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Dear Anna,

**SSE response to Ofgem consultation on reviewing smart metering costs in the default tariff cap**

SSE welcomes the opportunity to provide views on the scope of this important review. Overall, while we recognise the challenge that Ofgem's faced with, we firmly oppose some of the fundamental assumptions used in the model as this would penalise efficient market operators as they rollout smart-meters. Additionally, as outlined in our response to working papers we remain concerned over the process and timelines Ofgem has imposed on this consultation. We have summarised our concerns below. Please refer to annex 1 for our full response and appendix 1 for our economic advisor CRA's non-confidential report.

**Summary of SSE response**

- We strongly oppose the proposed allowance as we believe it is too low. We further explain our reasons behind this in the following two points below.
- In respect of the rollout profile presented in the model, we recognise that whilst the profile cannot hold true for each individual supplier's experience, the magnitude of the difference in SMNCC between the BEIS profile and SSE's actual/forecast profile is very significant. As an efficient market operator, we would fully expect closer alignment in the rollout profile set out in the methodology and consider it entirely unreasonable for Ofgem to impose the same allowance on all suppliers given the disparity in rates produced by different rollout profiles.
- We have concerns over the productivity assumptions ✂ We believe the productivity figure is overly aggressive for 2020 (vs. Ofgem's own implied figure). Additionally, we have concerns that Ofgem has not applied its 200 working day assumption consistently to ✂ . We would welcome clarification on this.
- CRA have identified instances where Ofgem is basing its calculations on ✂ The assumptions behind this approach are unclear and have not been consulted upon. We would urge Ofgem to share such assumptions and/or request the necessary data from suppliers. Further, Ofgem should ensure that assumptions based on weighted averages are both robust and accurate ✂

- We are concerned that when Ofgem benchmarked its 2017 operating costs for an efficient lower quartile supplier, it based its costs on a supplier who was behind the average rollout profile. The issue then being, they have delayed their investment in smart rollout and will face higher cost inflation in a later period. However, as the SMNCC assumes an average roll out profile, this will not be picked up in the cap indexation.
- There is an error in the ~~the~~ Ofgem should rectify this issue to ensure the SMNCC allowance is accurately reflected.
- We have concerns over the absolute value of the proposed carry forward. We do not believe this to be an accurate representation of events. The fact that demand and technical issues have resulted in a slower pace of rollout has not enabled us to avoid these already committed costs.
- We are supportive of Ofgem using the current model as a contingency plan should the model and underlying data be deemed unsuitable pending supplier responses. Equally, should it be concluded that full consideration has not been taken with regards to BEIS post-2020 framework. We would recommend Ofgem further reviews the SMNCC in line with any decisions BEIS makes on its 2020 policy.
- The SMNCC model revisions will impact – and be impacted by – BEIS’s post-2020 smart framework consultation. We are not seeing evidence that Ofgem and BEIS are working in harmony in developing these two interrelated policies simultaneously. We urge Ofgem to provide the necessary transparency around this.

We firmly believe that urgent revisions are required to correct the unreasonable assumptions within these proposals that will penalise efficient market operators as they roll out smart metering. We would be happy to discuss this, and any wider questions you may have on the matters we raise in this response.

Yours Sincerely,

Cher-Rae Fairlie

**Policy and Regulation**

## Annex 1: SSE response to Ofgem consultation on reviewing Smart Metering Costs in the Default Tariff Cap

### 1. Feedback on Ofgem's consultation Process

#### SSE remains concerned over Ofgem's process and associated timescales

We are concerned over the process Ofgem has followed throughout its SMNCC consultation phase. Our concerns, which echo those raised in 2018 during the consultation phase of the Default Tariff Cap, are set out below. We firmly believe that Ofgem must now consider how it can better accommodate the need to enable enough time for proper external scrutiny of these wide-reaching and major industry changes. Current proposals do not accommodate this, and therefore exposes the framework to risk of error.

- In-line with Energy UK's response to this consultation, we do not consider the four weeks provided for responding to the consultation to be fair or proportionate, given the magnitude of this review and we disagree with Ofgem's response to EUK.
- We strongly disagree with the notion that the timescales granted for the DTC were adequate and further that this review warrants less time for review, in comparison to the complexity of issues presented within the DTC consultation. Suppliers have had no sight of the SMNCC till this point, therefore no prior familiarity. The matter being consulted upon does not constitute a minor change and as a result, should have been granted a more generous amount of time as per Ofgem's policy on consultation.
- Suppliers were asked to respond to a series of four SMNCC working papers, with overlapping two-week deadlines. This was not enough time to consider the key interactions between each of the four working papers. We additionally would argue that Ofgem's proposals within the working papers were unclear e.g. with regards to the carry forward mechanism. This conflicts with Ofgem's own policy on consultation and the Government's good practice guide to consultation.
- With regards to confidentiality arrangements, suppliers had been advised that there would be a two-week window to arrange and submit appropriate arrangements for Ofgem's confidentiality ring. However, suppliers were provided four working days to compile and respond to this request and additionally, achieve board level sign-off. This was especially disruptive given Ofgem's late decision not to use a virtual disclosure room, which was contrary to what it had previously signaled.

#### We are concerned that Ofgem's SMNCC review and BEIS post 2020 are not informing each other

As highlighted in our response to the BEIS post-2020 framework consultation, we are not seeing evidence that Ofgem and BEIS are working in harmony in developing these two interrelated policies simultaneously. While Ofgem acknowledges that BEIS is yet to reach a decision, there has been no transparency as to how Ofgem and BEIS are working together to ensure that the key linkages between policies, have been considered. We have outlined our concerns on this matter as follows:

- **We have concerns over the recovery of Smart Costs.** Any increase in targets proposed by BEIS may depart from the assumptions currently being used by Ofgem to develop the SMNCC model within the Default Tariff Cap methodology and as such this would require

a revision of the SMNCC model. Ofgem has not made reference to this eventuality or shared any plans or assumptions with stakeholders around how it might address this. We urge Ofgem to do so.

- **We are concerned over Ofgem's 'high bar' for re-opening its decisions on the SMNCC values.** We note that Ofgem will set a 'high bar' for reconsulting on its SMNCC allowance and therefore it is unlikely that there will be any further scope for review. We would question the appropriateness of setting a definitive SMNCC allowance from 2020 till 2023 where BEIS post 2020 policy has not yet been defined or enshrined into licence conditions. We urge Ofgem to set out arrangements that would accommodate a review following the conclusions of BEIS's policy development on the post-2020 framework. The purpose of the review would be to ensure that the smart allowance accurately reflects the cost suppliers will incur in seeking to achieve the new BEIS targets.

## 2. Methodological concerns

### Question: Do you agree with our methodological considerations?

The confidentiality arrangements of the model have been unnecessarily restrictive and have prevented us from being able to validate assumptions. There are elements of the SMNCC where unstated assumptions have been made in respect of the underlying data that we are unable to assess as a supplier without a view of the decisions taken to arrive at the figures used as model inputs. For example, we cannot assess the validity of the cost of install used throughout the model without assessing the underlying data and the method of combining individual supplier returns.

We accept Ofgem's efforts to protect the confidentiality of the SMNCC model and Disclosed data, however, we feel that the restrictions placed around the confidentiality of the model have been unnecessarily restrictive and obstructive. Whilst we agree that individual supplier data warrants certain restrictions in accordance with applicable competition law, including the Competition Act 1998 and Articles 101 and 102 EC, we do not agree that the same restrictions should be applied to either the underlying BEIS data, or SMNCC model. It would be useful for the model itself to be discussed among a wider audience e.g. EUK as we have been unable to utilise this channel for the purposes of this consultation, on this occasion.

Due to overlap of questions, please refer to section 3 for further views on Ofgem's methodological considerations.

## 3. Reviewing efficient net costs

### Question: Do you agree with our review of efficient costs and its underlying methodology?

The disparity between SSE's rollout profile and the rollout profile applied to the model is significant and will not reflect the costs that we incur as an efficient supplier

SSE has spent significant amounts (in terms of preparing a sufficient workforce and equipment and contractual arrangements with meter manufacturers and meter asset providers) to deliver to the planned rollout profile. The fact that demand and technical issues have resulted in a slower pace of rollout has not enabled us to avoid these costs, which had already been committed. This means that the actual cost of the rollout has been in closer alignment with the planned – rather than actual –

installation rates. Whilst Ofgem have recognised that individual supplier's circumstances vary due to many factors, including the makeup of their customer base, we do not feel that the SMNCC fairly allows for this variability. The impact of replacing the BEIS rollout profile in the model with SSE's actual rollout to date and planned installs for the remainder of the price cap produces a very significant increase in the SMNCC for future cap periods – even when including the clawback mechanism. Flexing the rollout profile in the model suggests that ✂ on the SMNCC over the rollout period through the application of BEIS' rollout profile, relative to our own rollout plans

Ofgem state that: "suppliers are at different stages of their rollouts. In any specific cap period, different suppliers may therefore incur different costs compared to the average rollout profile. In the long run however, these differences in timing should net out." We do not agree that this is the case, given the results of replacing the rollout profile in the model with SSE's profile as discussed above.

✂

Assuming an average rollout profile may cause additional distortions to the cap – through the assumption made when calculating the 2017 baseline costs and the subsequent indexation applied to this cost.

We are concerned that when Ofgem benchmarked its 2017 operating costs for an efficient lower quartile supplier (which will have included any investment in smart metering) it has based its costs on a supplier who was behind the average rollout profile. We believe the supplier is low cost because they hadn't invested in the smart rollout, not necessarily because they are efficient. The issue then being, that they have delayed their investment in the smart rollout and will face higher cost inflation in a later period. However, as the SMNCC assumes an average roll out profile, this will not be picked up in the cap indexation.

We have concerns over BEIS SMIP CBA productivity assumptions

CRA have been unable to ✂

We have concerns over BEIS SMIP CBA productivity assumptions. We note that the CBA assumes that productivity will improve – reaching a maximum of five installations per worker per day in 2020 and 2021, then reducing as the number of customers with traditional meters decreases, to three installs per worker per day by 2023. ✂ We do note that the productivity assumptions used in the CBA and by Ofgem are based on a standardised annual working days assumption of 200 days/year. This would go some way to explaining the disparity between our productivity assumptions and those assumed in the model (though not completely filling the gap). However, we have some concerns around the consistency of this working day assumption – has it been applied consistently for productivity and expected annual installs or could there be a disconnect between the two. Please refer to appendix 1 section 2.4 for further information.

We note that Ofgem outline the quality of the CBA and the extent of the research undertaken to produce this piece. We would flag our concerns that suppliers were not provided with an opportunity to scrutinise the CBA to ensure its accuracy and cost reflectivity, including the above productivity assumption.



✂ reduces the overall SMNCC allowance

✂ It is proper practice during a consultation for Ofgem to make clear how assumptions have been derived so that stakeholders make proper considerations of the proposals and the reasonings behind them. Ofgem should be transparent in its reasoning for not providing a substitute, where there are financial implications. Additionally, Ofgem should liaise with the suppliers in question, to request suitable data that can be used in the ✂ to ensure a more accurate and cost reflective SMNCC allowance.

We have identified errors within the model with regards to ✂

✂

Ofgem should rectify this within the model as this impacts the SMNCC.

Ofgem has based assumptions on ✂

We have been advised that some data is not comparable, as it is based on ✂ of suppliers' data. We are therefore concerned that returned data e.g. ✂ is not being produced on a consistent basis and as a result, negatively impacting the SMNCC allowance in multiple areas. ✂

#### 4. Setting the allowance

**Question: Do you agree with how we propose to set the SMNCC and its underlying methodology?**

We have concerns over the absolute value of the proposed carry forward

Ofgem currently assert that because the true rollout profile of smart meters has lagged the profile on which the price cap for periods 1-3 was based, suppliers have not spent the allowance on the smart rollout program. We do not believe this to be an accurate representation of events. As outlined in section 3, like many other suppliers, SSE has spent significant amounts (in terms of preparing a sufficient workforce and equipment and contractual arrangements with meter manufacturers and meter asset providers) to deliver to the planned rollout profile. The fact that demand and technical issues have resulted in a slower pace of rollout has not enabled us to avoid these costs, which had already been committed. This means that the actual cost of the rollout has been in closer alignment with the planned – rather than actual – installation rates. This is a genuine additional cost to the smart program which we have had to carry and would have been extremely difficult to predict and avoid.

#### 5. Contingency allowance

**Question: Do you agree with our proposals for setting a contingency allowance?**

SSE agrees that Ofgem should reconsult should the SMNCC model be unsuitable

As noted within section 1 we are concerned by the 'high bar' Ofgem intends to impose with regards to reviewing the SMNCC allowance. As discussed, we question the appropriateness of setting a

definitive SMNCC allowance till 2023 where BEIS has not yet reached a decision on its policy. An SMNCC allowance is needed in the meantime, therefore, in principle we agree with there being a contingency arrangement in the short-term.

Should Ofgem decide to reconsult it must allow enough time for its proposals to benefit from proper external scrutiny. As discussed in section 1, we do not consider the four weeks provided for responding to the consultation to be fair or proportionate, given this magnitude of this review and oppose Ofgem's justification of allowing only four weeks. Furthermore, Ofgem must engage suppliers earlier to ensure sufficient time to set-up confidentiality arrangements and organise support for review of underlying data. Doing so otherwise is counterproductive to the objective of proper consultation, which should be of paramount importance to Ofgem in their consideration of the objectives of the Act and in ensuring an accurate, cost-reflective cap that does not penalise efficient operators and their customers.