



Holders of Gas and Electricity Supply
Licences, consumers and their
representatives, consumer bodies and other
interested parties

*Promoting choice and value for
all gas and electricity customers*

Email: colin.sausman@ofgem.gov.uk

Date: 14 June 2012

Dear colleagues,

Regulating the smart meter roll-out: how DECC's proposals for the provision of information to Ofgem might work in practice

On 31 May 2012, the Department of Energy and Climate Change (DECC) published a consultation on proposed information requirements for monitoring and evaluating the roll-out of smart meters ('DECC's May 2012 consultation')¹. The purpose of this letter is to set out our current thinking about how the proposed framework for provision of information to Ofgem² described in DECC's May 2012 consultation ('the proposed framework') might work in practice.

This letter is intended to be read alongside DECC's May 2012 consultation, and we hope it will facilitate stakeholders' responses to that consultation. This letter is **not** a consultation, and formal views on the proposed framework should be directed to DECC as a response to its May 2012 consultation. However, we welcome the engagement we have had with stakeholders so far, and look forward to this continuing in the coming months.

We set out below an explanation of our role in relation to the roll-out and summarise the proposed framework. We then consider each element of the proposed framework in turn, and how we currently envisage that the proposals would work in practice. At the end of the letter, we set out our initial thoughts on using our existing regulatory tools in relation to compliance with any new smart meter obligations.

Ofgem's role in relation to the smart meter roll-out

As the gas and electricity market regulator, we have an important role in ensuring the interests of consumers remain protected both during the transition to smart metering and in the enduring framework. In addition, many smart metering obligations on suppliers and other parties are being introduced by DECC via licence conditions. Ofgem is responsible for monitoring and, where appropriate, enforcing compliance with those conditions. This role differs from that of DECC, who is responsible for developing the policy for the smart meter roll-out and the associated regulatory framework, and monitoring the delivery of benefits associated with smart meters.

To inform DECC's May 2012 consultation, we have discussed with DECC the information that we might want to receive from suppliers to help us monitor the roll-out effectively. The

¹ http://www.decc.gov.uk/en/content/cms/consultations/sm_evaluation/sm_evaluation.aspx

² Ofgem is the executive arm of the Gas and Electricity Markets Authority (GEMA) and references in this letter to Ofgem as the regulator should be read to include GEMA (referred to as 'the Authority' in the draft licence conditions in DECC's May 2012 consultation).

proposed framework reflects these discussions. We have also had helpful informal feedback from industry in this regard.

Ofgem could take a number of different approaches to regulating the roll-out under the proposed framework. This letter sets out our initial thoughts on how this might be done in practice, in order to protect the interests of consumers. In developing our thinking to date, we have sought to ensure that suppliers are held accountable for delivery of smart meter roll-out where appropriate, that there are practical and effective safeguards against poor delivery, and that we avoid unduly onerous regulation. We are also considering issues raised by stakeholders thus far, such as whether the proposed framework might create perverse incentives on suppliers to delay their installation of smart meters until later in the roll-out period ('back-loading').

The proposed framework

DECC's May 2012 consultation builds on the high-level approach to monitoring set out in the government's March 2011 Prospectus Response³, and includes proposals for the provision of information to Ofgem from suppliers about their plans and progress in relation to the smart meter roll-out. It also includes accompanying draft licence conditions to implement the proposed framework.

Chapter 9 of DECC's May 2012 consultation sets out the main elements of the proposed framework⁴:

- suppliers would be required to provide a single plan to Ofgem for fulfilling their roll-out obligations (the '**baseline plan**');
- suppliers' baseline plans would be required to contain a specific series of **interim milestones** indicating the percentage of their domestic and smaller non-domestic customers who will have a smart meter installed by set dates. These percentages would be set by suppliers themselves and once submitted, suppliers would be required to meet them; and
- suppliers would be required to report to Ofgem on progress against their baseline plan (the '**progress report**').

In the remainder of this section, we discuss our current thinking on the timing for provision of the baseline plans; developing the content of the baseline plans (including the format of the interim milestones); the status of the information in the baseline plans; and reporting against the baseline plans.

Proposed timing for provision of baseline plans

DECC's May 2012 consultation proposes that each supplier would be required to provide a single baseline plan to Ofgem. This would cover the whole roll-out period, from the date of submission of the baseline plan to Ofgem until the end of 2019. The intention is that each supplier's progress could then be tracked against their individual baseline plan. It is expected that the baseline plan would be distinct from the 'Annual Supplier Report' that DECC proposes to request from larger suppliers each year.

The draft licence conditions give Ofgem the power to direct when the baseline plan should be provided. Our current thinking is that we are likely to require suppliers to provide their

³ <http://www.decc.gov.uk/assets/decc/Consultations/smart-meter-imp-prospectus/1475-smart-metering-imp-response-overview.pdf>

⁴ Chapter 9 of the DECC May 2012 consultation uses the terms 'baseline plan' and 'interim milestone'. The terminology in the associated draft licence conditions in Annex A of DECC's May 2012 consultation differs slightly, with the corresponding terms being 'Roll-out Plan' and 'Annual Milestone' respectively. This letter uses the same terms as in the main consultation document for clarity, and the draft licence conditions should be read accordingly.

baseline plan when the 'key enablers' for the roll-out are in place. Key enablers could include mass availability of compliant smart metering equipment, an operational Data and Communications Company and widespread communications coverage. Subject to the outcome of DECC's May 2012 consultation, we would indicate in advance and invite views on what these key enablers are likely to be.

Whilst the current proposal is for suppliers to provide one baseline plan for the whole roll-out period, we appreciate that unforeseen events could affect a supplier's original plan. Suppliers have said that, even after the start of mass roll-out, there would need to be ongoing amendments to their plans for the roll-out. Our intention is that the baseline plans would for the most part contain relatively high-level information, so that fluctuations in procedures or localised issues should not significantly affect them.

As recognised in DECC's May 2012 consultation, there could be factors outside a supplier's control that might impact on their progress. Learning from experience gained during the early stages of mass roll-out could be used by suppliers to change their strategy for rolling out smart meters. Our view is that the impact any such events might have on an individual suppliers' progress could be addressed in their progress reports to Ofgem. The draft licence conditions also include a mechanism that could allow suppliers to amend all or part of their baseline plan where Ofgem considers it is appropriate in the circumstances. We envisage that use of this mechanism would require the supplier to demonstrate, to our satisfaction, that such changes are indeed attributable to material reasons that can be clearly justified.

Proposed approach to developing the content of the baseline plan

The primary purpose of the baseline plan is for suppliers to set out how they intend to meet their obligation to roll-out smart meters by the end of 2019. To do this, the plans will need to contain both high-level trajectories and an appropriate level of supporting information to justify these. As noted above, the intention is for the information provided in the baseline plans to be the minimum consistent with demonstrating that the interim milestones are well founded. It might be appropriate for a supplier to provide additional supporting information over time, as part of their progress reports.

A key feature of the baseline plan would be the supplier's trajectory for their own roll-out from when the baseline plan is provided to Ofgem until the end of 2019. The proposal is that this trajectory would be a series of specific interim milestones set by suppliers themselves, not by Ofgem or DECC.

As set out in DECC's May 2012 consultation, current thinking is that the format of the interim milestones should link directly to the roll-out obligation (which is what the proposed framework intends to monitor suppliers' progress towards). This would mean that interim milestones would be set at portfolio level, ie across a suppliers' entire portfolio of domestic and smaller non-domestic customers. We think that this is appropriate, and will help ensure that minor fluctuations in activity are managed by suppliers at an operational level without impacting on their baseline plans. DECC's May 2012 consultation sets out that DECC is proposing to collect information at a more granular level, including information on a regional basis and by consumer group, to inform their policy development.

As set out above, in the proposed framework the interim milestones are the percentage of a supplier's domestic and smaller non-domestic customers who will have a smart meter by a set date. Clearly, the format of the interim milestones is a key part of the proposed framework, and suppliers have informally raised concerns about the suggested format. Our intention is that the proposed format provides the advantage of having a simple, objective standard to measure progress against. However, we recognise suppliers' concerns about how far ahead they would be able to plan accurately, and about the need for further explanation about how these milestones would link to the obligation to take all reasonable steps to complete the roll-out by the end of 2019. There are potential options that could partially mitigate these concerns. For example, an option could be to require suppliers to

take 'all reasonable steps' to meet the interim milestones, in line with the main roll-out obligation. Also, DECC's May 2012 consultation considers whether it is appropriate to place tolerances around the milestones. We encourage stakeholders to respond to the specific question in DECC's May 2012 consultation on whether alternative formulations for the milestones would be appropriate.

Based on the proposed timing set out above, it is likely that the baseline plans would cover a period of approximately five years. To allow progress to be monitored effectively throughout the roll-out, any interim milestones should be spaced appropriately during that period. The proposal is that the interim milestones would be annual, so suppliers would be required to notify us of a series of four or five milestones as part of their baseline plan.

The spacing of the interim milestones is intended to be sufficient so as to enable suppliers to accommodate minor operational fluctuations without affecting individual milestones, but to balance that against having sufficiently regular information about suppliers' progress to help identify issues at an early stage. On that basis, our initial view is that annual milestones would be appropriate, but we are interested in stakeholders' views as to the benefits of alternative durations between milestones. Again, we encourage stakeholders to respond to the specific question in DECC's May 2012 consultation on this issue.

It is also proposed that baseline plans should include supporting information to justify suppliers' high-level trajectories and put them in context. We consider that this should primarily be specific, measureable information, such as data relating to any smart meter procurement contracts in place. This information could include actions taken by the supplier, and any actions they plan to take going forward.

Subject to the outcome of DECC's May 2012 consultation, we would plan to consult on the supporting information that would be required in the baseline plans. As part of any such future consultation, we would also consider the information provided to DECC as part of its monitoring of the roll-out, and ensure that wherever possible we align our requests. For example, we would consider whether it would be appropriate for parts of the Annual Supplier Report provided to DECC to also be provided to us. However, as we are collecting information for different purposes, this may not always be possible.

Status of the information in the baseline plans

We consider that the interim milestones described above are an important tool to facilitate effective regulatory oversight of the roll-out. To ensure that suppliers are accountable for their progress, our view is that suppliers should be required to meet their own planned interim milestones. As such, there is scope for Ofgem to consider taking enforcement action in relation to any failure on the supplier's part to meet an interim milestone. We do not currently consider that it would be appropriate for any other elements of the baseline plans to be binding.

When considering whether to take enforcement action, we would continue to act in accordance with our Enforcement Guidelines on Complaints and Investigations ('the guidelines')⁵. The guidelines are intended to enable us to act proportionately in investigating matters and to enhance the transparency of our investigation processes. In particular, they include a non-exhaustive list of the factors we will generally take into account in deciding whether to proceed with an investigation. These include whether it is a priority matter for Ofgem; the seriousness of the alleged breach; the harm, or potential harm, to consumers or to competition resulting from the alleged breach; and the deterrent effect of any enforcement action, in terms of the likelihood of discouraging similar behaviour in the future.

⁵<http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20Guidelines%20post%20consultation.pdf> (currently under review)

Progress reports and publication of information

The draft licence conditions would require suppliers to report to Ofgem on their progress against their baseline plan. Subject to the outcome of DECC's May 2012 consultation, we would also plan to consult on the specific information required in the progress reports. We consider that the frequency of reporting would align with the spacing of the interim milestones. We therefore propose that annual progress reports would be required if annual interim milestones in the proposed framework were implemented. As with the baseline plans, our current thinking is that the progress reports would be high-level and primarily fact-based.

The proposed framework would also allow Ofgem to direct which (if any) pieces of information from the baseline plan or progress report that suppliers should publish. Subject to the outcome of DECC's May 2012 consultation, we would consult on which information it might be appropriate to require suppliers to publish. This consultation would consider issues such as potential impacts on competition and commercial confidentiality.

We already have statutory powers which allow us to publish information where we consider this would promote the interests of consumers. We could use these powers, where appropriate, to publish information in relation to suppliers' baseline plans and progress reports, in addition or as an alternative to suppliers publishing information.

Appropriate framework for smaller suppliers

We recognise that there are differences between the domestic and non-domestic sectors, and between small and large suppliers. Concerns have been expressed by smaller and non-domestic suppliers about the potential reporting burden, and its proportionality, if the proposed framework was applied to them in its entirety. DECC's May 2012 consultation invites views on which elements of the proposed framework would be appropriate for different types of supplier, and we encourage stakeholders to submit views on this.

We acknowledge the suggestions that it might be appropriate for some smaller suppliers either to provide a different level of supporting information in their baseline plan, or perhaps not to be required to provide a baseline plan at all. As drafted, the licence conditions would allow Ofgem the discretion to apply all or parts of the framework only to certain suppliers, or certain groups of suppliers. Any information collected should provide a meaningful insight into suppliers' progress towards meeting their obligations. If appropriate, we could tailor the information required from smaller or non-domestic suppliers to the individual characteristics of those suppliers. Subject to the outcome of DECC's May 2012 consultation, we would consider this carefully, including through further consultation, to help ensure that we do not place a disproportionate reporting burden on smaller suppliers.

Reviewing our existing regulatory tools

We want to ensure that the final framework for provision of information to Ofgem strikes an appropriate balance between sufficient regulatory oversight, and giving suppliers flexibility in terms of meeting their obligations in a way that fits with their own commercial strategy. We recognise there are concerns that the proposed framework might create perverse incentives on suppliers to delay their roll-out to later in the roll-out period, or discourage suppliers from providing ambitious plans.

We are considering how we can use our existing regulatory tools to provide clarity to suppliers about our expectations and likely approach. For example, we are considering whether it might be appropriate to provide additional guidance on Ofgem's use of its power to impose and determine the amount of any financial penalties for failure to comply with

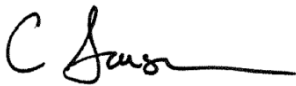
smart meter roll-out obligations⁶. We would consult appropriately on any proposals, and envisage further detail being provided to stakeholders in the first half of 2013.

Next steps

DECC's May 2012 consultation will close on 27 July 2012. Following that, DECC is expected to publish a formal response document, including any decisions taken in relation to the licence conditions. The licence conditions are expected to be laid before Parliament in Autumn 2012 and to come into force before the end of the year. Subject to the outcome of DECC's May 2012 consultation, we intend to consult on more detailed aspects of the framework in Spring 2013. We will continue to engage with stakeholders on an informal basis prior to issuing any such consultation. We note that the final framework for provision of information to Ofgem would need to be kept under review in light of any relevant future policy developments.

If it would be helpful to discuss the specific content of this letter, please contact Philippa Pickford, philippa.pickford@ofgem.gov.uk or Rachel Zammett, rachel.zammett@ofgem.gov.uk. Formal comments on the proposed framework in DECC's May 2012 consultation should be submitted to DECC in line with the process described in that document.

Yours faithfully,



Colin Sausman
Partner, Smarter Markets

⁶ Currently set out in the Utilities Act Statement of policy with respect to financial penalties (October 2003): <http://www.ofgem.gov.uk/About%20us/Documents1/Utilities%20Act%20-%20Statement%20of%20policy%20with%20respect%20to%20financial%20penalties.pdf>