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Ofgem  
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2 March 2021

Dear Anna

**Smart meter rollout and the default tariff cap: working paper**

Thank you for the opportunity to respond to this second working paper on issues relating to the rollout of smart meters in credit mode and the appropriate level for the rollout profile to be used in setting the SMNCC from October 2021 (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.

This working paper does not elaborate on Ofgem's plans for future reviews of the SMNCC. Ofgem needs to be open and transparent in the way it selects the issues to be reviewed to allay supplier concerns that it may 'cherry pick' items where costs have fallen. We encourage Ofgem to take the opportunity in the Spring consultation to provide transparency over plans for future SMNCC reviews.

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

- We believe Ofgem should adopt Option D – Market Leader Target to set the SMNCC allowance under BEIS's new framework. This would deliver the stability of a no-regrets strategy and reduce the risk of creating barriers to rollout.
- We would encourage Ofgem to put aside the suggestion of a separate (adjustment) mechanism and focus instead on ensuring that advanced payment adjustments are fairly implemented.
- We disagree with Ofgem's assumption that there could be an increase in installer productivity in a target-based profile. We expect installer productivity to be lower.

- Ofgem has the opportunity, as do suppliers, to form a view of trends in marketing, asset and installation costs ahead of the Spring consultation and we encourage Ofgem to consider requesting information from suppliers ahead of that consultation.

Please do not hesitate to contact me or James Soundraraju (tel 07548707639, [jsoundraraju@scottishpower.com](mailto:jsoundraraju@scottishpower.com)) if you have any questions arising from this response.

Yours sincerely,

A handwritten signature in blue ink that reads "Richard Sweet". The signature is written in a cursive, flowing style.

**Richard Sweet**  
Head of Regulatory Policy

**SMART METER ROLLOUT AND THE DEFAULT TARIFF CAP: WORKING PAPER –  
SCOTTISHPOWER RESPONSE**

**1. Introduction**

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

- Rollout profile options
- Separate mechanism
- Implications of rollout profile

**2. Rollout profile options**

The working paper sets out options for the rollout profile Ofgem will use to determine SMNCC for credit meters once BEIS's new smart meter framework begins on 1 July 2021.<sup>1</sup>

Ofgem stated in its last review of the SMNCC in August 2020 that it would consider whether to maintain its current approach of using a rollout profile for an average supplier or use a higher rollout profile than the average.

Therefore, the working paper outlines four rollout profile options based on a combination of two variables:

- Level of rollout at the start of BEIS's new framework. This could either be a market leader or an average supplier.
- Rate of rollout during the new framework. This could be in-line with BEIS's policy ambition for market-wide rollout by mid-2025 (the 'target' approach) or supplier minimum installation requirements (the 'tolerance' approach).

These two variables and their permutations lead to the options Ofgem has summarised in Table 1 of the working paper (reproduced below). Ofgem does not state a preference at this stage but will do so in the Spring 2021 consultation.

	<b>Average</b>	<b>Market Leader</b>
<b>Tolerance</b>	Option A – Average Tolerance	Option C – Market Leader Tolerance
<b>Target</b>	Option B – Average Target	Option D – Market Leader Target

We have previously advocated a no regrets strategy with the SMNCC allowance.<sup>2</sup> 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.

<sup>1</sup> In this new framework suppliers will be set individual installation targets subject to an annual tolerance level. We are currently awaiting the outcome of BEIS' consultation on annual tolerance levels (closed on 15 Jan).

<sup>2</sup> A view we expressed in our response to Ofgem's 'Reviewing smart metering costs in the default tariff cap' May 2020 statutory consultation

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.

**We believe Ofgem should adopt Option D – Market Leader Target to set the SMNCC allowance under BEIS's new framework. This would deliver the stability of a no-regrets strategy and remove barriers to rollout.**

We explain our reasoning below.

#### Average or Market Leader Supplier

Option A – '*Average Tolerance*' generates the lowest rollout profile (and lowest SMNCC) of the four options. We do not consider it to be a viable option on the basis that it would not allow suppliers to recover efficient costs of delivering market-wide rollout targets.

Option B- '*Average Target*' is Ofgem's current approach. The current assumed rollout profile for credit meters does not adequately take account of BEIS's decision on rollout targets which will likely require suppliers to go beyond the current all reasonable steps obligation. We have previously called for an adjustment to SMNCC model assumptions in a way that would have increased the NPT SMNCC allowance from Periods 5 onwards to reflect the increased costs that suppliers will incur under the new regime.

In principle, we do not support any option that is based on 'tolerance' levels. We explain our position on 'targets' and 'tolerance' in the next section. Therefore, our preference lies with Option D – '*Market Leader Target*' over Option C – '*Market Leader Tolerance*'.

Option D would deliver the highest SMNCC. As Ofgem notes, this level of funding could maintain or even increase the speed of rollout. We disagree with Ofgem's view that this option presents the greatest risk of customers paying an amount that is not commensurate with the benefits delivered. If anything, this is the only option that opens up the possibility of suppliers installing more smart meters than planned and delivering smart benefits to consumers sooner.

We also disagree with Ofgem's view that there is no guarantee under Option D that suppliers will spend additional revenue on smart metering. Ofgem has a range of policy options to ensure spending is ring-fenced but ultimately, the risk of legal penalties for missed targets is a compelling incentive on suppliers to spend additional SMNCC allowances on the smart metering implementation programme.

In our view, Ofgem should adopt Option D – '*Market Leader Target*' to promote rollout under BEIS's new framework and to create an opportunity for consumers to benefit sooner from smart meters.

#### 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 over-shoot 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.**

### **3. Separate mechanism**

Ofgem has received a suggestion that there should be a separate mechanism (parallel to the cap) to adjust suppliers' revenues based on their actual rollout performance. Ofgem is considering the suggestion but recognises that there would be a number of practical and legal challenges in implementing such a mechanism.

We strongly discourage the introduction of an additional adjustment mechanism. The price cap methodology already has a facility for truing up or down allowances with the use of advanced payment adjustments. Notwithstanding the challenges Ofgem has already outlined, a separate mechanism introduces additional complexity and risk to suppliers for no obvious benefit to consumers. As we noted above, Ofgem's approach should not hinder the progress of rollout in any way.

**Therefore, we would encourage Ofgem to put aside the suggestion of a separate (adjustment) mechanism and focus instead on ensuring that advanced payment adjustments are fairly implemented.**

### **4. Implications of rollout profile**

Ofgem has considered the potential implications of the rollout profile for other areas in the SMNCC model: installer productivity, marketing costs, and smart meter asset and installation costs. The working paper sets out the following initial views from Ofgem:

- Installer productivity:
  - In a tolerance rollout profile, the base level of productivity could be the level Ofgem currently uses in the model, based on average productivity between 2017-2019.
  - In a target rollout profile, Ofgem would estimate productivity impacts by applying a percentage uplift to BEIS's productivity expectation such that any increase in rollout would be delivered by productivity improvements and part by increased operational costs.
- Marketing costs – no additional allowance for marketing is required in either a tolerance or target rollout profile
- Smart meter asset and installation costs – there is no need to apply an uplift to asset or installation unit costs to reflect any increase in rollout under either a tolerance or target approach.

#### Installer productivity

We do not provide views on installer productivity under a 'tolerance' profile as we do not believe tolerances should feature in any assumed profile.

**We disagree with Ofgem’s assumption that there could be an increase in installer productivity in a target-based profile. On the contrary, we expect installer productivity to be lower** (and installation costs higher) post-COVID for a range of reasons including: longer travel times between jobs; increased duration of calls to customers to discuss social distancing in advance of an engineer visit; and the additional time it takes the engineer to prepare themselves before and after each visit. It is currently uncertain how long this will persist, but most likely during the vaccination process and observation period thereafter, and it is likely that some precautions may be required on an enduring basis.

*Marketing; smart meter asset and installation costs*

Coupled to the COVID-related increases in cost, BEIS’s June 2020 decision confirmed that it had no plans to restrict consumer choice regarding smart meter installation (other than in cases of theft). So, in our view there will be little opportunity to mitigate the expected increase in the cost of persuading customers to accept a smart meter installation as the pool of willing adopters is exhausted. BEIS notes that consumers are likely to be incentivised by more attractive tariffs tied to smart meters, and this may well be the case, but Ofgem must recognise that such incentivisation comes at a cost to suppliers and there is currently no allowance in the price cap to reflect it.

At this point, it is challenging to fully crystallise the implications of the pandemic and Brexit on smart meter assets and installation costs. Therefore, we think it is premature for Ofgem to reach an initial view prior to the commencement of BEIS’s new framework that there would not be an increase in marketing, asset and installation costs.

**Ofgem has the opportunity, as do suppliers, to form a view of trends ahead of the Spring consultation and we encourage Ofgem to consider requesting information from suppliers ahead of that consultation.**

**ScottishPower**

March 2021