

23 December 2022

Marcus McPhillips
Head of Price Cap Policy
Ofgem
10 South Colonnade
London E14 4PU

Email: alisonrussell@utilita.co.uk

Dear Marcus,

Re: Price cap: November 2022 consultation on approach to reviewing the SMNCC allowances

Thank you for the opportunity to comment on the above.

Utilita has made strong and consistent representations on the flawed implementation of the prepay element of the Default Tariff Cap (DTC) since both its inception and that of its predecessor Prepayment Charge Restriction. These repeated engagements and powerful representations have included robust evidence, both from Utilita and prepared by our expert advisors, CMS and NERA following participation in the various confidentiality rings. This was necessary as the approach to consultation chosen by Ofgem precluded Utilita's direct engagement with the data.

Our most recent, highly detailed submission on this matter was the confidential submission of June 2021 (and the subsequent version provided for publication in July 2021). We consider that the arguments we presented there have not been sufficiently addressed and continue to apply. We therefore restate these previous submissions as Appendix 1.

In terms of the detailed current consultation, we believe that far from being 'mature', as Ofgem asserts, the methodology for formulating the SMNCC is fundamentally flawed and ought to be thoroughly reviewed prior to being fixed. We do not believe this position is affected by the proposals in chapter four.

As Ofgem notes:

'4.9. Reducing the frequency and detail of our reviews of SMNCC reduces our ability to regularly check the model against new developments and make relevant adjustments. However, as previously set out, the methodology behind the SMNCC values is mature. There is therefore limited scope to improve the accuracy of the model without significantly increasing its complexity.'

However, as set out above and in our numerous detailed submissions, we do not consider that the methodology is mature and hence it is clearly unsuitable to be set in amber in its present form.

Ofgem proposes a more thorough review and intends to simplify the model, as part of its Programme of Work. We agree that this is necessary and welcome Ofgem's recognition that this is needed. However, we cannot support the timeline. In order to be able to 'fix' the methodology the review proposed must be completed beforehand and as soon as possible, not in arrears after suppliers have experienced further irrecoverable detriment. Winter 2024/25, as Ofgem intends is simply too late:

'4.7. As set out in our Programme of Work, published at the same time as this consultation, we currently intend to review the operating cost allowance by Winter 2024/25. Smart metering costs are embedded within the operating cost allowance. SMNCC allowances are there to reflect the fact that those embedded allowances may change over time. SMNCC and the operating cost allowances are therefore intrinsically linked.

4.8. As a result, any review of the operating cost allowance would represent an opportunity for us to review our approach to SMNCC as well. This could include a more fundamental look at our approach to SMNCC rather than just a refinement of our current methodology, as existing annual reviews have become. This could include giving consideration as to how we might significantly simplify our approach to SMNCC, reflecting anecdotal comments that the current approach is complex and difficult to engage with. We welcome any early views stakeholders may have on the how we could best use an operating cost allowance future review to improve our approach to SMNCC.'

Moving to consideration of the detailed proposals, we consider them in turn.

Alternative 1: Continue with annual reviews

This is our preference as any changes to the methodology ought to be consulted on. As per our comments above, we do not consider that methodology is of a maturity to be fixed and a full review is needed. If Ofgem implements this alternative 1, it must still carry out a full review of the methodology, as it intends, but much sooner than 2024/25.

Alternative 2: Roll forward already published values

We have considered this carefully and we do not understand why this alternative is proposed. We do not consider it offers any additional advantage or protection to consumers and it continues the ongoing failure to allow efficient suppliers to recover their efficient costs by payment type.

Such an approach would fail to take into account known changes to costs, and Ofgem ought to consider this legitimate only if it has no confidence in the SMNCC model's accuracy (i.e., it expects the result of updating the inputs to the model to be no less accurate than using outdated inputs, which incidentally is probably true).

Chapter 5 and the consultation on the Model extension.

We agree that the general extension of the model to 2030 is reasonable and we do not oppose it in principle. However, this should not be taken as support for the price cap (and in particular the prepay elements) being continued in the current flawed state. As we have set out elsewhere, fundamental review and reform is required to ensure that efficient suppliers by payment type and recover their efficient costs and make normal profits. The extension of a model alone does not address these points.

Advanced payments

As we have noted in previous submissions, this reconciliation of actual and expected costs is not something Ofgem has implemented elsewhere in the price cap, and the under-recovery of efficient costs associated with prepayment customers ought to be recovered in a similar fashion, should Ofgem consider it appropriate to ensure neither over- nor under-recovery of efficient costs, as it does here.

In general, Utilita disputes the notion that there could have been any advanced payments to prepayment suppliers under the SMNCC, which, for the reasons we have previously outlined in detail, is grossly understated.

Notwithstanding the above points, a twelve-month recovery of over- or under-payment is preferable to a six-month period as the variability and uncertainty of the level of the price will be less.

We further consider that the current proposal will lead to a new decision on the methodology which decides not to address the longstanding anomalies and flaws within the DTC. We hope this submission has been helpful, and we would be happy to arrange a call to discuss any points in more detail.

Yours sincerely,

By email

Alison Russell
Director of Policy & Regulatory Affairs

Encs: Appendix 1