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Reviewing Smart Metering Costs in the Default Price Cap

EDF Energy is the UK's largest producer of low carbon electricity. We operate low carbon nuclear power stations and are building the first of a new generation of nuclear plants. We also have a large and growing portfolio of renewable generation, including onshore and offshore wind, as well as coal and gas stations and energy storage. We have around five million electricity and gas customer accounts, including residential and business users. EDF Energy is committed to building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

EDF Energy welcomes the opportunity to provide comments on the above paper. We are supportive of Ofgem undertaking a robust and accurate review of the smart metering allowance within the default price cap, with the aim of ensuring that for the duration of the cap suppliers are able to recover the efficient costs of their roll-out programme.

Our response to the questions set out in the consultation paper in respect of the methodology adopted by Ofgem and its review of efficient costs and underlying model, can be found in the attachment to this letter. These views have been informed by our access (including that of our appointed advisors) to the Ofgem model and underlying data through the confidentiality ring set up by Ofgem. In addition to these detailed comments, we would also like to raise the following concerns with Ofgem's proposals and the approach it has adopted.

Smart Meter Policy Framework post 2020

BEIS has recently consulted on a proposed smart meter regulatory framework that would apply to suppliers after the end of 2020 when the current regulatory framework ends. These proposals involve placing new obligations on suppliers, through the introduction of binding annual milestones, which seek to deliver smart meter penetration levels of 85% by 2024. We observe that within the consultation Ofgem has stated that its proposals reflect the "new proposals for the smart meter rollout beyond 2020". We believe this raises two significant issues.

Firstly, we have in our response to BEIS argued against a policy framework that places fixed milestone targets on suppliers with no additional policy support to increase the take up of smart meters in a customer opt-in programme. Adopting such an approach without tackling the primary constraint on rollout progress of customer engagement provides no opportunity for suppliers to complete an efficient roll-out and introduces significant regulatory risks.

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We consider that the form of obligation BEIS is proposing will certainly have the effect of driving up suppliers' roll-out costs, including for example through financial incentives to promote customer acceptance, in order to have any prospect of achieving the level of installs required. These additional costs are inconsistent with the roll-out costs included within the Government's cost benefit assessment (CBA). The cost assumptions included in the CBA, which to a large degree have been adopted within Ofgem's methodology approach for its SMNCC review, will not deliver the install levels proposed under the post 2020 framework. Furthermore, suppliers have not been provided with the opportunity to scrutinise the accuracy, assumptions and underlying data of the revised CBA prior to it being incorporated in to any updated SMNCC analysis. We have previously identified this risk in our earlier responses to Ofgem's consultation on this matter, such that external validation is required in order to ensure that Ofgem's approach to revising its methodology leads to a robust estimate of net costs. Through constraining timeframes, we believe the consultation approach Ofgem is adopting is limiting the extent to which suppliers can undertake a full and effective review. In particular, we consider that within the revised CBA BEIS has unreasonably used current cost and install volume data in their projection of future costs and rollout profiles, which, if included in Ofgem's revised SMNCC methodology will therefore understate the efficient costs that suppliers will incur in future cap periods.

Secondly, there would appear to be a mismatch in timings in respect of Ofgem's current SMNCC review and that of BEIS's post 2020 policy framework review. We note that Ofgem are aiming to set a revised SMNCC allowance for, and beyond, the next tariff cap period commencing on 1 April 2020. This would involve making a final decision by the **middle of December** in order for it to take effect by 7 February i.e. the date which the next cap level will be published. However, the initial consultation on the smart meter policy framework post 2020 has only recently closed, such that any final decision is likely to occur in the first quarter of 2020 at the earliest. Given this mismatch in timings and the possibility of any final policy decision on a post 2020 framework diverging from the current proposals, it is not possible for Ofgem to have confidently taken account of any new policy framework in setting an SMNCC allowance for cap period four and beyond.

On this basis, we would not agree that Ofgem can, at this point of time, form a robust and accurate view of smart meter costs and set an appropriate Smart Metering Net Cost Change (SMNCC) allowance for the remainder of the default tariff cap period. Not only does there remain some uncertainty as to the final policy framework that will be put in place by BEIS, it is also unclear what impact any such policy will have on the costs faced by suppliers.

We are deeply concerned with Ofgem's position that this current review will set allowances up to the end of 2023 and that it is placing a "very high bar" on undertaking any further reviews in the future. Such an approach fails to take due account of the evident uncertainties, and is also inconsistent with BEIS's current proposal for a mid-point review of its annual milestone obligations in line with market conditions. There is a clear and obvious link, which needs to be acknowledged by Ofgem, between any post 2020 smart meter framework and the costs suppliers are exposed to under such an approach, and that of the default tariff cap and the setting of an allowance that allows suppliers to recover their efficient costs

Given the above, it would appear Ofgem should as a minimum commit to reviewing the smart meter allowance within the tariff cap during the post 2020 period, but also consider whether it would be more appropriate to await a final decision from BEIS before implementing changes in order to undertake further assessment and consultation as appropriate.

Carry Forward Balances

Throughout 2019, we have through our responses to earlier consultations on reviewing smart metering costs signalled our opposition to the use by Ofgem of any retrospective correction mechanism within its model for future cap periods. We continue to hold this view. Adopting a policy of adjusting the allowance to address any instances where Ofgem subsequently considers that the allowance was somewhat higher than the actual efficient costs in earlier periods distorts competition and will mean suppliers are not able to recover the efficient costs of their roll-out programme from 2020, for their customers within the price cap.

Ofgem should consider the distortive effects that such under-funding will have on market dynamics and whether this impact will help create the conditions for a competitive market that are desired. The extent to which any supplier has been overcompensated for their costs in the smart programme in the past was itself a market distortion, most likely leading to that supplier offering lower prices than they would otherwise have been able, as suppliers compete for scale. The review of the SMNCC is an opportunity to correct and remove market distortions by allowing efficient costs.

The concept of 'advance payments' might be understandable in a static market where customers remain with their suppliers through the period of the price cap, but is a difficult one to explain in a market with 20% churn and large shifts in market share between market participants. If a supplier wins an SVT customer without a smart meter from a competitor they take on all of the obligation to fit a smart meter, but, unlike the previous supplier, have not received any 'advanced payments' for doing so. The commercial value of that customer has therefore diminished (assuming they may fall under the cap at some point) and the price that must be charged to be profitable is increased.

The Carry Forward proposal introduces a new and deliberate distortion by not allowing the costs necessary for suppliers to finance the smart roll-out from 2020. The proposal further exacerbates the unintended creation of winning and losing suppliers, relating to their customer portfolio and smart meter roll-out profile and not their relative efficiency.

However, in the event that Ofgem continues with its proposals to adjust the allowance to take account of its assessment of advanced payments, we are supportive of an approach that spreads the carry forward over all of the potential cap periods up to the end of 2023. We agree that this would be the least disruptive approach to SMNCC in each future cap period.

Contingency

We are supportive of Ofgem having in place contingency arrangements in the event that through its consultation process it determines the need for further assessment and consultation prior to making revisions to its methodology. We do not believe that Ofgem should look to make piecemeal adjustments and are therefore supportive of Ofgem using the existing the SMNCC model for cap period four in the event that it is not in a position to revise its methodology in time. As we have stated above, Ofgem needs to duly consider the implications of the post 2020 regulatory framework not being determined until sometime in early 2020 and the clear link this policy will have on its approach to setting an appropriate SMNCC allowance going forward.

Review Process/Timings

We are disappointed that Ofgem has undertaken a review process involving consultations, working papers and formal requests for information, which have generally involved short timescales for suppliers to assess and respond to. This includes the current consultation where only the statutory minimum 28 days consultation period has been granted. This is despite the consultation comprising of significant proposals and involve gaining access to and scrutiny of Ofgem's detailed model and underlying assumptions through its confidentiality ring. Furthermore, the methodology adopted has been heavily based on the latest BEIS smart metering programme CBA, which itself was only published a month before this consultation and has not been subject to industry review and consultation.

We consider the short timescales provided for responding to an issue of this significance and complexity is inappropriate and contrary to good regulation practice and the need for a full and fair consultation process. The statutory minimum 28 day consultation timeframe is normally used at the end of a full and transparent consultation process where initial proposals have been fully consulted upon, whereas this consultation is the first opportunity stakeholders have had to consider the full extent of Ofgem's proposals including the impact of the new BEIS CBA and its cost assumptions and the revised SMNCC methodology and supporting model/underlying assumptions. Providing the minimum period to respond inhibits stakeholder's ability to effectively scrutinise the information and data made available and limits their ability to make accurate, robust and informed responses.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre, or myself.

I can confirm that this letter may be published on Ofgem's website. Please note the content of the attachment to this letter is confidential and should not be published without our express consent.

Yours sincerely,

R. Beresford

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