

RESPONSE PAPER COVER NOTE – REVIEWING SMART METERING COSTS IN THE DEFAULT TARIFF CAP

The April consultation

1. On 30 April 2019, we published an initial consultation (“the April consultation”) on how we proposed to review the efficient costs of rolling out smart meters and how we proposed to set the non-pass-through Smart Meter Net Cost Change (SMNCC) allowance (“the allowance”) in the default tariff cap (the cap).¹
2. In that consultation we set out our initial proposals for:
 - **Considering what constitutes an appropriate SMNCC allowance.** We explained how we propose to ensure that the allowance protects default tariff customers, to have regard to efficient costs, and to consider whether our estimates are sufficiently robust for the purpose of setting the allowance.
 - **Reviewing efficient smart metering costs.** We explained that we propose to assess efficient costs using the new Smart Metering Implementation Programme Cost Benefit Analysis (“SMIP CBA”), and we would consider where we should make modifications to ensure the allowance is suitable. We proposed to consult stakeholders in late August or early September on our approach to estimating efficient costs. We proposed to make our modelling available in a confidentiality ring, alongside our final consultation in late October.
 - **Setting the non-pass-through SMNCC allowances.** We proposed to set the allowances in two stages. We proposed to set the allowance for the third cap period using our current SMNCC model, prior to the completion of our review of efficient costs. We proposed to set the subsequent allowance based on our review of efficient costs. When setting the allowance, we proposed to have regard to any substantial advance payment (or lagged payment) in the first three cap periods, to ensure that, over the life of the cap, smart metering allowances reflect the efficient costs of installing smart meters (based on our reviewed assessment of efficient costs).

Responding to stakeholders

3. We are responding to the April consultation through a number of documents, which focus on major themes in stakeholders’ responses.
4. We have already responded on points specific to the third cap period, through our consultation of 18 June 2019.² On 7 August 2019, we confirmed our approach and announced the cap level for winter 2019-20.³

¹ Ofgem (2019), Reviewing smart metering costs in the default tariff cap. (<https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap>).

² Ofgem (2019), Default tariff cap: approach to the third cap period. (<https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-approach-third-cap-period>)

³ Ofgem (2019), Decision: approach to the third cap period for the default tariff cap. (<https://www.ofgem.gov.uk/publications-and-updates/decision-approach-third-cap-period-default-tariff-cap>)

5. We are responding to four major themes through a suite of papers (“the Response Papers”).
- Response paper #1: This paper responds to points specific to our general approach and the timetable for our review, including contingency arrangements in the event that we cannot use our updated methodology in cap period four. We published this paper on 16 August 2019.⁴ Should you wish to submit views on any of the positions in this paper, please do so no later than close of business on **06 September 2019**.
 - Response paper #2: This paper responds to points specific to additional data gathering requirements. We published this paper on 16 August 2019.⁵ Should you wish to submit views on any of the positions in this paper, please do so no later than close of business on **30 August 2019**.
 - Response paper #3: This paper examines our proposal to have regard to advance payments or lagged payments in the first three cap periods when setting the allowance in forthcoming cap periods. It responds to stakeholders’ responses to our initial proposal. We will publish this paper later in August.
 - Response paper #4: This paper sets out our approach for providing sufficient transparency to stakeholders for them to understand our decision, the reasoning for it, and how we plan to disclose the new SMNCC model that supports it. We plan to publish this paper later in August.
6. In our April consultation, we proposed to assess efficient costs taking the new SMIP CBA as a starting point, and to consult with stakeholders in late August or early September on our approach. Stakeholders were concerned that the new SMIP CBA may not be available early enough to make this possible and they recommended that we should consider contingency arrangements. The new SMIP CBA has not been published yet, so we will not describe our methodology in August or September. In Response Paper #1 we describe our arrangements in the event that the new SMIP CBA is published before our consultation in October, and also in the event that it is not.

Yours faithfully,

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⁴ Ofgem (2019), Response Paper #1: Reviewing smart metering costs in the default tariff cap – our approach and timeline (https://www.ofgem.gov.uk/system/files/docs/2019/08/response_paper_1_-_our_approach_and_timeline.pdf).

⁵ Ofgem (2019), Response Paper #2: Reviewing smart metering costs in the default tariff cap – data gathering (https://www.ofgem.gov.uk/system/files/docs/2019/08/response_paper_2_-_data_gathering.pdf).