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Dear Anna

Setting the level of rollout for the PPM smart meter rollout cost allowance – working paper

Thank you for the opportunity to respond to this second working paper on Ofgem's initial thoughts, proposals and rationale for setting the rollout profile for the purpose of the PPM SMNCC for cap period seven onwards.

We note that Ofgem is planning a more substantive consultation in the Spring and we anticipate being able to critique Ofgem's approach in more detail at that point. We encourage Ofgem to ensure that stakeholders are presented with sufficient information and access to its modelling in the Spring consultation to enable us to do so.

We set out our key points below and elaborate on them in Annex 1.

- We agree with Ofgem's proposal to calculate a PPM-specific rollout profile to set the SMNCC allowance in the PPM cap.
- We encourage Ofgem to clarify in the Spring consultation how it proposes to treat 'pure play' outlier suppliers when calculating a weighted average rollout profile for the historical period component.
- Option 2 (suppliers' actual rollout over 2020) and Option 3 (use of suppliers' rollout plans for 2021) have the potential to be a suitable way to estimate the rollout in the first half of 2021 provided Ofgem excludes outlier suppliers.
- Ofgem should be open to considering the supplier profile with largest forecast cumulative SMNCC over the full potential life of the cap (as it is considering doing with credit) for modelling the PPM rollout under the new framework. In any event, it should exclude 'pure play' prepayment outliers.
- Ofgem should base its assumed rollout trajectories on the targets set by BEIS without adjusting for the 'tolerances'.
- Although the option of taking average PPM SMNCC allowances generated by a sample of rollout profiles is likely to be more robust, we share Ofgem's wish to avoid unnecessary complexity. We would cautiously agree with Ofgem's preferred

approach of using a single rollout profile instead, subject to Ofgem satisfying itself that the single rollout profile adopted yields a similar result to the more robust approach.

Please do not hesitate to contact me or James Soundraraju (tel 0141 614 2421, jsoundraraju@scottishpower.com) if you have any questions arising from this response.

Yours sincerely,

Richard Sweet
Head of Regulatory Policy

Annex 1

SETTING THE LEVEL OF ROLLOUT FOR THE PPM SMART METER COST ALLOWANCE – WORKING PAPER – SCOTTISHPOWER RESPONSE

1. Introduction

We comment below on the following aspects considered in Ofgem's paper:

- Setting a PPM-specific rollout profile
- Calculating the PPM-specific rollout profile
- Relationship between profile and costs

2. Setting a PPM-specific rollout profile

We are pleased that Ofgem has reconsidered its proposals from the May 2020 consultation to use a single aggregate rollout profile for credit and PPM when calculating SMNCC. As we noted in our response to that consultation, we believe that PPM rollout is lagging substantially behind credit meter rollout and the use of a single aggregate rollout profile would have risked substantially overstating savings realised by efficient suppliers. **Therefore, we agree with Ofgem's proposal to calculate a PPM specific rollout profile to set the SMNCC allowance in the PPM cap.**

However, we disagree with Ofgem's view[1] that the progress of the PPM rollout is not significantly different to the credit rollout in general. As we have previously noted, significant technical issues prevented the proper functioning of the Communications Hub (CH) for gas smart meters operating in prepayment mode in all areas north of Manchester (i.e. 'CSP-N' or 'North Region').[2] We would not install electricity smart meters in prepayment mode for dual fuel customers where we are unable to provide a fully functioning gas smart meter in prepayment mode[3]. Therefore, this fundamental technical constraint has significantly impacted (smart) PPM rollout in the North Region, disproportionately hindering the progress of suppliers with large customer bases in this area of the country.

3. Calculating the PPM-specific rollout profile

Ofgem proposes to construct its PPM specific rollout profile by considering three distinct periods:

(a) historical periods (Up to end 2020),
(b) remainder of the 'All reasonable steps' framework (January 2020 – June 2020)
(c) the new smart meter rollout framework (1 July 2021 onwards)

We comment below on the points and options set out for each of these periods.

[1] Expressed in paragraph 2.8
[2] An issue with the CH that DCC provided for use in North Region meant it could not support gas PP top ups.
[3] This avoids burdening DF PPM customers with two different top-up methods

Historical periods

Ofgem proposes to use a combination of a modelled approach for the period 2011-2015 (as Ofgem does not have rollout data for this period) and actual data collected by BEIS through the Smart Meters Annual Information Request (SMAIR) for the period 2016 - end 2020.

There are ambiguities in Ofgem's narrative in Appendix 1 relating to how it proposes to calculate the profile for historical periods.

- It does not explain the purpose and value of calculating the profile all the way back to 2011.
- From paragraphs 1.3 and 1.6, it is unclear whether Ofgem's use of suppliers' data will commence from 2017 or 2016. Paragraph 1.5 does not clarify whether Ofgem has considered the impact of outlier suppliers on the weighted average for the period 2016 to end 2020.

As this affects the base starting point for the PPM specific rollout profile, **we would encourage Ofgem to clarify in the Spring consultation how it proposes to treat outlier suppliers when calculating a weighted average rollout profile for this historical period.**

'All reasonable steps' framework

Ofgem sets out three options for estimating the rollout in the first half of 2021 under the current BEIS framework but has not reached a view on which option to use. The options identified are:

Option 1 – use the average rollout between 2017 and 2019
Option 2 – roll forward suppliers' rollout over 2020
Option 3 – use suppliers' rollout plans for the first half of 2021

We do not believe that historical performance over 2017-2019 would be a suitable benchmark for the first half of 2021 on the basis that it does not reflect the impact of COVID-19 restrictions (and may not reflect any technical constraints that have been overcome since then). We agree with Ofgem that Option 1 could risk overstating the rollout rate that is achievable.

Option 2 takes the view that COVID-19 impacts on the rollout rate in 2020 could make it a suitable proxy for the rollout rate in the first half of 2021. However, Ofgem anticipates that COVID-19 impacts in 2020 may be more severe than those during the first half of 2021 and the use of 2020 data could understate the rollout that is achievable.

We do not necessarily share Ofgem's view that rollout will be easier in 2021 than in 2020. Regardless of precautionary measures for COVID-19, the Scottish Government decided in January 2021 that all installations in Scotland should cease until further notice, except for emergencies. At the time of writing, this directive is expected to remain in force until late April 2021. We would reiterate that large variations between suppliers' smart PPM rollout progress in 2020 continued to be driven by a combination of regional technical constraints and the different growth strategies pursued by suppliers. Ofgem does not elaborate on how it has considered this variation between suppliers in Option 2.

Option 3 is potentially the most closely aligned with our overarching view[4] that it would be more appropriate for Ofgem to use a rollout profile based on the latest forward-looking industry average, *excluding* outlier 'pure-play' suppliers (eg Utility and E). The extent to which outlier suppliers skew the overall average rollout is significant and we have provided analysis in our

[4] Expressed in our response to the 'Protecting energy consumers with prepayment meters: May 2020' statutory consultation

response to the May 2020 statutory consultation to demonstrate that outliers could skew the GB average by up to 24%.

None of the options as currently presented are suitable. **Option 2 and 3 have the potential to be an appropriate proxy for estimating the rollout in the first half of 2021 provided Ofgem excludes outlier suppliers.**

We note that Ofgem has issued an RFI that captures the actual rollout of PPM and credit smart meters in 2019 and 2020. But there is no mention in the working paper of how Ofgem proposes to cross-reference this information in its estimate of the rollout in the first half of 2021.

New smart meter rollout framework

Ofgem has identified two options for modelling the rollout under BEIS's new framework. These are to:

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

Unlike the approach to credit rollout, where Ofgem keeps all options open, there is a stated preference by Ofgem to use the market average PPM rollout.

The information presented in the working paper would suggest that the PPM SMNCC for the period 2021 to 2023 would be downward adjustments to the current level of the cap. The lowest rollout supplier profile would lead to a smaller reduction in the level of the cap compared with the market average. Ofgem argues that customer protection is best achieved by reflecting the average cost to PPM customers, essentially through a greater reduction in the level of the cap from the market average.

Given that the risks are overwhelmingly weighted in the direction of increased supplier costs (due to more stringent rollout obligations, and higher unit costs), we believe **Ofgem should be open to considering the supplier profile with the** largest forecast cumulative SMNCC over the full potential life of the cap **(as it is considering doing with credit) for modelling the PPM rollout under the new framework.**

By doing so, Ofgem would be adopting a no regrets strategy. If, as we expect, costs are higher than currently modelled, this can all be reconciled in the 12-month review, without the need for any additional claw-back. If costs are in line with (or lower than) current modelling, Ofgem has the opportunity to make a correction via the advanced payments adjustment process. Adopting the market average supplier profile risks curtailing rollout by lowering allowances when suppliers are expected to deliver more stringent statutory targets.

Should Ofgem's approach hinder rollout in any way, the resulting delay in realising smart meter benefits for consumers would be counter to its aim of protecting existing and future customers. At the very least, Ofgem should not be discounting at this stage the possibility of setting PPM SMNCC allowance based on the lowest PPM rollout supplier.

Target or Tolerance

We do not believe that Ofgem should be setting allowances using a rollout profile based on tolerance levels. The purpose of tolerances is to allow some contingency margin before suppliers become exposed to penalties for non-compliance, to cater for factors typically outside the suppliers' control. Prudent suppliers will aim to overshoot the compliance-minimum and it would not be appropriate to base the allowances on this minimum level of rollout. Rather, for the purpose of setting the allowance, it would be appropriate to assume that suppliers will be planning to achieve the targets set out by BEIS.

Any risk of overpayment by customers if suppliers do not roll out smart meters beyond their obligations is mitigated by the advanced payments adjustment mechanism.

Suppliers, in aggregate, should be allowed to collect enough revenue to reflect the costs of delivering market-wide rollout so that regulatory policy aligns with BEIS's policy ambitions for the smart meter framework.

Therefore, we believe Ofgem should be considering rollout trajectories that are based on the BEIS targets not the 'tolerance' levels.

4. Relationship between profile and costs

We welcome Ofgem's inclusion of charts in Appendix 1 to illustrate the dependence of costs on different rollout profiles, but we are disappointed that it has chosen to omit all information relating to the y-axis (notably location of zero and an indication of scale). Ofgem says that it does not include the value of modelled costs 'because it is not important' (para 1.22). From our perspective it is very important to have some idea of the magnitude and materiality of the differences (and whether values are positive or negative) – and we would encourage Ofgem to provide such information in future.

Ofgem's analysis suggests that the PPM SMNCC calculated using the weighted average rollout profile could be lower than the PPM SMNCC for a supplier who is significantly ahead or behind the average.

However, Ofgem does not have a position on whether the weighted average rollout profile sets an appropriate level of funding and considers two options in the working paper for setting the PPM SMNCC.

These are:

- Using a single rollout profile; and
- taking the average of the PPM SMNCC allowances generated by using a sample of rollout profiles.

We agree with Ofgem's preferred option of using a single rollout profile provided it commits to excluding 'pure-play' prepayment outliers from the sample of suppliers used to generate the weighted average (single) rollout profile.

The option of taking average PPM SMNCC allowances generated by a sample of rollout profiles is, as Ofgem notes, sensitive to the sample of suppliers, overly complex and limits Ofgem's ability to break down the allowance into cost categories.

ScottishPower
March 2021