

02 March 2021

Anna Rossington
Interim Director, Retail
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Ofgem
10 South Colonnade
Canary Wharf
London E14 4PU

Dear Anna,

Re: Setting the level of rollout for the PPM smart meter cost allowance – working paper and Smart meter rollout and the default tariff cap: working paper

Thank you for the opportunity to comment on the two working papers listed above. As you are aware, Utilita Energy Limited (Utilita) is primarily a smart prepay supplier, with our focus on providing a high-quality service to a sector which is traditionally poorly served.

As a prepay specialist, our comments in this joint submission are mainly focused on the working paper on 'Setting the level of rollout for the PPM smart meter cost allowance' (the PPM WP). However, where applicable, our remarks should also be considered against the working paper on the 'Smart meter rollout and the default tariff cap' (the DTC WP).

There are several important general points we wish to make on the papers, as well as some more specific comments on the PPM WP in particular.

We are concerned at the apparent degree of divergence between the two proposed methodologies. We appreciate that these are only working papers, and hence in the actual consultation, issues and approach may be more aligned.

In our view, the differences should be minimised to ensure that as far as possible there is a consistent approach between payment methods. It is not clear why the methodology should be vastly different, given that the required result - that suppliers can fund their efficient costs of rollout – is the same. On this basis, any difference should be properly evidenced and fully justified to ensure that Ofgem is not 'cherry-picking' simply to deliver a chosen outcome, regardless of whether or not this allows suppliers to finance their regulated activities.

Suppliers must be able to finance their regulated activities. However, yet again, we are disappointed to see that Ofgem is clearly contemplating a course of action which would not allow this.

Suppliers are to be set targets by BEIS after the end of the 'All Reasonable Steps' obligation. A tolerance will be applied to these targets, reflecting that difficulties may be faced, but nevertheless the targets are what the supplier must aim for. If suppliers are not funded to the target, they cannot be expected to deliver it. Ofgem suggests that suppliers cannot be trusted to use the funds to try and deliver the target (rather than the tolerance) if so funded. This approach is not sound. To suggest that it is potentially more appropriate to fund only to the tolerance rather than the target makes this a self-fulfilling prophecy and is in direct opposition to the stated aim of the government.

There is a further point which Ofgem fails to consider and that is the effect of tolerances as a supplier progresses through its rollout. We raised this point to BEIS in our submission on the post 2020 framework, and we believe BEIS to be cognisant of the issue, given they have only set tolerances for two years.

The tolerances are applied to the target of Qualifying Relevant Premises (QRP) for each supplier resulting in a variable target according to progress on their rollout. Where suppliers are broadly homogeneous in terms of progress this is not an unreasonable approach. However, the installation curve is generally 'S' shaped, suppliers ramp up in the early stages, progress steadily (*ceteris paribus*) and then slow down installs as they seek out the final hard to reach or hard to convince customers.

The issue arises in two ways:

- a) As all suppliers move up the installation curve, as they near the end of their rollout, their rollout gets harder and slows
- b) Where one or more suppliers have progressed earlier – they face a much harder task and tighter target due to the operation of the tolerances.

In the second case in particular, this unfairly penalises those suppliers, such as Utilita, who have met the challenge and progressed early and well. As our remaining targets are smaller in number, the percentage tolerance bites harder at the time when it is also harder to reach/persuade the remaining customers. We have suggested that, in order for the tolerances to operate fairly at the higher levels of portfolio installs, either the percentage tolerances must be higher, or there could be a minimum numeric value.

In consistently underfunding suppliers, when it is harder to both contact/persuade customers to accept an install, and more expensive to install (due to wider distribution of customers, greater travel, fewer installs per day etc.), Ofgem is making it much more likely that suppliers will not be able to efficiently fund their rollout and will fail in their obligations. This does not meet Ofgem's duty to ensure that suppliers can fund their regulated activities.

Moving to specific points on the PPM WP, we would like to make the following observations:

1. In section 3, Ofgem proposes to use the average roll-out profile; based on the information currently available, we believe this approach is consistent with the approaches used in other aspects of the cap. It is also not possible for suppliers to further assess whether an alternative approach would be an improvement, as the model that will determine the level of the non-pass through SMNCC is still unavailable.
2. In paragraph 3.28, Ofgem acknowledges the approach to which it refers would result in an under-recovery, in aggregate, of efficient costs. Such an approach is clearly at odds with the principles of the cap, namely that efficient suppliers ought to be able to recover their costs, and so this potential approach must be disregarded.
3. In section 4, Ofgem describes that the benefits of smart metering are not linear. It is impossible to be certain without sight of the model Ofgem has developed, but we believe the cause may be either:
 - a. That Ofgem is considering the cost of exchanging a meter as an expense, rather than a cost that is capitalized into the meter asset on which rental is charged, with a cash-neutral impact, at least theoretically. This is

notwithstanding that suppliers have incurred, and will continue to incur, fixed installation costs because of COVID related lockdowns, that cannot be recovered - and for which provision in the price cap ought to be made.

- b. That Ofgem has persisted in using an unnecessarily complex adaptation of a BEIS model, which was designed for an entirely different purpose, that calculates the non-pass through SMNCC by comparing actual 2017 relevant costs with a 2017 counterfactual case (where there is no smart meter roll out) and compares this result with a second factual comparison with the counterfactual case for the relevant cap period.

The complexity is entirely without merit. The unnecessary complexity of the model previously shared could easily cause an erroneous non-linearity of cost that Ofgem observes. It is imperative that this wholly inappropriate approach of counter-factual to factual comparison compared with another factual to counter-factual comparison be abandoned in favour of an approach consistent with the rest of the price cap – namely that non-pass through SMNCC costs for 2017 and the contemporary period should both be estimated directly, and the direct change in the cost be provided as an allowance in the cap.

As Ofgem has had many months to develop its own model, as we suggested, we hope that the non-linearity observed by Ofgem results either from point a) above, or some other easily remedied error that becomes apparent once the model is made available for wider review and scrutiny.

- 4) In addition to the point made under 3(a) above, we have identified a further, related issue. The straight-line approach assumes installation costs are recovered through future meter rentals and that no profit or loss is made on installation.

In the normal course of business this should be true. However, COVID-19 has meant that inefficiencies in installation will, and have, caused a permanent loss that is not currently recovered within the price cap.

To address this inequity, which could not have been foreseen or prevented by suppliers, Ofgem should consider an uplift in the October 2021 price cap to recompense suppliers for these additional costs in the same way it has made an allowance for bad debt experience. This would need to be applied to both the PPM and DTC SMNCC.

We trust these comments have been helpful, and we would welcome an opportunity to discuss the points raised with the team in more detail. If you would let me know your diary availability, I will be happy to co-ordinate at this end.

Yours sincerely,

By email

Alison Russell
Director of Policy and Regulatory Affairs