Making a positive difference
for energy consumers

All stakeholders

Email: RetailPriceRegulation@ofgem.gov.uk

Date: 05 August 2020

Dear Stakeholders,

Decision on minor changes to 'Annex 5 – Methodology for determining the Smart Metering Net Cost Change' of SLC 28AD

The default tariff cap ("cap") includes a smart metering net cost change (SMNCC) allowance. This is an allowance for the changes in the net costs of smart meters since 2017. The SMNCC is set out in 'Annex 5 – Methodology for determining the Smart Metering Net Cost Change' of Standard Licence Condition (SLC) 28AD of the gas and electricity supply licences. The SMNCC consists of two components, the pass-through SMNCC and the non-pass-through SMNCC.

In June 2020, we issued an open letter to consult on minor changes to the methodology set out in Annex 5.[1] We proposed these changes to make sure Annex 5 was consistent with the proposed changes in the May 2020 consultations for reviewing smart metering costs in the default tariff cap and for protecting energy consumers with prepayment meters.[2,3]

This letter sets out our decision to proceed with our proposed positions. These are:

- to add new input rows for the Prepayment meter ('PPM') non-pass-through SMNCC;

[1] Ofgem (2020), Consultation on minor changes to 'Annex 5 – Methodology for determining the Smart Meter Net Cost Change
https://www.ofgem.gov.uk/publications-and-updates/consultation-minor-changes-annex-5-methodology-determining-smart-metering-net-cost-change
[2] Ofgem (2020), Statutory consultation for protecting energy consumers with prepayment meters.
https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-protecting-energy-consumers-prepayment-meters
[3] Reviewing smart metering costs in the default tariff cap: May 2020 statutory consultation
https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap-may-2020-statutory-consultation

- to change our SMETS2 meter volume source from the original non-pass-through SMNCC model to the relevant non-pass-through SMNCC model that will apply to the upcoming cap period that we are calculating the DCC charges for.

In reaching this decision, we have carefully considered the feedback received. Annex 1 to this decision provides a high-level summary of these views, and gives our response.

We have published the revised Annex 5 alongside this letter. We have made minor corrections to the version we published alongside our open letter consultation. We detail these in the decision section.

Background

PPM non-pass-through SMNCC

In our May 2020 consultation on protecting energy consumers with prepayment meters[4], we proposed to add a PPM non-pass-through SMNCC allowance, which accounts for the net impact of replacing traditional prepayment meters with smart meters on the efficient operating costs of suppliers with an average rollout profile. We proposed to add this allowance in both our main proposal and our contingency option.

Alongside that consultation, we disclosed the SMNCC model that included our calculation of the proposed PPM SMNCC.

We proposed to change Annex 5 to reflect these proposals. Specifically, adding input rows for PPM so that Annex 5 calculates separate SMNCC levels for PPM and credit meters.

Pass-through SMNCC

Communications hubs send information from a smart meter to suppliers (via other organisations, such as the Data Communications Company (DCC). The cost of communications hubs for SMETS2 meters are recovered in DCC charges that are paid by suppliers.

The pass-through SMNCC is an allowance for changes in industry body charges (such as those from the DCC and Smart Energy GB) over and above the 2017 level, which we include in the operating cost allowance. We calculate the pass-through SMNCC for each six-monthly cap level update, using publically available charging statements and budgets. In

[4] Ofgem (2020), Statutory consultation for protecting energy consumers with prepayment meters. https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-protecting-energy-consumers-prepayment-meters

our 2018 decision[5] we used the original 2018 non-pass-through SMNCC model as the source for the volume of SMETS2 meters, to calculate the SMETS2 communications hub fixed charge element of DCC charges in the pass-through SMNCC model. We also used assumptions from the original non-pass-through model, including the roll-out profile and a simplified split of SMETS1 to SMETS2 meters that would ultimately determine the SMETS2 meter volumes.

In our May 2020 consultation on reviewing Smart metering costs in the default tariff cap,[6] we consulted on changes to the non-pass-through SMNCC model, and signalled our intent to conduct regular reviews which might involve further modifications. The proposed changes to the non-pass-through SMNCC model are outside the scope of this decision. In our June open letter[7] we asked suppliers to provide any views on the non-pass-through SMNCC model, including the volume of SMETS2 meters, via the May 2020 consultation 'Reviewing smart metering costs in the default tariff cap: May 2020 statutory consultation'.[8]

The focus of the June open letter was to gather stakeholders' views on our proposed changes to the methodology set out in Annex 5 to clarify the source of SMETS2 meter volumes used to determine the communications hub fixed charge element of DCC charges.

We proposed to change our source of SMETS2 meter volumes from the original non-pass-through SMNCC model to the relevant non-pass-through SMNCC model that applies to the upcoming cap period that we are calculating the DCC charges for. At that point, we were consulting on revisions to the non-pass-through SMNCC allowance and therefore had not reached a decision on the non-pass-through SMNCC model.[9] We proposed to align our source with the decision made from this consultation and resulting from any future reviews of the non-pass-through SMNCC model.

Decision

We have summarised the comments we received on this consultation and our considerations in Annex 1. In the section below we set out our decisions.

---

[5]Ofgem (2018), Appendix 7 – smart metering costs, pg22.
https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_7_-_smart_metering_costs.pdf
[6] Ofgem (2019) reviewing smart metering costs in the default tariff cap – May 2020 consultation.
https://www.ofgem.gov.uk/system/files/docs/2020/05/reviewing_smart_metering_costs_in_the_default_tariff_cap_may_2020.pdf
[7] Consultation on minor changes to 'Annex 5 – Methodology for determining the Smart Metering Net Cost Change'
https://www.ofgem.gov.uk/publications-and-updates/consultation-minor-changes-annex-5-methodology-determining-smart-metering-net-cost-change
[8]Ofgem (2019) reviewing smart metering costs in the default tariff cap – May 2020 consultation.
https://www.ofgem.gov.uk/system/files/docs/2020/05/reviewing_smart_metering_costs_in_the_default_tariff_cap_may_2020.pdf
[9] Ofgem (2019), reviewing smart metering costs in the default tariff cap: May 2020 statutory consultation
https://www.ofgem.gov.uk/publications-and-updates/reviewing-smart-metering-costs-default-tariff-cap-may-2020-statutory-consultation

PPM non-pass-through SMNCC

We have decided to proceed with our proposal to include new rows in the PPM non-pass-through SMNCC. This reflects our decision to create a PPM level in the default tariff cap, and include a PPM non-pass-through SMNCC.

We have inserted the new rows as rows 9 and 10 in tab 2a 'Non pass-through costs' of Annex 5. We have made minor amendments to Annex 5 compared to the version we included in our consultation. Specifically we have corrected the formula in rows 31,32,40 and 41 in the output tab '1a SMNCC Values' to ensure the PPM non-pass-through SMNCC is pulled through to the output tab and the PPM SMNCC is calculated accurately. These minor changes do not impact the level of the PPM SMNCC and this is not a change to the current methodology.

Pass-through SMNCC

We have decided to change the source of SMETS2 meter volumes from the original non-pass-through SMNCC model to whichever non-pass-through SMNCC model that will apply to the upcoming cap period that we are calculating the DCC charges for.

This decision means we will use the value of SMETS2 meter volumes from the non-pass-through SMNCC model that forms part of the decision that sets the non-pass-through SMNCC for the relevant cap period. This is irrespective of any changes we make to the non-pass-through SMNCC allowance.

We have made a decision on our review of smart metering costs in the default tariff cap. This includes a new non-pass-through SMNCC model for the upcoming cap periods. This means that we will align our source for SMETS2 meter volumes in the pass-through SMNCC with the non-pass-through SMNCC model resulting from that decision and will also align our source resulting from any future reviews of the non-pass-through SMNCC model.

This decision means that we will use the new non-pass-through SMNCC model that was used in the decision of reviewing smart metering costs in the default tariff cap, and any subsequent updates to this model from future reviews to determine the values in Tab '2c DCC' Cell O14:U14 and O15:U15.

Yours faithfully,

Anna Rossington
Deputy Director, Retail Price Regulation

Annex 1: Summary of relevant stakeholder views and considerations

We received one response to our May 2020 consultation. We have uploaded this non-confidential response to our website.[10]

We have carefully considered this response. We provide a high level summary of the points raised and have responded to specific points.

Stakeholder's view: PPM non-pass-through

One supplier reiterated their views that were included in their response to the May 2020 consultation for protecting energy consumers with prepayment meters. It told us that we need to adopt our contingency option of rolling forward the current PPM cap methodology, which is equivalent to setting the PPM non-pass-through SMNCC to zero.

The supplier said that this could be achieved by following our proposal to add new input rows into Annex 5 for PPM non-pass-through SMNCC and setting these equal to zero, but they highlighted that they did not think this would be appropriate.

Considerations: PPM non-pass-through

We have considered any comments relating to the determination of the cap level for consumers with PPM meters within the respective consultation as this sits outside the scope of this decision.

Although we have decided to implement the contingency option presented in our May 2020 statutory consultation and have decided to set the PPM non-pass-through SMNCC values in cap periods five and six to zero, we still consider it is appropriate to make this change to Annex 5. In our statutory consultation the contingency position which we proposed involved including a PPM specific non-pass-through SMNCC, and setting it to zero for cap period five. This was with the explicit intention to set non-zero values for this allowance in the future. In order to implement this decision, we have to make this consequential change to Annex 5.

[10] Consultation on mnor changes to 'Annex5 – methodology for determining the SMNCC': https://www.ofgem.gov.uk/publications-and-updates/consultation-minor-changes-annex-5-methodology-determining-smart-metering-net-cost-change

Stakeholders view: Pass-through SMNCC

One supplier questioned why such a substantive change was being proposed via a non-statutory consultation. They also stated that they did not have access to the original SMNCC model, and access to the new SMNCC model was restricted to specific purposes, which did not explicitly include responding to this consultation.

The supplier agreed that it may be appropriate to revisit our current source (of using the assumptions in the original non-pass-through SMNCC), but only in the context of further substantive consultations in the light of BEIS' confirmed policy decisions regarding the policy target of 100% smart penetration by mid-2025.

Consideration: Pass-through SMNCC

Our decision (following a statutory consultation) following our review of smart metering costs in the default tariff cap has created a new version of the non-pass-through SMNCC model which has replaced the previous version. The original data source (i.e. the original, 2018 non-pass-through SMNCC) no longer exists.

The decision in this letter is therefore a consequential decision to use a suitable successor data source, given the original data source no longer exists. Therefore a statutory consultation was not required. However, we consider the process for our consultation to be sufficient for suppliers to provide appropriate representation to the proposed changes. We provided four weeks for stakeholders to respond to the consultation which we consider to be sufficient time to review our proposal, come to a view and provide a meaningful response.

We disclosed the new non-pass-through SMNCC model as part of the smart metering costs statutory consultation.[11] We consider that stakeholders have had the opportunity to comment on the new non-pass-through model, and the underlying assumptions that drive the SMETS2 meter volumes via this process. We have considered any comments relating to the assumptions and process for disclosure of the new non-pass-through SMNCC model via our decision on the review of smart metering costs. We do not consider that there are reasons why stakeholders would need separate access to the SMNCC model for the purpose of this consultation.

[11] https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-protecting-energy-consumers-prepayment-meters

We do not view this change as being dependent on further consultations relating to BEIS' new Framework for the rollout of smart meters. As set out in this decision, the source of SMETS2 volumes will now be the relevant non-pass-through SMNCC model that will apply to the upcoming cap period that we are calculating the DCC charges for. Therefore, if we update the non-pass-through SMNCC model in future reviews, the data source will still be valid.