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By email to: Retailpriceregulation@ofgem.gov.uk

Dear Anna

Reviewing smart metering costs in the default tariff cap: Response Paper #2 on data gathering

On 16 August¹ Ofgem published the first two papers in a suite of four ‘response papers’ outlining Ofgem’s current thinking in relation to aspects of its review of smart metering costs in the default tariff cap, following its April 2019 initial consultation.² Also on 16 August, Ofgem issued a formal request for information (RFI) concerning two specific areas of cost. Centrica will respond separately to the RFI and other response papers.

This letter provides Centrica’s initial comments on Response Paper #2 (RP2) concerning data gathering. While we welcome the opportunity to comment, given the limited explanation provided by Ofgem for its proposed approach and the short deadline Ofgem has allowed for consideration and comment, this response is necessarily brief. We reserve the right to comment further on these matters in due course.

In summary

- We welcome Ofgem’s decision to gather further data in relation to premature replacement charges (PRC)s and additional net advertising costs. We note Ofgem’s comments which we will consider alongside the RFI on these matters. We therefore reserve the right to comment further as part of our RFI response next week.
- However, we do not find Ofgem’s brief explanations for why it does not currently propose to collect additional data in other areas compelling. We recognise that there are practical limits to further data collection in time for a consultation in October or November. But Ofgem’s administrative timetable is of secondary importance to the

¹ <https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap-response-papers-1-and-2>

² <https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap>

prior question of whether additional data gathering and evaluation are necessary and appropriate to inform the review of smart allowances within the default tariff cap.

- Whether or not Ofgem gathers additional data prior to its next substantive consultation we consider it will need to do so before reaching final conclusions on the appropriate level of smart allowance within the default tariff cap. We note that
 - Ofgem is already considering contingency plans for cap period 4 due to the continuing risk that BEIS' updated cost benefit analysis (CBA) is still not available in time for Ofgem's next consultation
 - Ofgem appears to recognise that current unit cost estimates are unrealistically low³, and proposes that whenever better data is available it would use it to re-evaluate the sufficiency of allowances to date as well as implications for future allowances⁴
- In these circumstances, shortage of time is not a valid reason for declining to gather and assess all necessary data, particularly given that the need for it has been clearly and consistently signalled by suppliers ever since Ofgem first proposed a review of smart metering allowances.⁵

Our specific comments against individual data headings are set out in the attached appendix. Please note that the present response focuses on Ofgem's stated reasons for declining to gather further data, dealing only briefly with the two areas where additional data gathering is planned. We may have further comments in relation to PRCs and additional net advertising costs in the context of our forthcoming RFI response next week.

We look forward to engaging further with Ofgem in the context of this consultation and further consultations to come. If you have any immediate questions on our present response, please contact me or don.wilson@centrica.com in the first instance.

Yours sincerely



Tim Dewhurst
Regulatory Affairs Director

³ Centrica has long maintained that modelled net costs are artificially low, not least to due to benefits being substantially overstated

⁴ <https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap-response-paper-3>

⁵ See for example EUK letter of 18 February 2019 on this subject, enclosing data 'gap analysis' re-submitted with EUK's 30 May response to Ofgem's April consultation. This view was endorsed and reaffirmed by Centrica most recently in response to Ofgem's draft RFI. In fact, it is nearly a year since Centrica urged Ofgem to commence its review of smart costs in January 2019 as part of its response to Ofgem's final statutory consultation in September 2018,

Appendix – specific comments on Ofgem’s position in each area

Cost area	Comments
Category 1: Additional data gathering planned	
Premature replacement charges (PRC)	We welcome Ofgem’s decision to collect additional data in this area and will elaborate as necessary in response to the RFI.
Additional net advertising costs	We welcome Ofgem’s decision to collect additional data in this area. However, we reject Ofgem’s assertion that marketing expenditure to support smart represents a reallocation of existing marketing activity <i>and can be disregarded on that basis</i> . We will elaborate as necessary in response to the RFI.
Category 2: Information considered available	
Operation and maintenance (O&M)	Ofgem’s rationale for rejecting additional data collection is extremely brief – Ofgem says it understands BEIS had had discussions with Meter Asset Providers (MAPs) and that it is satisfied BEIS approach was sufficient. We reserve judgment pending much fuller disclosure and explanation from Ofgem as to what it understands BEIS has asked of MAPs, and the basis on which Ofgem declares itself satisfied as to robustness. For example, how have BEIS and Ofgem gone about ensuring that responses from MAPs are broadly representative, and on what basis have cross-checks with suppliers been discounted?
Debt management	<p>Ofgem argues that BEIS has information on the debt management costs of traditional meter customers. However, in order to determine the debt management benefits of smart meters, Ofgem must combine this with an assumption of how much of the debt cost of traditional meter customers is saved by the installation of a smart meter.</p> <p>Ofgem argues that BEIS has information from ‘a variety of sources’ to allow BEIS to estimate the debt management savings from smart meters. However, no details are given on how BEIS makes such estimations.</p> <p>To estimate this properly BEIS would need to control for the differences in the relevant characteristics of customers that accepted smart meters and those that have not. It may be the case that customers that accepted smart meters had lower debt management costs to begin with. This would mean any simple comparison between the debt management costs for those with and without smart meters would not show the impact of smart meters.</p> <p>Ofgem does not address this issue in relation to this cost and it does not seem likely that BEIS would be able to control for this with the data Ofgem says it has. Given the underlying need to assess the extent to which smart meters do or do not reduce debt management costs in practice, we invite Ofgem to reconsider and in any event clarify the analysis it intends to undertake absent any further data.</p>

Supplier IT costs	<p>Ofgem argues that it would be too hard to ensure that any new data was not double counting because individual suppliers may have timed their expenditure differently from that assumed by BEIS. It states that it would be hard to be clear about what IT costs are only down to the Smart programme and not more general (such as billing systems). Finally, Ofgem argues that costs up to 2017 are already included.</p> <p>Avoiding double counting may be challenging but it is not clear that this is more challenging for IT costs than for marketing costs where Ofgem proposes to collect and evaluate additional data. Moreover, Ofgem notes that it has been told costs have increased since 2018 but seems content to rely on data collected by BEIS in 2010 – long before any unanticipated additional costs would have arisen. This does not seem to address the point.</p> <p>We note that the additional costs since 2018 Ofgem refers to relate particularly to the prepayment solution and rollout of dual band communications hubs. Separately, Ofgem asserts that prepayment is ‘irrelevant’ but this is not the case – see further comments below.</p>
Inbound enquiries	<p>Ofgem argues that it and BEIS already have sufficient information on inbound enquires and notes that suppliers have “made BEIS aware of their concerns about an initial increase in contacts”.</p> <p>Ofgem also notes concern about the fact that the data it has does not really capture the ‘impact’ of smart meters and may be driven by differences in the characteristics of those that take up smart meters and those that don’t. It proposes to “gain a broad understanding” of this by looking at survey data on the differences in characteristics of smart and traditional meter customers.</p> <p>It is not clear what the survey data that Ofgem refers to is or if it will be capable of providing suitable insights in to the issue. However, Ofgem appears to be pre-judging the proportionality of further information gathering by emphasising potential complexity of any analysis which it asserts would “only be indicative” in any event.</p> <p>Ofgem already has indicative data from Centrica showing material differences in call centre contact costs immediately before and after smart meter installation⁶. This would appear to undermine Ofgem’s current inclination not to prioritise further enquiry.</p>
Avoided site visits	<p>Ofgem does not propose to gather additional data on the average cost of regular safety inspections on basis that BEIS “has data which it could apply” as a way of estimating the cost of regular safety inspections.</p> <p>However, it is not clear whether or not BEIS will indeed derive reliable estimates of the cost of regular safety inspections for smart meters (which, unlike traditional meters, it is assumed would not be combined with physical meter reading). We request that Ofgem makes explicit what it assumes about the costs of such regular safety inspections, and the basis for it, as part of the substantive consultation.</p>

⁶ See tables 13 and 13A on page 71 of Centrica confidential response to Ofgem’s 25 May 2018 DTC policy consultation
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Category 3: Additional data gathering not considered robust	
Meter rental	Ofgem intends to rely on the 15-year asset life for SMETS1 meters assumed in the relevant standard and states that given the short length of time that SMETS1 meters have been in place collecting data on actual asset lives at this stage would not be informative. However, concern remains that the modelled 15-year asset life does not reflect commercial reality where we understand 10-year rental is the norm across industry.
Pavement reading inefficiency	Ofgem’s stated reasons for not intending to collect additional data are extremely brief. Ofgem does not appear to suggest that additional data collection would be difficult. Rather, it suggests that data on current trends may not be a good indicator of costs in future periods – apparently because “smart meter rollout is at a relatively early stage”. This is not self-evidently true, however. Current data may, in fact, shed potentially useful light on the reliability or otherwise of current modelling assumptions. We therefore invite Ofgem to reconsider and/or explain its position further.
Legal and organisational costs	Ofgem’s objections are not well substantiated and appear open to question. It is not clear that distinguishing between 2017 baseline costs and additional increments since should be any more challenging in relation to this cost heading than others, and we would not expect identification of specific smart programme operational costs to be especially problematic. If Ofgem intends to rely on lack of materiality we would expect to see some quantitative analysis to support this assessment. At the very least, we would expect Ofgem to check the validity of its assertion that any change since 2017 is not material in relation to the benchmark supplier.
Category 4: Additional data considered irrelevant	
Smart PPM costs	<p>Ofgem has said it does not intend to gather data about smart PPM costs because the DTC “does not apply to most prepayment customers, and does not currently include a specific cap level for prepayment customers.”</p> <p>While the first half of this statement is true in the short term, it is set to change as more PPM customers adopt fully interoperable smart meters and as SMETS1 meters become fully interoperable. The second part of Ofgem’s statement is incorrect. The DTC <u>does</u> currently include a specific cap level for prepayment customers with fully interoperable smart meters – the level is currently set identically to the DTC for credit customers paying by direct debit. However, Ofgem has acknowledged that it lacked reliable data in November 2018 and committed to review the position in future.</p> <p>There are further reasons why Ofgem should now collect data in relation to PPM. The CMA has recommended that Ofgem undertakes a review to determine whether it should provide continuing price protection to PPM customers from October 2020 – within the minimum life of the DTC. And, critically, the CMA has decided that non-pass-through SMNCC costs should not be included in the allowance for PPM customers within the scope of the current PCR. Ofgem therefore needs to consider how these costs will be recovered from customers which are within the scope of the DTC and the SMNCC review, including PPM customers with fully interoperable smart meters.</p>

	<p>We acknowledge that Ofgem may not be able to complete this work in time for a consultation in October/November but that is not an appropriate reason to reject necessary data gathering as 'irrelevant' when it is, in fact, highly relevant.</p>
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