By email:

Anna Rossington
Deputy Director, Retail Price Regulation
Ofgem

18th September 2019

Dear Anna,

RESPONSE PAPER #4: REVIEWING SMART METERING COSTS IN THE DEFAULT TARIFF CAP – DISCLOSURE ARRANGEMENTS

Thank you for the opportunity to respond. We have several comments and concerns:

- We are supportive in principle of a virtual data room for the new SMNCC model. However, there would need to be a significant improvement in transparency compared to the previous data room for this to be a worthwhile exercise. Our key concerns with the previous data room (from our response to your April consultation) are appended to this letter.

- In our view the guiding principles should be that i) the model with all non-confidential information (including aggregate/average data) should be published. As a minimum, we see no reason why suppliers should not have access to aggregate/average data; ii) individual supplier data should be disclosed in the data room for review by advisors, subject to confidentiality safeguards.

- We believe that the definition of Permitted Purpose is unduly restrictive, being limited to dealing with the SMNCC consultation. For example, aggregate/average data could be beneficial for benchmarking to facilitate efficiency improvements.

- Timing – to maximise the opportunity for informed input to the review, the data room should be opened as soon as possible, rather than a one week lag after the publication of the consultation. We note that the updated SMIP CBA has been published.

I trust this is helpful for putting in place arrangements that help to ensure the price cap facilitates the delivery of the smart programme for the benefit of consumers. This response is not confidential.

Yours sincerely,

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APPENDIX: npower concerns with initial SMNCC data room (extracts from response to April consultation, 29th May 2019

Our concerns on the relative methodology are exacerbated by a comment that appears a number of times in Annex A of Appendix 7, which at best can be described as misleading. This comment states that "DCC Charges are included in the SMNCC as pass-through charges". This is incorrect – it is only the movement of DCC charges since the April – September 2017 charging period that is included. The same principle applies to Smart Energy GB costs. These costs from 2017 should remain within the baseline non-pass-through costs, but due to the restrictions and redactions of the data disclosure room we have been unable to ascertain whether this is the case. Therefore, we are concerned that the principle of pass-through costs has not been applied in practice and that these costs are not fully included in the price cap;

<u>Comments on Non-Pass-Through Costs</u>

It has been particularly challenging to assess whether the proposed non-pass-through element of the SMNCC is an accurate reflection of the principles outlined in the consultation due to the rules and restrictions of the data disclosure room. However, based on the information we have been able to obtain, together with the consultation proposal, we have identified five specific areas of concern which are outlined below:

<u>Productivity Assumptions</u>

We note the 40% productivity assumption increase that has been applied to the insourced variable costs, and that this has been applied on the basis of assumptions provided in supplier returns. However, based on the information available in the data disclosure room we cannot be comfortable that this is an accurate reflection of supplier returns. We have the following concerns regarding the calculation of this increase:

- The 40% assumption is stated to be based on the average of six suppliers. However, as npower did not submit a 2017 figure, this is not the case unless data was used from five other large suppliers and complemented from information of one of the small or medium suppliers.
- It is unclear if the other five suppliers provided both 2017 and 2018 data, and if one or more suppliers did provide data for both years whether the sample is large enough for this assumption to be relied upon.
- It is unclear how robust this figure is, and it is unclear how it would be impacted if npower's 2017 figures are included, or if mid-tier suppliers are included.

<u>SMETS 1 Costs & Pass-Through Methodology</u>

The methodology that has been proposed implies that certain costs, in particular those relating to SMETS 1 meters, have been removed from the baseline costs on the basis these will be charged by the DCC, and that "DCC charges are included in the SNMCC as pass-through costs". As mentioned above, we have particular concern with this statement, as it is only the movement in DCC charges from 2017 that are included in SMNCC. There is considerable ambiguity around this whole area, and this has not been helped by the fact that key information from the data disclosure room has been redacted.

A particular concern within this is the treatment of SMETS 1 meters, where there is reference to a downward adjustment in 2019, and removal from 2020. As a supplier with around ✂ SMETS 1 meter installations by the end of 2018 we will continue to incur charges for communication hubs

(✂ per year) and data processing (✂ per year) until these meters are adopted by the DCC. Based on the current DCC proposals for Enrolment & Adoption (E&A) migration, the npower group of customers will not migrate until either Q4 2019 or Q1 2020, both of which are outside the two cap periods covered by the SMNCC. As mentioned above, the data disclosure room restrictions have meant that we have not been able to ascertain the assumptions around E&A, but we do not believe there should be any downward adjustment for SMETS 1 meter costs until after the first two cap periods, and that full allowance for the additional £11 communications and data costs of SMETS 1 meters should be made. With ✂ such meters, this comes to an annualised cost of ✂, which equates to over £2 per meter over all our customer base.

<u>Industry IT Costs</u>

We do not believe that the additional supplier IT costs, which are outside our control and driven by industry-wide issues that are noted above, have been adequately reflected in the calculation of non-pass-through costs.
The consultation references an industry-wide increase in supplier IT costs in paragraphs 3.44 to 3.49 of Appendix 7. We have not been able to ascertain what this allowance is, and the assumptions underpinning it, as all the key assumptions that would help us to do this have been redacted from the data disclosure room. Therefore we have no evidence to ascertain whether the allowance adequately reflects the costs incurred, and in particular we cannot determine whether the additional costs that have been incurred from the ongoing delays to SMETS 2 installation have been captured.

Finally, we have not been able to ascertain whether the accounting treatment of supplier IT costs is appropriate, and reflects the actual treatment by suppliers. Paragraph 4.31 of Appendix 7 states that the cost of system changes are capitalised over a 15 year period. It is not clear from our analysis of the data disclosure room what the capitalisation period is, and what percentage of supplier IT costs are not capitalised (i.e. are operating costs). Supplier IT costs are not capitalised over a 15 year period (5 to 10 years being general accounting practice) and a significant minority of supplier IT costs (around ✂ in our case) are not capitalised. We have not seen evidence to suggest that the accounting policy assumption match those of suppliers in relation to IT costs. All this information should have been available in the data disclosure room, and the fact that it has all been redacted is, in our view, highly unsatisfactory.

Furthermore, we are particularly disappointment in the Ofgem response to our question as to why these data has been redacted. The response essentially justifies redacting information on the basis that it is not in the public domain. This seems to imply a logic that suggests that only publically available information is available for disclosure, in which case it begs the question as to why there are confidentiality requirements in place at all. We consider the decision to redact this information as being deliberately obstructive. It has significantly undermined our ability to review the information in the data disclosure room, as well as our confidence in the overall process.

We believe that the impact of supplier IT opex costs and depreciation is around ✂ per meter in 2019, based on a total cost of around ✂ in operating IT costs and depreciation. We believe that this number should be reflected in the SMNCC, but have no way of determining the extent to which it is. Depending on a supplier’s accounting policies, we believe that these costs could be between £3-7 per meter.

Overall Impact on SMNCC

Overall, we believe that the SMNCC is potentially understated by at least £10 per meter, although it is impossible to determine the exact amount due to the extensive restrictions of the data disclosure room.