

# Decision

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## Price Cap – February 2023 decision on approach to reviewing the SMNCC allowances

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This document sets out our decisions on the approach taken to reviewing and updating the non-pass-through Smart Metering Net Cost Change (SMNCC) allowances in the default tariff cap.

We have carefully considered all responses to our consultation. We have published non-confidential responses alongside this decision.

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## Executive Summary

On 19 July 2018, the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the 'Act') came into force. This legislation requires the Gas and Electricity Markets Authority (GEMA) to design and implement the default tariff cap. We introduced the default tariff cap (the 'cap') on 1 January 2019, which protects households on standard variable and default tariffs (which we refer to collectively as 'default tariffs'). The cap ensures that default tariff customers pay a fair price for their energy, that reflects the efficient underlying cost to supply that energy.

We currently conduct annual reviews of the Smart Metering Net Cost Change (SMNCC) allowances in the cap for credit and prepayment meters (PPM). These reviews focus on the 'non-pass-through' elements which reflect the change in costs to suppliers of meeting their smart meter rollout obligations compared to a 2017 baseline.

In our November 2022 SMNCC consultation, we proposed alternatives to the current annual reviews as a way of updating non-pass-through SMNCC values.<sup>1</sup> We also set out our approach to extending this model, given the Energy Prices Act 2022 removed a fixed end date to the price cap.<sup>2</sup>

This document sets out the decisions we have made following our consultation. The decisions reached are the same as our minded to positions outlined in our original consultation proposals. In summary, we have decided to:

- (i) Indefinitely pause annual methodology reviews of the non-pass-through SMNCC models.
  - This reflects that our approach to modelling the change in smart metering costs is mature, with further reviews likely to generate increasingly smaller gains in accuracy, at the expense of increased complexity.
- (ii) Continue to update the inputs into the SMNCC models annually.
  - Updating models using the latest available data and Department for Energy Security & Net Zero framework parameters will ensure allowances remain reflective of efficient costs.

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<sup>1</sup> Ofgem (2022), November 2022 Consultation on approach to reviewing the SMNCC. <https://www.ofgem.gov.uk/publications/price-cap-november-2022-consultation-approach-reviewing-smncc-allowances>

<sup>2</sup> Amendments made by the Energy Prices Act 2022 to the Domestic Gas and Electricity (Tariff Cap) Act 2018. <https://www.legislation.gov.uk/ukpga/2022/44>

(iii) Include SMNCC in any future review of the operating cost allowance.

- We intend to use the future review of operating costs, highlighted in the November 2022 Programme of Work publication, as an opportunity to more fundamentally consider our approach to SMNCC.<sup>3</sup> This will go beyond the modelling refinements that have typified annual reviews to date.

(iv) Extend the non-pass-through SMNCC models to 2030.

- Following the removal of a known end date to the cap, the non-pass-through models need to be extended. We have decided to extend the models up to 2030, reducing the risk that further extensions will be needed.

(v) Recover advanced payments over a 12-month rolling window.

- Following the removal of a known cap end date, the current approach of recovering advanced payments up to the end of 2023 is no longer appropriate. A rolling 12-month window provides an enduring solution and limits any potential increase in the volatility of allowances.

(vi) No longer publish provisional non-pass-through SMNCC values.

- This reflects our view that provisional values now offer a limited benefit as indicators of future values.
- We will continue to publish 12 months' worth of final non-pass-through values each August covering the price cap periods between October and September.

Collectively these decisions will reduce the administrative burden placed on suppliers, while having a negligible impact on the accuracy of the SMNCC allowances. We do not expect that these changes will have a financial impact on customers, suppliers, or to impact public spending. We will next consider our approach to SMNCC as part of the forthcoming review of operating costs.

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<sup>3</sup> Ofgem (2022), "Price cap - Programme of Work", Table A2.1.  
<https://www.ofgem.gov.uk/publications/price-cap-programme-work>

## 1. Introduction

### Subject of this decision

- 1.1 The default tariff cap ('the cap') protects approximately 27 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 that reflects the underlying costs to supply that energy. We set the cap by considering the different costs notional 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:
- i. The operating cost allowance includes the cost of smart metering in the 2017 baseline year (alongside other operating costs).<sup>4</sup>
  - ii. The Smart Metering Net Cost Change (SMNCC) allowances reflects the change in smart metering costs since 2017.
- 1.3 The SMNCC allowances comprise 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 every six-months, as part of the April and October price cap updates, via changes to the Annex 5 model.<sup>5</sup> Pass-through values cover two quarterly cap periods. **This pass-through element is not the focus of this decision.**
  - We use a forward-looking modelled approach to set the non-pass-through element for future cap periods. **This decision focuses on (i) when and how we review the methodology for the non-pass-through SMNCC values and (ii) our approach to extending the non-pass-through model to calculate values beyond the end of 2023.**

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<sup>4</sup> We index this allowance with inflation as part of the six-monthly cap update.

<sup>5</sup> Ofgem (2022), "Annex 5 – Smart metering net cost change methodology v1.12" [https://www.ofgem.gov.uk/sites/default/files/2022-08/Annex\\_5 - Smart%20metering%20net%20cost%20change%20methodology\\_v1.12.xlsx](https://www.ofgem.gov.uk/sites/default/files/2022-08/Annex_5_-_Smart%20metering%20net%20cost%20change%20methodology_v1.12.xlsx)

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## Overview of decisions

1.4 We have decided to proceed with our minded to positions as set out in our November 2022 consultation.<sup>6</sup> In summary we have decided to:

- Indefinitely pause automatic annual methodology reviews of the non-pass-through SMNCC model. However, we are committed to re-opening SMNCC methodology in response to unforeseen circumstances, or if we identify material systematic errors.
- Update the non-pass-through model in August of each year using the inputs and data set out in Table 3.1 of this document.
- Include SMNCC in the scope of any future review of operating costs.
- Extend the functionality of the non-pass-through SMNCC model to 2030 without making changes to the underlying methodology where possible.
- Recover advanced payments over a rolling 12-month window.
- Publish 12-months' worth of final non-pass-through SMNCC values in August each year covering the October to September period. However, no longer publish provisional values for any future cap periods beyond those 12 months.

## Structure of this decision document

1.5 This decision document has the following structure:

- Chapter 1 introduces the subject of our decisions and summarises them.
- Chapter 2 sets out our decision-making process.
- Chapter 3 sets out our decisions on our approach to reviewing SMNCC.
- Chapter 4 outlines our decisions related to model extension.

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<sup>6</sup> Ofgem (2022), November consultation on approach to reviewing the SMNCC. <https://www.ofgem.gov.uk/publications/price-cap-november-2022-consultation-approach-reviewing-smncc-allowances>

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## **2. Decision-making process**

### **Consultation stages and process**

- 2.1 To date, we have reviewed the SMNCC annually and updated all future values of the cap when we concluded an Annual Review.<sup>7,8</sup> Consequently, in our August 2022 decision document we provided the final SMNCC allowances for cap periods up to the end of September 2023 and provisional values for the October to December 2023 period.
- 2.2 In that August 2022 decision we also announced our intention to consider alternative approaches to updating the SMNCC allowances for future cap periods.<sup>9</sup> Subsequently, in November 2022 we published a consultation which set out our preferred alternative approach to reviewing and updating the SMNCC allowances. We also set out our intention to extend the functionality of the SMNCC model, and supplementary models, to 2030 and to spread advanced payments over a rolling 12-month period. The consultation closed on 24 December 2022.

### **Approach to considering impacts**

- 2.3 Although not specifically required to by the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act'), as part of our 2018 decision we conducted an extensive Impact Assessment (IA). This included an equalities assessment.<sup>10</sup> We have since continued to consider the impact of our decisions on customers and suppliers, paying particular attention to the impact on customers in vulnerable situations.
- 2.4 The decisions detailed in this document do not directly lead to a change in our assessment of efficiently incurred smart metering costs, and so do not affect the overall amount suppliers can charge customers over time. As a result, there is no quantitative impact to be assessed. In general, we therefore do not consider that these decisions have significant implications for the five matters we must have regard to under the Act (see paragraph 2.9). However, our decisions should

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<sup>7</sup> 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.

<sup>8</sup> We normally announce the conclusions of our review ahead of our winter cap announcement.

<sup>9</sup> Ofgem (2022), Price Cap – August decision, paragraphs 1.12, 1.13 and 1.14.

<https://www.ofgem.gov.uk/publications/price-cap-august-2022-decision-credit-and-ppm-smncc-allowances>

<sup>10</sup> Ofgem (2018), Default Tariff Cap: Decision. Appendix 11 – Final Impact Assessment.

<https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview>

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reduce the administrative burdens placed on suppliers, potentially enabling greater efficiency and competition.

- 2.5 More generally the value of SMNCC allowances differ between energy and payment types, and therefore could have equalities impacts. It is currently the case that the SMNCC allowance for PPM customers is lower than for credit or direct debit customers. On a dual fuel basis, the overall PPM SMNCC allowance is currently negative, reducing customer bills. As there is a greater extent of vulnerability among PPM customers our SMNCC approach currently offers protection to vulnerable customers by reducing the PPM cap level.

## **Related publications**

- 2.6 The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018:  
<https://www.legislation.gov.uk/ukpga/2018/21/contents>
- Default tariff cap decision: <https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>

- 2.7 The main documents relating to this decision are:

- November 2022 consultation on the approach to reviewing the SMNCC allowances ('November 2022 consultation'):  
<https://www.ofgem.gov.uk/publications/price-cap-november-2022-consultation-approach-reviewing-smncc-allowances>
- August 2022 decision on credit and PPM SMNCC allowances ('August 2022 decision'):  
<https://www.ofgem.gov.uk/publications/price-cap-august-2022-decision-credit-and-ppm-smncc-allowances>
- August 2020 decision on reviewing smart metering costs in the default tariff cap ('August 2020 decision'):  
<https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap>

## The default tariff cap

- 2.8 We set the cap with reference to the Act (Tariff Cap).<sup>11</sup> The Act requires us to put in place and maintain the licence conditions which give effect to the cap. The objective of the Act is to protect existing and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs of a notional supplier.
- 2.9 Under the Act, we must have regard to five matters when setting the cap:
- the need to create incentives for holders of supply licences to improve their efficiency;
  - the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
  - the need to maintain incentives for domestic customers to switch to different domestic supply contracts;
  - the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence;
  - the need to set the cap at a level that takes account of the impact of the cap on public spending.<sup>12</sup>
- 2.10 The requirement to have regard to the five matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future consumers who pay standard variable and default rates. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgement. Often, a balance must be struck between competing considerations.
- 2.11 Following the passing of the Energy Prices Act 2022, those specified considerations to be taken into account include 'the need to set the cap at a level

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<sup>11</sup> Domestic Gas and Electricity (Tariff Cap) Act 2019.  
<https://www.legislation.gov.uk/ukpga/2018/21>

<sup>12</sup> Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(e) as inserted by Schedule 3 to the Energy Prices Act 2022. In performing the duty under section 1(6)(e) we must have regard to any information provided by the Secretary of State, or any guidance given by the Secretary of State on this matter (section 1(6A)).

that takes account of the impact of the cap on public spending'.<sup>13</sup> This consideration reflects the fact that while the government's Energy Price Guarantee (EPG) is in place, and is lower than the price cap level, the cap level directly affects the level of payment from government to energy suppliers.

- 2.12 In setting the cap, we may not make different provisions for different holders of supply licences. This means that we must set one cap level for all suppliers.

## **General feedback**

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
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. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk).

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<sup>13</sup> Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(d) as inserted by Schedule 3 to the Energy Prices Act (2022).

<https://www.legislation.gov.uk/ukpga/2022/44/>

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### **3. Approach to reviewing and updating SMNCC allowances**

#### **Section summary**

This chapter sets out our decision to indefinitely pause automatic annual methodology reviews of the non-pass-through (NPT) SMNCC model. We will continue to update the inputs into the NPT model annually to maintain accuracy. It also sets out our intention to consider our approach to SMNCC as part of a future operating cost review.

#### **Background**

- 3.1 In our May 2020 consultation, we proposed to review the SMNCC allowances every 12 months in recognition that the progress of the smart meter rollout and its impact on a notional supplier's efficient operating costs was highly uncertain.<sup>14</sup> This uncertainty increased the chance that the SMNCC allowances could be clearly, materially, and systematically misstated. Regular reviews could therefore help prevent the cap from becoming misstated and could form part of having regard to the statutory needs set out in the Act, including the need for an efficient supplier to finance the costs of its licensed activities.<sup>15</sup>
- 3.2 In response to our May 2020 consultation, stakeholders generally supported reviewing the SMNCC allowances. Some stakeholders supported our proposal for annual reviews. However, some stakeholders felt that the allowances should be reviewed only in response to one-off changes such as COVID-19 and/or changes to the smart meter policy framework.<sup>16</sup> This was primarily because they considered that annual reviews would create budget uncertainty for operational planning.<sup>17</sup>

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<sup>14</sup> Ofgem (2020), Reviewing smart metering costs in the default tariff cap: May 2020 statutory consultation, paragraph 3.1. <https://www.ofgem.gov.uk/publications/reviewing-smart-metering-costs-default-tariff-cap-may-2020-statutory-consultation>

<sup>15</sup> Domestic Gas and electricity (Tariff Cap) Act 2018, section 1(6).

<https://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted>

<sup>16</sup> BEIS (2019), Smart meter policy framework post 2020.

<https://www.gov.uk/government/consultations/smart-meter-policy-framework-post-2020>

<sup>17</sup> Ofgem (2020), August 2020 decision on credit and PPM SMNCC allowances.

<https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap>

- 3.3 After consideration of stakeholder views, we decided, in our August 2020 decision document, to proceed with annual reviews.<sup>18</sup> We set out that we intended reviews to be subject to consultation, and for them to take effect in the winter cap update.
- 3.4 Our August 2020 decision also set out the expected scope of annual reviews. Reviews were to consider (i) the latest data, (ii) the latest policy announcements, and (iii) changes to our rollout methodology. Only the first of these was relevant to all reviews, with the other two being dependent on external developments or changes in circumstances.
- 3.5 Following the completion of the 2021 and 2022 annual reviews, we believed that the case for automatically reviewing and consulting on SMNCC methodology each year had diminished. We therefore consulted on alternative approaches in our November 2022 consultation and proposed an indefinite pause of annual SMNCC methodology reviews.

## **Pausing annual SMNCC methodology reviews**

### **Context**

- 3.6 Our November consultation proposal to indefinitely pause annual methodology reviews stemmed from our judgement that the benefits of reviews had diminished. The main drivers of this are:
- lower levels of uncertainty surrounding the pace of the smart meter rollout, as a result of the introduction of the post-2020 Smart Meter Policy Framework in July 2021;
  - clear and material systematic errors have diminished over time as our modelling approach has matured; and
  - an ongoing opportunity cost for stakeholders and Ofgem, given the resource costs of annual reviews and the diminished benefit of completing them compared to more consequential allowances.

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<sup>18</sup> Ofgem (2020), August 2020 decision on credit and PPM SMNCC allowances, paragraph 5.2. <https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap>

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## **Decision**

- 3.7 We have decided to maintain our consultation position and will no longer automatically review the SMNCC methodology each year. This includes no longer disclosing the non-pass-through SMNCC model to stakeholders and their advisers annually.
- 3.8 We do, however, retain the option of undertaking a full review informed by a consultation should we feel this is necessary for any reason, including changes in circumstance which give rise to clear and material systematic errors.

## **Overview of responses**

- 3.9 We received consultation responses from five suppliers, four of whom supported the proposal to indefinitely pause methodology reviews. These suppliers in general accepted that the approach to modelling the non-pass-through SMNCC values was mature, and that further methodology reviews would yield diminishing improvements in accuracy.
- 3.10 Two suppliers noted that this change would reduce burdens on suppliers by removing the need for suppliers to engage with the review and disclosure process on a regular basis.
- 3.11 While responses were overall supportive of the proposal, three suppliers also highlighted the need to ensure that the SMNCC methodology could be reopened if unforeseen issues arose, and that any changes to the modelling approach should be subjected to a full consultation and disclosure process.
- 3.12 One supplier was not supportive of the proposed change. They highlighted concerns previously raised in response to SMNCC methodology consultations which they believe have not been sufficiently addressed. As part of their response, they provided their submission to our April 2021 consultation on updating the PPM SMNCC allowance.<sup>19</sup>
- 3.13 Given these continuing concerns, the supplier rejected the assessment that the current SMNCC methodology was mature, and therefore did not see a case for pausing annual reviews. They considered that the SMNCC methodology should be

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<sup>19</sup> Ofgem (2021), "Price Cap - final consultation on updating the PPM SMNCC allowance". <https://www.ofgem.gov.uk/publications/price-cap-final-consultation-updating-ppm-smncc-allowance>

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reviewed and changed in line with the comments they have previously provided but which were not fully accepted by Ofgem. The supplier did not provide any new objections to the current methodology.

## **Considerations**

- 3.14 Given the maturity of the current approach, we consider that pausing annual reviews will have a minimal impact on the accuracy of the SMNCC allowances. There is limited scope to improve the accuracy of the non-pass-through model without significantly increasing its complexity.
- 3.15 Equally, as we are no longer proposing to make methodological changes, the rationale for disclosing the non-pass-through model to stakeholders no longer applies. We consider that there is therefore no meaningful reduction in the transparency of the SMNCC methodology because of the decision to pause annual reviews.
- 3.16 We have also given due consideration to the five matters we must have regard to under the Act when reaching this decision. We do not consider that pausing annual reviews will have material implications for any of these five matters (see paragraph 2.9), although reducing the administrative burden placed on suppliers may allow them to be more efficient and compete more effectively.
- 3.17 We have responded in detail to the methodological concerns raised by the one supplier who did not agree with this proposal, notably in our February and August 2022 documents.<sup>20,21</sup> We do not consider that any new issues have been raised, so we refer to our response on these matters in our previous decision documents, which we consider remain appropriate in the context of this decision.

## **Annual data updates**

### **Context**

- 3.18 In our November 2022 consultation, we proposed to continue to update the inputs into the SMNCC model on an annual basis. This would include all the inputs

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<sup>20</sup> Ofgem (2022), “Price Cap - 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>

<sup>21</sup> Ofgem (2022), “Price Cap – August decision on credit and PPM SMNCC allowances”, Appendix 4. <https://www.ofgem.gov.uk/publications/price-cap-august-2022-decision-credit-and-ppm-smncc-allowances>

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which are based on the Annual Supplier Returns (ASR) data collected by the Department for Energy Security & Net Zero. We also proposed to update the rollout inputs using the latest outturn figures and reflect any changed or new rollout tolerance values as set by the Department for Energy Security & Net Zero.

- 3.19 Furthermore, we proposed to update the SMNCC model's measure of inflation, the GDP deflator, using the latest outturn values from the Office for National Statistics (ONS) and the latest forecasted values from the Office for Budget Responsibility (OBR). The GDP deflator will also be updated for all relevant supplementary models, with their new outputs being fed into the SMNCC model.<sup>22</sup>
- 3.20 Finally, we proposed to complete all necessary model updates to ensure the impact of new input values are fully reflected in the final allowances.
- 3.21 Table 3.1, below, sets out in detail the inputs we proposed to update each year.

**Table 3.1 –Annual data/input updates to non-pass-through SMNCC model**

Area	Components	Sources of Data
Costs	<ul style="list-style-type: none"><li>the cost of smart meters</li><li>the cost of communication hubs</li><li>the cost of In-Home Displays (IHDs)</li></ul>	ASR data
Benefits	<ul style="list-style-type: none"><li>the number and cost of avoided site visits</li><li>change of supplier benefits (credit only)</li><li>benefits of reduced inbound enquires (credit only)</li><li>improved debt management (credit only)</li><li>benefits of a remote change of tariff (credit only)</li></ul>	ASR data
Rollout	<ul style="list-style-type: none"><li>data on actual customer numbers by metering type to update smart meter roll out percentages for upcoming years</li><li>new or changed rollout target or tolerance values</li></ul>	ASR data; Smart meter policy framework publications
Other inputs	<ul style="list-style-type: none"><li>GDP deflator</li></ul>	ONS and OBR

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<sup>22</sup> We will seek to use the most recent ONS estimates and OBR forecasts as are available by the 30th of June each year.

## **Decision**

- 3.22 We have decided to maintain our consultation position and update the non-pass-through model in August of each year, using the inputs and data as set out in Table 3.1.

## **Overview of responses**

- 3.23 Only one supplier commented on the proposed approach to updating model inputs. The supplier highlighted that, for example, the ASR data used to set SMNCC values for October 2022 to September 2023 will reflect suppliers' experiences over the course of 2021. The supplier argued that this built-in lag generates a risk that suppliers' actual costs could exceed the allowance given.
- 3.24 The supplier acknowledged that this issue is not generated by this proposal but is a long-standing feature of the approach to calculating the SMNCC allowances. Nevertheless, they advocated for the introduction of an ex-post adjustment to SMNCC allowances where it was identified that installation costs had materially diverged away from what was assumed when setting the allowances.

## **Considerations**

### *Ex-post adjustment*

- 3.25 The purpose of an ex-post adjustment would be to reflect material and systematic differences between assumed and actual costs incurred by suppliers when setting SMNCC allowances. The adjustment would allow suppliers to recover efficiently incurred costs that they weren't originally able to; either due to the use of historic data or due to being set using a previous less accurate methodology.
- 3.26 In general, if an adjustment was needed to correct for material and systematic difference in an allowance, we would consider this following a consultation on the approach and after considering the costs and benefits of doing so. However, in this case we see no reason to introduce such an adjustment given the existence of the current "advanced payments" adjustment mechanism.
- 3.27 The advanced payments adjustment is calculated by considering the difference between the allowances set and the allowances that would have been set had we used newer data or an updated methodology. It therefore achieves the aim of the adjustment proposed in the supplier's response.
- 3.28 We therefore maintain our consultation position on updating the inputs into the non-pass-through model, which we consider will ensure that SMNCC allowances

continue to reflect the latest available supplier data, smart meter policy framework parameters, and inflation.

## **Including SMNCC in a wider review of the operating cost allowance**

### **Context**

- 3.29 As set out in the November 2022 Programme of Work publication, Ofgem currently intends to review the operating cost allowance by Winter 2024/25.<sup>23</sup> Smart metering costs are embedded within the operating cost allowance and SMNCC allowances reflect the fact that those embedded costs may change over time. SMNCC and the operating cost allowances are therefore intrinsically linked.
- 3.30 In our November consultation we indicated that the review of operating costs could include a more fundamental look at our approach to the SMNCC, rather than just refining our current methodology as annual reviews have recently done. We asked stakeholders for any early views they might have on how we might use this upcoming review to improve our approach to SMNCC.

### **Decision**

- 3.31 We have decided to maintain our consultation positions and will include SMNCC in the scope of any future review of operating costs.

### **Overview of responses**

- 3.32 Two suppliers welcomed the proposal to include SMNCC as part of a future review of the operating cost allowance.
- 3.33 One supplier, however, did not support the proposed timeline for the review, arguing that Winter 24/25 was too late. This objection was made in the context of their wider objection to pausing annual reviews. This reflects the supplier's view that the approach to calculating the SMNCC allowances is subject to several methodological flaws.

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<sup>23</sup> Ofgem (2022), "Price cap - Programme of Work", Table A2.1.  
<https://www.ofgem.gov.uk/publications/price-cap-programme-work>

## **Considerations**

- 3.34 The intended delivery periods of the workstreams indicated in the Programme of Work publication reflect factors such as complexity, and the level of process and information required. We will continue to assess the relative priorities of different workstreams over time and adjust delivery periods as required.
- 3.35 However, given the consideration we have already given to previously raised methodological concerns, we do not currently see a case for expediting the operating cost review purely to reassess previous SMNCC decisions – particularly as no new objections have been raised.
- 3.36 As a result, we maintain our consultation position and will include a wider look at SMNCC as part of any future operating cost review. The precise timings of when such a review may conclude will be subject to a range of factors; including, but not exclusively driven by, supplier concerns related to SMNCC methodology.

## **4. Non-pass-through model extension**

### **Section summary**

This chapter sets out our response to the removal of a known end date to the price cap. We have decided to extend the non-pass-through SMNCC model to 2030 and will now recover any advanced payments balance over a 12-month rolling window.

### **Background**

- 4.1 Before the amendments made by the Energy Prices Act 2022 to the Domestic Gas and Electricity (Tariff Cap) Act 2018, the cap was due to cease operating no later than the end of 2023. However, following last year's amendments the Secretary of State may, at any time, give notice that tariff cap conditions cease to have effect, as a result there is now no known end date to the price cap.<sup>24</sup>
- 4.2 Given these legislative changes, the non-pass-through SMNCC model and any relevant supplementary models need to be modified to allow us to produce SMNCC allowances beyond 2023.<sup>25</sup> Separately, we are consulting on the impact of the removal of the cap end date from supplier licences and other models, to ensure they reflect these legislative changes.<sup>26</sup>

### **Extending the non-pass-through model**

#### **Context**

- 4.3 In our November 2022 consultation, we proposed to extend the functionality of the non-pass-through model and any relevant supplementary models to the end of 2030. We stated that we would do so without changing the existing modelling approach, and simply extend the calculations into future years.

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<sup>24</sup> Ofgem (2022), November 2022 consultation on approach to reviewing the SMNCC. <https://www.ofgem.gov.uk/publications/price-cap-november-2022-consultation-approach-reviewing-smncc-allowances>

<sup>25</sup> Supplementary models are models used to generate inputs to the primary non-pass-through SMNCC model.

<sup>26</sup> Ofgem (2023), "Price Cap – Removal of the cap end date from licence conditions" <https://www.ofgem.gov.uk/publications/price-cap-removal-cap-end-date-licence-conditions>

## **Decision**

- 4.4 We have decided to maintain our consultation position and will extend the functionality of the non-pass-through SMNCC model to 2030 and intend to do so without making changes to the underlying methodology where possible.

## **Overview of responses**

- 4.5 Only one supplier commented on the proposal to extend the non-pass-through SMNCC model, stating that they do not oppose it in principle.

## **Considerations**

- 4.6 Given the limited stakeholder response to this proposal we maintain our view that extending to 2030 reduces the possibility that we will need to extend the model again and is therefore preferable to a shorter extension.
- 4.7 We expect the process of updating the model to be mechanical in nature, and to not require any methodological judgements. If we encounter any areas where there are options in how we can approach extending the model, we intend to default to maintaining the current approach as closely as possible.

## **Recovery period for advanced payments**

### **Context**

- 4.8 Sometimes, suppliers receive payment in advance for smart metering costs they have not yet incurred. The opposite can also occur, where suppliers have incurred costs prior to receipt of payment through the allowance.<sup>27</sup>
- 4.9 To ensure that the price cap best reflects the notional supplier's efficient costs we need to take account of these timing issues when setting SMNCC values. We do this by calculating SMNCC allowances in a given historical cap period using the latest version of the SMNCC model, with updated inputs and any changes to methodology applied, and compare it against the actual SMNCC allowances we set in that period. The difference between the two forms the basis of an advanced payments adjustment.

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<sup>27</sup> The opposite case would technically involve lagged payments (rather than advanced payments). However, for simplicity, we use the term advanced payments throughout this section. This is regardless of whether we are referring to suppliers receiving payments in advance or in arrears.

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- 4.10 To date, we have spread the balance of advanced payments over the maximum number of remaining cap periods (i.e. up to the end of 2023).<sup>28</sup> However, legislative changes have rendered this approach no longer suitable, as there is no longer a defined number of remaining cap periods.

**Decision**

- 4.11 We have decided to maintain our consultation position and will recover any outstanding advanced payments balance over a 12-month rolling period.

**Overview of responses**

- 4.12 Only one supplier commented on our advanced payments proposal.
- 4.13 The supplier stated that a twelve-month recovery of advanced payments is preferable to a six-month period, as it will result in less variability in the level of the final allowance.
- 4.14 In addition, the supplier repeated their view, expressed in response to previous consultations, that the reconciliation of actual and expected costs has not been implemented by Ofgem elsewhere in the price cap. The supplier also rejected the notion that SMNCC allowances may have resulted in over recovery in certain periods given the allowances, in their view, understate the true costs of smart meter rollout.

**Considerations**

- 4.15 We have set out the reasoning and principles behind our use of an advanced payments adjustment and responded to the supplier's points in previous decisions documents – notably our August 2021 decision.<sup>29</sup> We do not consider that any new issues have been raised, so we refer to our responses to these matters in our previous decision documents which we consider remain appropriate in the context of this decision.

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<sup>28</sup> Ofgem (2020), Reviewing smart metering costs in the default tariff cap: August 2020 decision, paragraph 5.52.

<https://www.ofgem.gov.uk/publications/decision-reviewing-smart-metering-costs-default-tariff-cap>

<sup>29</sup> Ofgem (April 2021), "Price Cap - final consultation on updating the PPM SMNCC allowance". <https://www.ofgem.gov.uk/publications/price-cap-final-consultation-updating-ppm-smncc-allowance>

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- 4.16 Given the limited feedback on the proposal, we maintain our view that recovering advanced payments over a rolling period rather than by a fixed date is preferable. Compared to a fixed date, which may have to be revisited, a rolling window is an enduring solution. Furthermore, customers or suppliers (depending on whether the advanced payments balance is positive or negative) will benefit from SMNCC allowances reflecting costs more quickly.
- 4.17 A 12-month recovery period also ensures that if the cap ends prior to the advanced payments balance being fully recovered any outstanding balance is likely to be smaller, compared to a longer recovery period.
- 4.18 Finally, in line with the supplier's comment, we consider a 12-month window to be preferable to a six-month window. A six-month window would also introduce arbitrary seasonality into the SMNCC allowances resulting in changes to either winter or summer period allowances which were unrelated to changes in supplier's net costs.
- 4.19 In practice, this will mean that the 12-months' worth of allowances set in August each year will reflect the totality of the advanced payments balance. The one exception is the October 2023 to September 2024 allowances. These will additionally include the advanced payments balance already contained in the provisional SMNCC value for October to December 2023.

## **Provisional values**

### **Context**

- 4.20 In our November 2022 consultation we proposed to publish 12 months' worth of final non-pass-through SMNCC values in August each year but to not publish any provisional values for cap periods beyond this 12-month period.
- 4.21 This proposal reflected the removal of a known end date to the cap and aligned with our proposal to recover advanced payments over a rolling 12-month window.

### **Decision**

- 4.22 We have decided to proceed with our consultation position, and only publish 12 months' worth of final non-pass-through SMNCC values in August each year covering the October to September period.
- 4.23 We will no longer publish provisional SMNCC values beyond this 12-month period.

## **Overview of responses**

- 4.24 Only one supplier commented on this proposal. The supplier said that publishing 12 months of provisional values beyond the 12 months of final values would be beneficial to suppliers as it would reflect that supplier planning horizons extend beyond one year. Additionally, without annual reviews there will be no disclosure of the non-pass-through model, meaning suppliers will not be able to generate their own forecasts.
- 4.25 Moreover, the supplier argued that publishing provisional values would come at no additional cost to Ofgem given the planned extension of the non-pass-through model to 2030.

## **Considerations**

- 4.26 To come to our decision, we have considered the quality of forward guidance provisional values would provide and the added complexity of publishing those values.
- 4.27 Under the decisions outlined in this document we believe the value of provisional values as indicators of future values to be diminished. The decision to recover all the outstanding advanced payments balance over 12 months means provisional values may be subject to greater revision than has been the case for most previous periods. This is because provisional values have previously only been adjusted by a proportion of the advanced payments balance when finalised, rather than all of it.
- 4.28 Provisional values under this new approach will therefore primarily reflect underlying rollout assumptions, about which we have been transparent through previous annual reviews. As a result, we judge that provisional values would not offer suppliers much more insight about future values than they are likely to already have by considering the published final values and our known approach to setting an assumed rollout profile.
- 4.29 Additionally, given the decision on advanced payment recovery, any provisional values published would require additional explanation and careful presentation to ensure it was clear they were calculated on a different basis; final values with an advanced payment adjustment applied, and provisional values without.
- 4.30 Taking the above considerations together we believe that publishing provisional values would add little value and would risk complicating the presentation and

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explanation of non-pass-through values. As a result, we maintain our consultation position on this question.