



Making a positive difference  
for energy consumers

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Smart Metering Implementation Programme  
Department of Energy and Climate Change

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Dear Richard,

### **Ofgem's response to DECC's further consultation the Foundation Smart Market**

We welcome the opportunity to respond to your further consultation on the Foundation Smart Market. Ofgem regulates the gas and electricity markets in Great Britain. We have an important role in ensuring that the interests of consumers remain protected both during the transition to smart metering and in the enduring framework. We will also play a key role in monitoring and, where appropriate, enforcing compliance with any new regulatory obligations relating to smart meters.

Ofgem continues to support the work that DECC is carrying out to establish a commercial framework for meters being rolled out during the Foundation stage. This is necessary to ensure that early, voluntary roll-out by suppliers is not unduly hampered and that the systems and processes associated with smart metering are fully tested and trialled in advance of mass roll-out.

Given the significance of the Foundation stage, we welcome this further consultation on Foundation policy to ensure that decisions can be taken based on the best available evidence base. The delay to DCC go-live will result in a longer Foundation stage. Given this, we would consider it helpful if DECC provided clarity to the industry regarding its view of the importance of Foundation and the levels of supplier participation during Foundation that would be beneficial to both customers receiving Foundation meters and to preparations for mass rollout. More generally, it is important that the possible consequences of any intervention are understood, in particular, with regards to the impacts on the cost of supply and the competitive market.

We welcome your constructive engagement with us and other stakeholders to date and look forward to continuing our work with you in this regard. Our main observations on the consultation proposals are set out below.

#### **Smart Change of Supplier**

##### *Licence Condition 1, 2 and 3*

DECC has concluded that it will introduce the three new Supply Licence Conditions, known as 'MAP identity provision,' 'agree or return' and 'no backwards step,' which were proposed in the November 2012 consultation. We will continue to engage bilaterally with DECC with respect to the drafting of these licence conditions.

##### *Licence Condition 4: Continue remote meter reads*

DECC is consulting on a further licence condition which would require gaining suppliers to deliver a minimum smart service by continuing to obtain regular remote meter readings.

It is important that DECC consider carefully what impacts the proposed Licence Condition 4 could have on the existing commercial arrangements between suppliers.

The existing commercial arrangements, combined with the introduction of Licence Conditions 1, 2 and 3, place incentives on suppliers to operate meters they gain on change of supplier in smart mode, where it is economic to do so. On 1 January 2013, Ofgem introduced licence obligations on installing suppliers to offer services to gaining suppliers to facilitate the retention of the smart functionality of the meter<sup>1</sup>. Some concerns have been raised by installing suppliers that offers to provide these services are not always taken up. When considering whether Licence Condition 4 is necessary, it would help to understand the extent to which these services are being taken up and the reasons why they are not being used in all circumstances. This would provide clarity as to the extent to which Licence Condition 4 is necessary and, therefore, appropriate or whether the introduction of Licence Conditions 1 to 3 is sufficient.

We are concerned that Licence Condition 4 could have a number of unintended consequences on installing suppliers' existing incentives to facilitate retention of smart services from its meter on change of supplier. In addition to the licence obligation to offer smart services to gaining suppliers, installing suppliers currently have commercial incentives to ensure these meters can continue to be operated in smart mode by a gaining supplier on churn. This is because the installing supplier may incur additional charges from its Meter Asset Provider (MAP) or have difficulties continuing to obtain smart meters should a gaining supplier choose to operate those smart meters in dumb mode and if the MAP has difficulty obtaining a smart rent for the meter<sup>2</sup>. Existing experience suggests that these commercial incentives may encourage the installing supplier to take additional steps over and above the licence requirements to enable gaining suppliers to operate their meters in smart mode.

The introduction of Licence Condition 4 will strengthen the position of the MAP in negotiating a smart rent for the acquired meter from the gaining supplier and as such reduce the potential exposure of the installing supplier. This could reduce incentives on the installing suppliers to take any actions above the minimum required by its licence obligation to facilitate the gaining supplier's use of the smart meter, resulting in increased difficulties for the gaining supplier. The installing supplier may also decide to increase its charges for smart meter services to the gaining supplier. These licence obligations are not subject to price regulation. The extent to which this is likely to cause a problem depends on the options available to gaining suppliers to use the smart functionality of the meter without using the installing suppliers' smart services. We are not clear on the extent to which other Smart Meter System Operators can offer cost effective alternatives to the installing suppliers' services. We would urge DECC to look into this issue prior to taking a decision on whether to introduce Licence Condition 4.

Given the requirement to operate at least some of the meter's smart functionality and the possibility that the installing supplier's offer to provide services could be expensive and difficult to operate, there is a risk that suppliers will be discouraged from seeking consumers with smart meters during the Foundation stage. This could have a detrimental effect on confidence in the smart meter roll-out.

It is possible that this obligation could lead to significant pressure on DCC to adopt Foundation contracts at an earlier point than would necessarily be efficient, so that suppliers can more easily fulfil their obligation. Premature adoption of Foundation contracts could have a destabilising effect on DCC during the implementation phase and should be avoided.

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<sup>1</sup> See SLC 25B.6 – SLC 25B.12 of the Gas and Electricity Supply Licences. Note the obligation does not apply to suppliers with less than 250,000 domestic customers or who have installed or arranged to install fewer than 25,000 Advanced Domestic Meters or who have installed or arranged to install fewer than 5,000 Prepayment Advanced Domestic Meters. Smart meters fall within the definition of Advanced Domestic Meters.

<sup>2</sup> Depending on the commercial terms between the supplier and the MAP.

Finally, should DECC decide to introduce this condition, we would welcome the opportunity to discuss the detail of the requirement, for example, with regards to defining what regular means in the context of 'regular remote meter readings.'

## **Enrolment and Adoption (E&A)**

Ofgem agrees that it is important for industry to be provided with certainty around the arrangements for enrolling Foundation meters into the DCC and adopting the associated communications contracts as soon as reasonably practicable. However, it is important to balance this with the availability of relevant information and robust analysis to support any decisions. We recognise the importance of information received from Service Providers and DCC with respect to E&A, and consider there might be merit in delaying some of the decisions regarding E&A until this information is available. Otherwise DECC should ensure that the framework is capable of being refined at a later point in light of emerging evidence.

### *E&A Mandate*

DECC has concluded that significant populations of SMETS 1 meters should be supported by the DCC, and the first enrolment should be undertaken as a single exercise. We agree there are material benefits to having as many SMETS compliant meters enrolled and adopted into DCC. We welcome the decision not to introduce an E&A mandate given the lack of evidence to suggest this is appropriate and the existing and commercial drivers on suppliers.

### *Criteria*

An important part of the arrangements will be the E&A criteria that will determine what meters will be eligible, and DECC in its response has sought to provide some clarity on these. In our view the criteria set out will still require further development as information emerges from the procurement process in relation to likely costs and technical feasibility of enrolment. We would advise DECC to ensure that the adoption criteria can be refined as further evidence emerges.

### *Cost Allocation*

In relation to the one-off costs of the system development DECC has decided these will be spread across all users, subject to an economic test. These costs are related to the one-off capital expenditure of enrolment and will include for example, the integration of adopted communication solutions, the building or purchasing of head-ends, data migration, and contract novation. We agree with this approach, given that these costs are likely to be relatively low and because it is consistent with the way development costs of the main DCC systems are treated.

### *Options for the allocation of on-going communication costs*

We understand why DECC has decided to consult further on the approach for recovering the ongoing costs. These costs are associated with the additional operational expenditure associated with Foundation meters, for example, potentially more expensive communication contracts. We recognise the importance of giving industry certainty on the allocation of ongoing costs, however we are concerned about the lack of evidence available at the current time to inform such a decision. The recent extension to the timetable, with mass roll out now planned for 2015 and to end in 2020, could now provide an opportunity for DECC to consider this decision when enrolment costs are known once the service procurement has concluded. The DCC communication costs could also be a relevant cost driver, and more will be known about these after the Licence has been awarded. This would provide industry greater certainty in the longer term. It would be helpful for DECC to include its analysis demonstrating how the preferred approach best fulfils the principles set out in the assessment criteria. We also recommend that DECC undertakes and publishes analysis on the impacts these proposals have for consumers.

### *DECC's preferred option*

DECC has set out a preference for option 1, whereby suppliers pay the same charges for their meters irrespective whether it is an enrolled SMETS 1 or SMETS 2 meter. It also introduces the concept of a cap on the number of meters that option 1 would apply to, over which the additional ongoing communication costs for those meters will be paid by the installing supplier.

If the ongoing communications costs associated with SMETS 1 meters were to be smeared across suppliers, as described under option 1, we support the proposal of a cap. While we understand the intention is for the cap to be set at a level which would accommodate new and replacement volumes, it would be helpful for DECC to set out more detail and analysis of exactly how the cap will be set. We would like to see a robust cost benefit analysis to support the cap being set at the most efficient level. It is equally important to ensure that the administration of the cap is as simple as possible. We note that the adoption criteria no longer includes 'price efficiency', therefore it is particularly important that there is some mechanism, through the cap or otherwise, to impose some discipline on Foundation communications costs.

We recognise and appreciate your constructive engagement with us and other stakeholders thus far on crafting this policy. We look forward to further discussions in the coming months as the policy is refined. If you have any questions about this response in the meantime, please contact Philippa Pickford, [philippa.pickford@ofgem.gov.uk](mailto:philippa.pickford@ofgem.gov.uk) or Paul Fuller, [paul.fuller@ofgem.gov.uk](mailto:paul.fuller@ofgem.gov.uk).

Yours sincerely

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