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Smart Meter rollout and the default tariff cap: February 2021 Working Papers

EDF 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 and solar generation, 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 aims to help Britain achieve net zero by 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.

We welcome the opportunity to provide comments on the two working papers that form part of Ofgem's work in updating the Smart Metering Net Code Change (SMNCC) allowance in the Default Tariff Cap (DTC) in time for winter 2021-22. We are fully supportive of Ofgem undertaking regular robust and accurate reviews of the smart metering allowance within the DTC, with the aim of ensuring that for the duration of the cap suppliers are able to recover the efficient costs of their rollout programme.

Cost Recovery

The speed and success of each supplier being able to meet their smart metering obligation is dependent on their ability to sufficiently fund it. It is therefore essential that the SMNCC allowance provides the opportunity for **all** suppliers to recover the efficient costs of meeting their smart metering obligations. Any under recovery in costs is likely to lead to a delay in the rollout and delay the delivery of the smart benefits set out in the Government's latest cost benefit assessment, which could lead to higher overall costs to the consumer.

Given the design of the DTC and the requirement to set the same allowance for all suppliers, Ofgem must set the non-pass-through SMNCC by reference to efficient costs assuming a single rollout profile. The consequence of this is that the SMNCC allowance is unlikely to reflect the true costs faced by any one supplier, which creates a mix of over and under recovery of costs across suppliers. It is therefore imperative that the SMNCC allowance is set to a level that will lead to the most efficient rollout for **all** suppliers, which requires consideration of the cost to consumers and suppliers not only over the period of the DTC but the lifetime of the smart meter rollout.

Given the profitability across the sector it would be wrong for Ofgem to assume that any perceived 'advanced payments' (where previous allowances had exceeded actual costs) had been used for anything other than allowing suppliers to offer lower prices than otherwise would have been possible, and as such any overpayment has already been returned to customers. Any proposals to apply a retrospective correction mechanism to account for any perceived advanced payments are likely to result in a supplier being unable to recover their efficient costs of their rollout programme within future cap periods.

Rollout profile options

Market Leader or Average profile

As part of the transition to a revised smart metering policy framework during 2021, it is right that Ofgem explore whether the current weighted average profile is the right approach. We are therefore supportive of Ofgem assessing whether alternative options to determine the roll-out profile would be more effective and provide confidence and certainty for suppliers in terms of meeting their roll-out obligations, as well as potentially unlocking the ability for suppliers to maximise their smart meter programmes.

Adopting a 'market leader' approach to setting the rollout profile within Ofgem's modelling would be a better solution compared to the current weighted average approach. The benefits of adopting such an approach would include:

- Providing the opportunity for **all** suppliers to recover their efficient costs of meeting their smart metering obligations
- Avoiding restricting funding at a time when suppliers are already encountering challenges in achieving smart metering penetration and which are expected to continue under the new policy framework in the absence of any additional consumer measures
- Improving the probability that challenging national rollout targets can be met – consistent with BEIS policy objectives
- Minimising the risk of the SMNCC allowance underestimating efficient costs more generally; a supplier's ability to recover their efficient costs could arise from either or both the rollout profile assumed, and the overall estimate of smart metering costs included within Ofgem's modelling. Any surplus that could arise from using a market leader profile approach could minimise the overall risk of suppliers being unable to recover their costs and any consequential delays in the rollout of smart meters.

Tolerance or Target Level

For the very reasons described above, **adopting a target level profile with a market leader approach** (i.e. Option D) is the optimum approach on the basis that it will to the greatest degree minimise the risks of some suppliers experiencing a deficit in revenue to cover efficient costs and thereby impacting their ability to deliver on their smart metering obligations.

We anticipate that under the new BEIS smart meter policy framework the incremental cost of installs is likely to increase as suppliers look to adopt additional measures to address the customer engagement challenges in order to achieve the level of annual installs and ultimately market-wide rollout as required under the new policy framework. It is possible therefore that if Ofgem were to

adopt a market leader tolerance level approach (i.e. Option C) then there remains a risk that a cohort of suppliers would still not recover their efficient costs and consequently reduce their rollout plans.

We fully accept the need for Ofgem to consider the cost impact on consumers that would arise from the rollout profile it adopts in setting the smart metering allowance under the DTC. There is clearly a balance to meet in minimising costs increases to consumers while at the same time ensuring suppliers can fully recover their efficient costs. In this context, we believe there is a need for Ofgem to consider both immediate and longer-term cost impacts for consumers in terms of smart metering cost recovery. For instance, it is possible that if suppliers were systematically under-recovering their smart metering costs under the price cap allowance that they would look to alternative measures to fund their rollout plans, including through increasing their MAP funding. Such a measure, while supporting a supplier's rollout plans, may ultimately lead to more expensive costs in the longer-term for consumers. Adopting a market leader target approach could minimise the need for any supplier to adopt such an approach.

Estimating rollout for first half of 2021

Ofgem has identified three options as to how it should estimate the rollout for the first half of 2021. However, each of these involve making several assumptions, most notably how best to reflect the ongoing uncertainties that arise from the COVID-19 pandemic and how these may or may not, be reflective of rollout performance achieved in 2020. We consider there are flaws in all three options and that an alternative option should be progressed which involves using more up to date 2021 rollout performance data. By the end of April, suppliers are required to provide BEIS with both rollout progress up to the end of March 2021 together with future projections that would cover the remaining period of the first half 2021. Ofgem should use this more up to date actual data within its modelling as this will better reflect actual performance within 2021 and better account for any ongoing COVID-19 impacts on rollout progress. The submission of this data by suppliers at the end of April would appear to compliment Ofgem's consultation process and the need to make a final decision by early August 2021.

Other considerations

Ofgem's paper highlights a suggestion that a separate mechanism should be introduced that adjusts suppliers' revenues based on their actual rollout performance. There is no further detailed information provided within the paper regarding the suggestion or how it would work in practice. On this basis it is difficult to provide any specific comments at this stage.

However, we would question what the legal basis would be for any separate mechanism that sits outside the price cap mechanism that Ofgem implemented as a result of the requirements set out in the Default Tariff Domestic Gas and Electricity (Tariff Cap) Act 2018. Furthermore, given the design of the DTC and the requirement to set the same allowance for all suppliers, Ofgem must set the non-pass-through SMNCC by reference to efficient costs assuming a single rollout profile. The consequence of this is that for individual suppliers the impact, and the extent to which their costs

match the allowance provided under the cap, will be highly dependent on their own rollout progress. This is an inevitable consequence of the tariff cap design and methodology.

Setting the level of rollout for PPM smart meter cost allowance

Many of the views expressed above in terms of setting the allowance for credit customers equally apply to the setting of any specific SMNCC allowance for PPM customers, particularly in respect of whether to use a tolerance or target level profile.

We accept in principle the need for Ofgem to consider whether there is a need to set a specific PPM rollout profile given the potential for significant variations in the level of PPM rollout across suppliers relative to average progress compared to credit. Ofgem also state that the relationship between rollout and costs is linear for credit, whereas this may not be the case for the PPM rollout where those who have installed at both the lowest and highest rate could have higher modelled net costs than the modelled average.

However, in the absence of access to Ofgem's modelling and scenario testing it is hard to judge the extent to which these differences drive the need for a different approach for the PPM allowance; or what approach option is appropriate when providing for efficient cost recovery and at the same time protecting the interests of consumers. We therefore look forward to providing further comments following the publications of Ofgem's formal consultation and model.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Jon Cole or myself. I can confirm that this letter may be published on Ofgem's website.

Yours sincerely

A handwritten signature in black ink that reads 'R. Beresford'.

Rebecca Beresford
Head of Customers Policy and Regulation