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Dear Anna,

SSE response to Ofgem consultation on the approach to the third cap period of the Default Tariff Cap

We welcome Ofgem's consultation on its proposed approach to the third cap period. Annex 1 contains our full response, and a summary is provided below.

Summary of SSE response

- SSE is comfortable with Ofgem's proposal for setting the allowance for the third cap period, but only on the basis that the allowance is unqualified, and that Ofgem removes its proposal for a claw-back mechanism in future periods.
- SSE fully supports Ofgem's proposal to include a full capacity market allowance in the third cap period to cover both the supplier charge and the administrative scheme costs.
- In relation to the wider development of the SMNCC model, as stated in our June consultation response, SSE encourages Ofgem to allow suppliers earlier and direct access to the model during the consultation process; to remove the claw-back proposal; and to allow suppliers to recover non-SEGB marketing costs.

We would be happy to discuss the points made in our submission in more detail.

Yours sincerely

Patricia Hall



Annex 1: SSE response to Ofgem consultation on the approach to the third cap period of the Default Tariff Cap

1 Calculating the allowance for the third cap period

As per our response to Ofgem's May 2019 consultation, SSE is comfortable with Ofgem's proposal for setting the allowance for the third cap period, but only on the basis that the allowance is unqualified, and that Ofgem removes its proposal for a claw-back mechanism in future periods.

As described more fully in our response to Ofgem's May 2019 consultation, SSE urges Ofgem to remove this claw-back proposal on the basis that:

- The reversal of policy is against the principles of natural justice, brings procedural unfairness and renders the earlier consultations regarding the setting of the price cap unfair as respondents were unable to understand Ofgem's proposals and comment on them. This opens Ofgem up to challenge.
- As Ofgem described in Ofgem's Default Tariff Cap Decision Document (Appendix 7), a negative adjustment resulting from a correction mechanism could lead to a cap being set beneath an efficient level of costs, distorting customers' incentives to engage in the market, suppliers' incentives to offer competitive tariffs, and the incentives of new suppliers considering entering the market. SSE is concerned as to how the introduction of this risk aligns with section 1 (6) of the Act, which requires Ofgem to have regard for matters relating to improving efficiency, enabling competition, maintaining incentives to switch, and ensuring suppliers who operate efficiently are able to finance their licenced activities.
- SSE believes that any claw-back in future periods could be detrimental to the success of progressing the smart meter rollout. Investments and commitments for early cap periods have already been made and cannot be used to sustain a strong rollout going forward. A negative adjustment for cap period four onwards would therefore reduce investment available and risk limiting the future pace of the rollout.
- This proposal also goes against the view set out by Ofgem elsewhere in its Default Tariff Cap consultation publications that any over or under-recovery by individual suppliers relating to their specific roll-out profile is expected to even itself out over time.
- As Ofgem has previously noted, the Act requires it to consider the rollout of smart meters as part of its assessment of the conditions for effective competition; we urge Ofgem to reconsider the potential impact a claw-back mechanism in the SMNCC

would have on suppliers' ability to roll out smart meters in an efficient and timely manner.

- Finally, we note that the proposal is inconsistent with all other elements of the cap. In outlining these proposals, Ofgem has not given any explanation as to why this particular element of the cap should be subject to a correction mechanism while other elements are not.

2 Proposed approach for the capacity market allowance

SSE fully supports Ofgem's proposal to include a full capacity market allowance in the third cap period to cover both the supplier charge and the administrative scheme costs. We believe this proposal is aligned to the Government's expectations around the recovery of supplier charges during the standstill period, and that it removes any risk to supplier financeability during the standstill period, which would be introduced if Ofgem was to remove the ability for suppliers to recover Supplier Charges (which is an efficiently incurred cost) during the standstill period.

As per our response to Ofgem's January consultation on this topic, we remain of the view that Ofgem should only seek to make alterations to the cap methodology once there is evidence to warrant such an intervention i.e. once Government has confirmed the final position, not before. We also firmly oppose any proposal to use the headroom allowance to recover known policy costs; these costs must be allowed for in the cap methodology.

3 Wider concerns around the development of the SMNCC model

SSE also considers it important to reiterate our views – as set out in our response to the May consultation – on the wider topic of how the SMNCC model is amended to calculate the allowance for beyond the third cap period:

- Suppliers should have earlier and direct access to the SMNCC model during the consultation process, so they can engage effectively in the consultation and help ensure cost-reflectivity of the model.
- SSE strongly opposes the introduction of a correction mechanism to claw-back any potential over recovery of smart costs during the first three cap periods. This would risk reducing investment in – and damaging the pace of – the rollout; it is a reversal of Ofgem's original policy on correction mechanisms, which brings procedural unfairness; and the associated risk of a negative adjustment could lead to a cap being set beneath an efficient level of costs.
- SSE supports Ofgem's willingness to consider modifications to the SMNCC model assumptions and believes there is a very strong case for the inclusion of the non-SEGB costs of consumer engagement in the model; Ofgem has repeatedly made it



clear that, in order to demonstrate all reasonable steps have been taken, it expects suppliers to go to significant lengths (and therefore incur additional efficient costs) to drive customer demand for smart meters over and above the activities undertaken by SEGB.