cost of avoided site visits - this applies to both the credit and PPM SMNCCs. The following benefits apply to credit only: change of supplier, inbound enquiries, debt, and remote change of tariff.
- rollout: use ASR data on actual customer numbers by metering type to update smart meter roll out percentages for 2021 (as previously mentioned in Chapter 4).

[50] Ofgem (2021), Working paper on 2022 annual review of SMNCC allowances, paragraphs 18-21: https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

1.5. We are not proposing to use ASR data to update smart meter installation costs, as we have gathered our own data (see Chapter 3).

1.6. We also propose to make some consequential edits as a result of using the ASR data. These are: removing optimism bias from the 2021 values, starting any assumed cost erosion[51] from after the last actual data, and updating the baseline adjustment for payment methods.[52]

1.7. These positions are unchanged from the proposals in SMNCC WP5.

Overview of responses

1.8. In response to SMNCC WP5 a supplier highlighted the indication given in that paper that we do not consider other areas included in the ASR data, outside those listed in paragraph 1.4 above, to be as significant or likely to change materially. It suggested we should not be predetermining whether or not to include aspects of the ASR data ahead of seeing the returns.

Considerations

1.9. The areas we propose to update using ASR data as part of the 2022 Annual Review are in line with our August 2021 decisions, where we decided to update four additional benefits.[53]

1.10. Our reason for considering ASR data outside the pre-identified areas as being less significant, is due to the limited (or zero) role that those aspects of the ASR data play within the SMNCC model's methodology.

1.11. The SMNCC model is mature. Further methodological and data changes therefore tend to have diminishing returns when it comes to improved accuracy or raw impact on the final

[51] The SMNCC model assumes that the costs of smart meter assets and SMETS1 communications hubs decline slightly over time, for years where data is forecast. The SMNCC model refers to this as cost erosion.
[52] for the avoidance of doubt, the figures presented earlier in the document incorporate all the proposals in this appendix.
[53] Ofgem (2021), Decision on credit SMNCC allowance, Appendix 10: https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance

SMNCC allowances. For this reason we consider it proportionate to focus on using the ASR data to update the most consequential aspects of the model.

Minor updates from August 2021 decisions

Context

1.12. For our August 2021 decision we decided to update the following inputs to the SMNCC model:[54]

- the profile for the proportion of SMETS1 meters enrolled with the DCC
- the date at which SMETS1 meters are treated as enrolled
- the proportion of SMETS1 meters expiring earlier
- the scaling factors for the proportion of SMETS1 meters losing smart functionality
- the proportion of installations which are SMETS1 or SMETS2 for 2020 and 2021

Proposal

1.13. We do not propose to update these elements again ahead of the August 2022 decision.

Considerations

Profile for the proportion of SMETS1 meters enrolled with the DDC

1.14. In our August 2021 SMNCC decisions (credit and PPM) we decided to shift the August 2020 enrolment profile back one year for all the years that were forecasts (ie 2020 onwards). This was to reflect the fact that enrolment was behind previous expectations due to COVID-19.

[54] Ofgem (2021), Decision on credit SMNCC allowance , Appendix 10 paragraph 1.29: https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Decision on PPM SMNCC allowance, paragraph 2.171: https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

1.15. We also decided to estimate enrolment in 2020 by averaging the enrolment profile values for 2019 and 2021.

1.16. After comparing the enrolment profile currently used in the model to the latest Data Communications Company (DCC) data we consider them sufficiently close that it is not necessary to update the profile during this Annual Review.[55]

1.17. Maintaining the current profile is consistent with our approach to other metrics in the model, where we focus on making changes where there is likely to be a significant improvement in accuracy from doing so. Adjusting the profile would only have small impact on the final SMNCC values, in the region of £0.22 for credit and £0.15 for PPM.

Date at which SMETS1 meters are treated as enrolled

1.18. In our August 2021 decisions we changed the year when it is assumed all SMETS1 meters have been enrolled from 2021 to 2022.

1.19. Adjusting this assumption would result in an adjustment in the enrolment profile, which we are not proposing to make. Maintaining this assumption therefore follows as a logical consequence of the previous proposal. We therefore propose not to alter this assumption.

Proportion of SMETS1 meters expiring early

1.20. The SMNCC model includes an assumption for the proportion of SMETS1 meters expiring early for reasons unrelated to enrolment.

1.21. Given that we are proposing to maintain the year SMETS1 meters are treated as enrolled, we also consider it appropriate to maintain this assumption.

1.22. This is because the value of this assumption for 2020 to 2023 is calculated by drawing a line from a 2019 value, based on 2017-19 supplier data, to an assumed low enduring rate of 0.2% by the year all SMETS1 meters have been enrolled (ie 2022 from the earlier unchanged

[55] DCC (2022), The smart meter network in numbers, SMETS1 meters connected to network. https://www.smartdcc.co.uk/our-smart-network/network-data-dashboard/

assumption). Maintaining this assumption therefore follows as a logical consequence of the previous proposal, and therefore we also propose not to alter it.

Adding an extra scaling factor for the proportion of SMETS1 meters without smart functionality at the end of 2021

1.23. In our August 2021 decisions we introduced the use of a scaling factor to amend the assumed number of SMETS1 meters losing smart functionality so that it better aligned with the latest data. This scalar was applied from 2020 onwards.

1.24. We do not consider it necessary to add an extra scaling factor for 2021 and beyond because the current scaling factor produces an estimate for the number of SMETS1 meters operating in traditional mode in 2021 that is sufficiently close to the latest BEIS metering statistics.[56]

1.25. The difference between the estimate and actual number, for 2021, is 256,789 or +6.2%. This is less than the 408,434 discrepancy for 2020 that led to the decision to introduce a scaling factor for that year. As enrolment of SMETS1 meters with the DCC reaches 100%, any difference between our estimates and the actual number should diminish.

1.26. Not making updates of this kind, where the materiality is low, is in keeping with our proposal in SMNCC WP5 not to carry out Annual Reviews with the same level of details as our May 2020 credit consultation.[57]

Updating the proportion of installations which are SMETS1/SMETS2 for 2021 & 2022

1.27. The SMNCC model includes assumptions for the proportions of SMETS1 and SMETS2 installations in each year. In our August 2021 decisions we updated these assumptions using industry data for 2020 and the first months of 2021.

[56] BEIS (2022), Smart meters in Great Britain, quarterly update December 2021, Table 5 O18 "All suppliers smart in traditional mode": https://www.gov.uk/government/statistics/smart-meters-in-great-britain-quarterly-update-december-2021

[57] October (2021), Price Cap - Working paper on 2022 Annual Review of SMNCC allowances, paragraph 27. https://www.ofgem.gov.uk/publications/price-cap-working-paper-2022-annual-review-smncc-allowances

1.28. We do not consider it necessary to update these assumptions using a full year of data for 2021. The current assumed proportion of installations that were SMETS1 in 2021 already aligns with the data we have seen.

1.29. We also consider it appropriate to maintain the assumption of zero percent SMETS1 installations in 2022. This is because the New and Replacement Obligation, which came into effect on 30 June 2019, requires energy suppliers to take all reasonable steps to install a SMETS2 meter wherever a meter is replaced or where a meter is installed for the first time.[58]

Traditional electricity PPM meter rental uplift

Context

1.30. We use the meter rental uplift to adjust our modelled approach to metering costs, taking into account data on suppliers' meter rental charges.[59]

1.31. The meter rental uplift is an approximation, so we do not apply one in all cases. We do not use one where there would only be a small difference between the modelled approach and the meter rental charge data.

1.32. In our October 2021 consultation model (and previous versions), we applied a meter rental uplift for traditional gas PPM meters, but set this to zero for traditional electricity PPM meters.

1.33. In our February 2022 decision we increased the amortisation period for PPM, which reduced annual metering costs in the modelled approach, as asset and installation costs are spread over more years. This in turn increased the difference between the modelled approach and the meter rental charge data.

[58] Ofgem (2019), Smart Meter Rollout: Energy Suppliers' Progress and Future Plans - Open Letter June 2019. https://www.ofgem.gov.uk/publications/smart-meter-rollout-energy-suppliers-progress-and-future-plans-open-letter-june-2019

[59] For an explanation of our approach to the meter rental uplift (in the context of the credit SMNCC, but also applicable to the PPM SMNCC), see: Ofgem (2020), Technical annex to reviewing smart metering costs in the default tariff cap: August 2020 decision, paragraphs 3.50 to 3.53. https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap

1.34. After recalculating the implied uplift values following the change in modelled PPM costs, it became apparent that there was now a greater a case to include a non-zero meter rental uplift for traditional electricity PPM meters. We decided not to make this consequential change as part of the February 2022 decision because stakeholders had not had the opportunity to comment on it. We stated it was our intention to consult on applying a non-zero meter rental uplift for electricity PPM as part of our next Annual Review.

Proposal

1.35. We propose to introduce a non-zero meter rental uplift for traditional electricity PPM meters.

1.36. We propose to set this at 35%, reflecting the proportional difference between the average modelled rental payments and actual meter rental payments as given by supplier data in 2019.

Considerations

1.37. Setting a non-zero meter rental uplift for traditional electricity PPM meters will increase modelled installation and asset costs of traditional electricity PPM meters. This will increase the modelled benefit of fewer traditional meters being bought and installed under a given smart metering rollout scenario, when compared to the counterfactual of no smart metering.

1.38. As a result this will reduce the modelled electricity PPM increment. The impact this change on the electricity PPM SMNCC value, when applied to the model used for our February 2022 decisions, is to reduce it by up to £2.49 from cap period nine onwards. However, this impact is unlikely to change the final non-pass-through PPM SMMNC allowance. This is because the PPM cost offset, which is added onto the non-passthrough value, is large enough to ensure the final value remains £0.00.

1.39. Making this change will reduce the discrepancy between modelled and measured costs, thereby increasing accuracy. It will also align the approach taken for traditional electricity PPM meters with the approach already taken for traditional gas PPM meters.

Appendix 5 – Calculation notes

Calculation notes relating to rollout

Calculation steps for credit rollout profile

1.1. For calculation steps for rollout up to and including 2017 to 2020, please see Appendix 8 of our August 2021 SMNCC decision for credit ('August 2021 Credit SMNCC decision').[60]

1.2. We have updated our estimates for 2021 rollout using the market leader's historical (actual) rollout. We have selected the market leader using the process set out in our February 2021 second credit SMNCC working paper ('SMNCC WP2').[61,62] This gives the starting point for the new framework – ie estimated cumulative rollout at the end of 2021.

1.3. For the remaining years of the cap, we calculate the obligation for a supplier with this starting point. We use the annual tolerance values for 2022 and 2023 from BEIS's decision.[63]

Calculation notes relating to installation costs in 2021

Sunk installation costs in 2021

1.4. We calculate sunk installation costs in 2021 using the same approach as we did for 2020 in our August 2021 SMNCC decisions, having now gathered data in our 2022 RFI. Please see Appendix 8 of our August 2021 Credit SMNCC decision for further information on this calculation approach.[64]

[60] Ofgem (2021), Price Cap – Decision on credit SMNCC allowance, Appendix 8. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
[61] Ofgem (2021), Smart meter rollout and the default tariff cap: working paper, paragraph 2.6. https://www.ofgem.gov.uk/publications/smart-meter-rollout-and-default-tariff-cap-working-paper
[62] As set out in SMNCC WP2, we select the market leader from the large legacy suppliers. Where the large legacy suppliers have been subject to significant mergers over time, we look at the rollout profiles based on the current structure of these suppliers (ie as if these suppliers had been combined over the entire period).
[63] 3.5% for 2022 and 5.1% for 2023. These are the values for domestic suppliers. BEIS (2021), Smart meter policy framework post 2020: government response to a consultation on minimum annual targets and reporting thresholds for energy suppliers, Table 3. https://www.gov.uk/government/consultations/smart-meter-policy-framework-post-2020-minimum-annual-targets-and-reporting-thresholds-for-energy-suppliers
[64] Ofgem (2021), Price Cap – Decision on credit SMNCC allowance, Appendix 8. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance

Costs per installation for 2021

1.5. We calculate costs per installation in 2021 using the same approach as we did for 2020 in our August 2021 SMNCC decisions, having now gathered data in our 2022 RFI. Please see Appendix 8 of our August 2021 Credit SMNCC decision for further information on this.[65]

[65] Ofgem (2021), Price Cap – Decision on credit SMNCC allowance, Appendix 8. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance

Appendix 6 – 2020 sunk installation cost update

1.6. We issued our 2022 RFI to gather data on sunk installation costs for 2021, whilst our 2021 RFI gathered data on sunk installation costs for 2020. In correspondence during the 2022 RFI, a supplier stated that part of their previous 2021 RFI submission should have been a nil return.

1.7. We have therefore revised our estimates of the 2020 sunk installation costs to reflect the exclusion of this data. Our new estimates of 2020 sunk installation costs are £114.3m. The August 2021 decision estimates sunk installation costs of £107.5m in 2020.[66]

1.8. For future SMNCC allowances, we will account for the difference in these estimates of 2020 sunk installation costs through advanced payments.

[66] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, paragraph 3.34. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, paragraph 2.113. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

Appendix 7 – Review of uncertainty

1.1. In this appendix we set out key changes to our review of uncertainty compared to the detailed review published as part of our August 2021 SMNCC decision.[67]

Context

1.2. We calculate the SMNCC using the SMNCC model, which includes a significant amount of detail. However, our analysis is still subject to uncertainty. This is made up of uncertainties about individual elements of the analysis. These uncertainties can arise from (for example): assumptions, simplifications to the analytical approach, and choices about whether to gather and update data.

1.3. Some of these uncertainties are likely be conservative (increasing the SMNCC), and others are likely to be less-conservative (decreasing the SMNCC). This gives an overall balance of uncertainty – whether our calculated SMNCC is conservative or less-conservative. We can then consider whether to make a numerical uncertainty adjustment to the calculated SMNCC.

1.4. In our August 2021 decision we continued to assess uncertainty qualitatively, in the same way we did for our August 2020 decision. Our assessment of uncertainty suggested that the net effect was roughly neutral. We therefore decided not to make a numerical uncertainty adjustment.

Proposal

1.5. We propose to continue assessing uncertainty qualitatively, in the same way that we did for our August 2021 decision. We consider that this is a straightforward and proportionate approach.

1.6. Our assessment of uncertainty suggests that the net effect is roughly neutral. We therefore have decided not to make a numerical uncertainty adjustment.

[67] Ofgem (2021), Price Cap - Decision on credit SMNCC allowance, Appendix 11. https://www.ofgem.gov.uk/publications/price-cap-decision-credit-smncc-allowance
Ofgem (2021), Price Cap - Decision on PPM SMNCC allowance, Appendix 3. https://www.ofgem.gov.uk/publications/price-cap-decision-ppm-smncc-allowance

Considerations

1.7. We have carried out high-level checks of our review of uncertainty in our August 2021 decisions to see if the considerations covered in that review still apply. Based on this, we have concluded that there has been no material change to the areas covered in our previous uncertainty review. We propose to mostly maintain the positions from that review. The areas with additional or different uncertainty considerations are those new changes that we are consulting on in this document. These are detailed below.

Conservative assumptions (increase the SMNCC value)

1.8. **SMETS1 enrolment** – The proposal to not update the profile of SMETS1 meters being enrolled in the DCC results in a slight underestimate of the number of enrolled SMETS1 meters by December 2021.[68] The net costs of smart metering are lower for suppliers once the meter has been enrolled, so this is a conservative assumption.

1.9. **Proportion of SMETS1 meters without smart functionality at the end of 2021** – The proposal not to introduce a scaling factor for 2021 to adjust the proportion for SMETS1 meters without smart functionality means we slightly overestimate this proportion.[69] This is a conservative assumption, as the model assumes SMETS1 meters without smart functionality do not realise smart metering benefits for suppliers.

1.10. **Trends in Long-Run Variable Cost (LRVC)** – We are proposing to update the LRVC profile we use, to project future energy costs, using the latest HMT Green Book "central" estimates.[70] This would not fully reflect the recent surge in wholesale prices and would therefore underestimate the debt management benefits for suppliers. This is therefore a conservative assumption – with a small impact as the debt management benefit itself is small.

[68] Appendix 4 paragraphs 1.14-1.17
[69] Appendix 4 paragraphs 1.23-1.26
[70] Chapter 5 paragraphs 5.22-5.24

Less-conservative assumptions (decrease the SMNCC value)

1.11. **Proportion of installations which are SMETS1/SMETS2 for 2021 & 2022** – The proposal to not update the proportion of installations which are SMETS1/SMETS2 for 2021 and 2022 using industry data means we maintain the assumption that zero percent of installations in 2022 will be SMETS1.[71] However, in certain specific circumstances, suppliers may still be rolling out a small number of SMETS1 meters in 2022. Assuming a lower proportion of SMETS1 than the reality, and therefore a higher proportion of SMETS2 than the reality, will impact both costs and benefits to suppliers. For example, SMETS2 communication hubs are assumed to cost more than SMETS1 equivalents, increasing costs. However SMETS2 meters are assumed to always realise smart metering benefits for suppliers, as they would not lose smart functionality unlike SMETS1 meters, increasing benefits. As this assumption affects multiple calculations, determining the net effect requires testing alternative values in the model. Exploratory analysis using the SMNCC model from the February 2022 SMNCC decision suggests that maintaining the assumption of zero percent SMETS1 installations in 2022 slightly decreases the SMNCC value, making it a less-conservative assumption.

1.12. **SoLR impact on the market leader rollout profile** – We note this as a slightly less conservative assumption as, when setting the SMNCC allowances for the current cap periods covered by this 2022 Annual Review, we assume a slightly higher market leader rollout profile for credit due to not making this adjustment. However, as described in Chapter 4 the impact of taking on customers through the SoLR process on smart meter rollout was very small.

Assessing further uncertainty

1.13. **GDP deflator -** We are proposing to use the updated GDP deflator series from the Treasury's Green Book supplementary guidance.[72] This series appears to give a higher inflation estimate in 2020 and lower inflation estimate in 2021, when compared other measures of inflation such as CPIH, as such we expect these differences to be partially offsetting. As a result we expect the impact of the uncertainty to be roughly neutral.

1.14. **Corporation tax** – We are proposing to continue to use a single value as the corporation tax input in our modelling. We are proposing to set it at the average rate of

[71] Appendix 4 paragraphs 1.27-1.29
[72] Chapter 5 paragraphs 5.2-5.11

corporation tax, weighted by smart meter installations, over 2012-2023.[73] This gives a figure of 20%. This will result in a higher assumed pre-tax cost of capital up to early 2023, and therefore higher asset and installation costs compared to using the 19% headline rate during those years. However, for the rest of 2023 it will result in a lower cost of capital estimate compared to using the increased 25% rate and by a greater extent. The impact of using an average rate therefore appears to be roughly neutral. The primary uncertainty remains in the underlying post-tax cost of capital assumption which is unchanged.

[73] Chapter 5 paragraphs 5.13-5.21

Appendix 8 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. ie a consultation.

3. With whom we will be sharing your personal data

We may share consultation responses with BEIS.

Please note that responses not marked as confidential will be published on our website. Please be mindful of this when including personal details.

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system.

9. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".