

National Energy Action (NEA) response to Ofgem's Setting the level of rollout for the PPM smart meter cost allowance: working paper



Action for Warm Homes

About National Energy Action (NEA)

NEA¹ works across England, Wales and Northern Ireland to ensure that everyone in the UK² can afford to live in a warm, dry home. To achieve this, we aim to improve access to energy and debt advice, provide training, support energy efficiency policies, local projects and co-ordinate other related services which can help change lives.

We have been actively promoting the smart rollout for several years and are currently delivering the 'Smart Energy GB in Communities' programme³ alongside our sister charity Energy Action Scotland (EAS). Through the programme, we are partnering with regional organisations from the voluntary and public sectors. This means we're able to work with trusted, expert organisations across the country to ensure people understand the benefits of smart meters and know how to get one.

NEA believes that smart metering has the potential to provide real benefits for vulnerable and low-income householders, but only if these individuals are effectively engaged and supported throughout the smart meter journey. We are proud to be working with Smart Energy GB and EAS to ensure that everyone has the same opportunities to engage in the smart meter rollout, regardless of personal circumstance or where they live.

Background to this response

Over the last five winters the number of excess winter deaths due to living in a cold home is estimated at approximately 10,000 per year⁴. In 2017/18, the number of excess winter deaths (EWDs) across England and Wales exceeded 50,000, the highest recorded for over 40 years⁵. While the causes of EWDs vary⁶, we estimate one of the largest contributors to these needless deaths is vulnerable people, often struggling with existing ill-health, being unable to heat their homes adequately, if at all⁷. As well as an unacceptably high number of preventable winter deaths, millions more people are struggling significantly to afford to adequately heat and power their homes and are suffering with poor physical and mental health due to cold homes⁸. NEA believes dramatically improving domestic energy efficiency levels remains the most enduring solution to addressing energy affordability⁹, however, we also know other key actions are to safeguard vulnerable domestic customers, particularly those living on the lowest incomes¹⁰.

NEA has actively engaged at every stage of the formation of the price cap, from the formation of the legislation through to Ofgem's final consultation on its decisions surrounding the cap design. We are therefore well placed to assess how the proposed changes arising within this consultation affect fuel poor and vulnerable customers.

Our Response

NEA is pleased that Ofgem is considering the differences between the rollout of smart meters to prepayment customers and those with credit meters, for the purposes of reaching a fair price cap for each market segment. This is something we previously identified as an important difference between the original prepayment meter cap and the default tariff cap¹¹. Although NEA supports the aims of the working paper to understand these differences, we do not agree with all of the interim conclusions it reaches:

- We do not believe that the consideration of costs of efficient suppliers is exhaustive. While the paper considers metrics based on the least efficient supplier, and average supplier, there is no consideration of frontier suppliers to set the benchmark.
- Although there is some consideration of how to treat targets and tolerance levels of the next phase of the scheme, we do not believe that all options are considered. NEA believes that setting a less generous allowance in the immediacy and correcting ex-post would be, on balance, the fairest way to recover these costs.
- There is little consideration of how the New and Replacement Obligation¹² would impact the rollout and therefore cost recovery through the cap.

Each of these are considered in turn below.

The cost of efficient supply

In the working paper, two options are explored in order to identify how to set the level of an efficient supplier in terms of rolling out smart prepayment meters. The options considered are:

- To set the PPM SMNCC allowance based on the market average PPM rollout; or
- To set the PPM SMNCC allowance based on the lowest PPM rollout supplier.

While these are both valid options to be considered, NEA believes that these two options are clearly weighted towards the 'slow' end of the market. We agree with the working paper that the suppliers should not be rewarded for a commercial decision to rollout their smart meters late. However, Ofgem should bring into consideration a third option, that sets the allowance based on a frontier of smart prepayment rollout. This would mean that those suppliers that were slow to rollout smart meters to prepayment customers would be able to recover their costs, and those that were relatively slow would be incentivised to accelerate their rollout plans.

NEA believes this would be a sensible approach. The CMA stated¹³ in the Energy Market Investigation (Prepayment Charge Restriction) Order 2016 that prepayment customers have higher actual and perceived barriers to switching that arise from both lack of internet connectivity and the need to physically change meter to switch to a wider range of tariffs (and associated perceptions of the complexity of this). In addition, PPM customers are often likely to: have a poor credit history; be severely indebted or; be stranded on PPM due to the preferences of their landlords. The CMA believed that the best way to remedy this was to enforce a price cap for all prepayment metered customers which should be active until the smart meter rollout had been substantively completed for this customer set. NEA agrees with this view.

At the end of the default tariff price cap in 2023 at the latest, the detriment to prepayment meter customers will persist. Ofgem, in its role to protect the interests of customers, should therefore make decisions to reduce the detriment before the mitigating cap ends. Allowing cost recovery based on a frontier of the rollout would achieve this in an elegant way.

Dealing with the difference between targets and tolerances

The working paper correctly identifies that there is a tension between setting the SMNCC allowance based on the targets that suppliers need to work to in the next phase of the work out, or the tolerance that they can 'under deliver' to.

In addition to the two options considered in the paper (i.e. setting the allowance based on either the targets or the tolerance), NEA believes that there is a third option. Ofgem could set the allowance based on the target level, and recover any effective underspend (i.e. any under delivery, up to the tolerance level) ex-post. NEA believes that this would be the fairest way to approach the problem. This would mean that suppliers would have the cashflow to meet their targets for replacing smart prepayment meters, but any under delivery would be returned to the consumer. It is important that suppliers are incentivised to rollout smart meters for prepayment customers for the reasons outlined above.

Considering the New and Replacement Obligation

In section four (4.8), which covers rollout plans, Ofgem make an argument that a supplier could roll out slowly by replacing traditional prepayment meters like for like with traditional meters. However, this is something that suppliers should be taking all reasonable steps to avoid. The Smart Meter New and Replacement Obligation (NRO)¹⁴ requires energy suppliers to take all reasonable steps to install a compliant smart meter (i.e. a SMETS2 meter) wherever a meter is replaced or where a meter is installed for the first time (e.g. in new premises). We do not believe that Ofgem should not consider the replacement of traditional meters like for like in this way, as it would reward suppliers that are effectively breaking the obligation. Like for like replacements should be few and far between, and not a consideration of this paper.

¹ For more information visit: www.nea.org.uk.

² NEA also work alongside our sister charity Energy Action Scotland (EAS) to ensure we collectively have a UK wider reach.

³ For more information visit <https://www.nea.org.uk/smartenergygb/>

⁴ Over the last 5 years, there has been an average of 32,058 excess winter deaths. NEA estimates that approximately 30% of these are attributable to the impact cold homes have on those with respiratory and cardio-vascular diseases and the impact cold has on increasing trips and falls and in a small number of cases, direct hyperthermia. This is in line with estimates made by the world health organisation - http://www.euro.who.int/__data/assets/pdf_file/0003/142077/e95004.pdf

⁵ Office for National Statistics, November 2018, see: <https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/deaths/bulletins/excesswintermortalityinenglandandwales/2017to2018provisionaland2016to2017final>

⁶ The main causes of excess winter deaths are attributable to respiratory and cardio-vascular diseases which are badly exacerbated by cold conditions. Other causes may include influenza, trips and falls or in a small number of cases, hyperthermia. Public Health England cites studies that 10% of excess winter deaths are directly attributable to fuel poverty and that a fifth of EWDs are attributable to the coldest quarter of homes. This was regarded as a 'conservative' estimate as separately the World Health Organisation stated that 30% is the best estimated share – based on European evidence – of EWDs that can be considered attributable to cold housing conditions. This suggests that poor energy performance – manifested in homes that are hard and/or expensive to heat, thereby exacerbating the risks of respiratory and circulatory problems and poor mental health – is a significant contributory factor to the number of EWDs in the UK.

⁷ On average, this results in over 10,000 British citizens dying needlessly due to cold homes each year. For more information see UK Fuel Poverty Monitor Report 2018, NEA and EAS, page 3. See: <http://www.nea.org.uk/wp-content/uploads/2018/09/UK-FPM-2018-FINAL-VERSION.pdf>.

⁸ According to a recent NEA call for evidence many fuel poor households are adopting unsafe strategies to try and survive winter. This includes the regular use of older dangerous or un-serviced heating appliances is commonplace, despite being potentially fatal or leading to heightened risks for nearby neighbours as a result of carbon monoxide poisoning or in extreme situations, fires, and explosions. Many more people are going to bed early to keep warm and using candles to save on electricity. People struggling to heat their homes are also spending their days in heated spaces such as libraries, cafes or even A&E to avoid the cold, damp and unhealthy homes continue to cause shocking levels of unnecessary hardship and premature mortality.

⁹ NEA stresses to the UK Government the central importance of domestic energy efficiency remaining the most enduring solution to achieve collective goals; ending fuel poverty, a successful industrial strategy⁸, supporting small business growth in every region, helping to achieve carbon emissions reductions, improving local air quality, reducing health & social care costs whilst providing real benefits to households who are struggling financially. In this context, NEA has warmly welcomed the publication of the National Infrastructure Commission's (NIC) interim National Infrastructure Assessment (NIA). The interim NIA rightly identifies the need to urgently address the energy wastage in UK homes and states dramatically enhancing energy efficiency must be a key national infrastructure priority. NEA is also an active member of the Energy Efficiency Infrastructure Group who strongly support this approach. This approach is also currently supported by a growing number of Non-Departmental Public Bodies, academics, industry and NGOs. They all highlight why ending cold homes and reducing needless emissions via improving domestic energy efficiency must be a priority; no other form of investment can deliver so much.

¹⁰ NEA highlights that net disposable income after housing costs of a low income household is £248 per week (£12,933 per year), equating to 60% of the UK median of £413 per week. The income after housing costs of a fuel poor household is even lower: £10,118 per year, equating to a net disposable weekly income of £194. Investigating income deciles shows the poorest 10% of UK society have a gross average weekly household income of £130 (£6,760 per year). Fuel poor households overwhelmingly comprise the poorest fifth of society: 85% of households in fuel poverty in England are located in the first and second income deciles and 78% of English households in those two deciles are fuel poor.

¹¹ In our response to the Ofgem Policy consultation for protecting energy consumers with prepayment meters, we argued that "Because of lack of competition in the prepayment market, the role of smart and the extent to which prepayment metered customers are more likely to be living in vulnerable circumstances, their cost make-up is different." For our full response see https://www.nea.org.uk/wp-content/uploads/2020/10/NEA-Letter-to-Ofgem-PPM-Cap-Stat-Con_Final-1.pdf

¹² On 30 June 2019, the New and Replacement Obligation (NRO) will come into effect in line with the Direction issued by the Secretary of State. The NRO requires energy suppliers to take all reasonable steps to install a compliant smart meter (i.e. a SMETS2 meter) wherever a meter is replaced or where a meter is installed for the first time (e.g. in new premises). This drives important benefits such as full interoperability without the risk of a meter change or temporary loss of smart functionality should the customer switch to a new supplier. For more information, see https://www.ofgem.gov.uk/system/files/docs/2019/06/2019.05_open_letter_2019_smart_rollout_plans.pdf

¹³ The Energy Market Investigation (Prepayment Charge Restriction) Order 2016, CMA, 2016
<https://assets.publishing.service.gov.uk/media/5847e1bfed915d0b1200004f/energy-market-prepayment-charge-restriction-order-2016.pdf>

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