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By email to: [Retailpriceregulation@ofgem.gov.uk](mailto:Retailpriceregulation@ofgem.gov.uk)

Dear Anna

## **Smart allowance working papers**

Centrica welcomes the opportunity to respond to Ofgem's two initial working papers on this critically important subject.<sup>12</sup>

Smart metering is a key part of Government's net zero carbon strategy, with progress towards the market-wide adoption of smart meters being a vital enabler for the green recovery. Government's commitment to the smart metering programme was reiterated in June in which the rollout trajectory required for the smart programme was determined: suppliers are required to target 100% rollout of smart metering (i.e. 'market wide') by 2025.<sup>3</sup> It remains vital to the success of the programme that sufficient funding is made available to enable its realisation.

We understand that the focus of the first working paper is on data collection and other specific issues where Ofgem is seeking early feedback, and that rollout profile will be the subject of a separate working papers early next year following publication by BEIS of its consultation on setting the tolerances which will apply as part of its post-2020 smart meter policy framework.<sup>4</sup> While we provide some initial views below, we note that stakeholders are being asked to respond to an incomplete picture and currently have no access to Ofgem SMNCC model. We therefore reserve the right to make further representations as necessary in due course once a fuller picture emerges with all necessary disclosure to enable informed responses.

At high level, we broadly agree at this stage with Ofgem's proposed approach in relation to data gathering. However, we remain strongly of the view that clawback or carry over of perceived 'advance payments' is misconceived, risks undermining the success of the smart programme

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<sup>1</sup> [Updating the allowance for smart metering costs in the default tariff cap: working paper | Ofgem](#)

<sup>2</sup> [Setting the PPM smart meter cost allowance in the default tariff cap – working paper | Ofgem](#)

<sup>3</sup> 'Delivering a Smart System: Response to a Consultation on Smart Meter Policy Framework Post-2020', BEIS, 18 June 2020.

<sup>4</sup> [Smart meter policy framework post 2020: minimum annual targets and reporting thresholds for energy suppliers: Annex A: Impact Assessment \(publishing.service.gov.uk\)](#)

and may consequently be open to challenge if Ofgem continues to pursue the approach indicated in these working papers. At the very least, we believe Ofgem must revisit this issue as part of its substantive review ahead of the October 2021 cap to ensure that the outcome is coherent with the final form of the future policy mandate.<sup>5</sup>

While these comments apply generally, we set out more specific comments on the proposals for credit and PPM SMNCC in appendices 1 and 2.

We look forward to engaging further on these issues in due course and in the meantime please let me know if you have any immediate questions.

Yours sincerely

Don Wilson  
**Head of Retail Market Policy (interim)**

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<sup>5</sup> This should not be understood as an acceptance either of the concept of 'advance payments' generally, or of how any 'advance payments' ought to be calculated. Centrica's position remains as set out in its previous consultation response  
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## Appendix 1 – comments on credit working paper

### *Data collection*

Ofgem proposes to update the SMNCC model using suppliers' Annual Supplier Returns (ASR) to BEIS in certain areas without carrying out further data gathering except in relation to actual 2020 installation costs to update its estimates of sunk installation costs.

We broadly agree that Ofgem should use ASR data to update its model where appropriate but that extensive further data gathering is unlikely to be necessary. We note Ofgem's apparent intention only to use updated data selectively but question the basis for asserting that a general update would be disproportionate – it is not obvious why this should be the case given ASR data will be available to Ofgem. Any selective use of data would require careful consideration, so Ofgem must set out its reasoning in detail to allow stakeholders to assess and comment accordingly. It is not sufficient simply to state that Ofgem does not intend to carry out a full review.

### *Sunk installation costs*

We agree that Ofgem cannot apply its 'normal' approach to updating installation costs using ASR data because they may be distorted by the impact of Covid-19 and do not distinguish between costs which can be amortised and those which are sunk.

Ofgem proposes three potential options to address this issue. At this stage, we tend to agree with Ofgem that Option 2 – estimating sunk costs as a residual by subtracting a modelled value of installation costs (based on ASR volumes and modelled unit costs) from total installation costs – is likely to be most appropriate option.

In relation to sunk installation costs in 2021 and beyond, we recognise there are significant uncertainties which, by their nature, are difficult to anticipate fully at this stage. Ofgem is right to note that there are limitations to how far suppliers can adjust their rollout programmes given long planning lead times. We refer Ofgem to evidence we have previously provided in this regard.<sup>6</sup>

### *Uncertainty, advance payments and contingency*

We welcome Ofgem's intention to consider uncertainty further as part of its review. We acknowledge that uncertainties are, by their nature, difficult to quantify accurately. But we do not think Ofgem can be confident that claimed conservatism e.g. due use of average rather than lower quartile benchmarks is real, let alone sufficient to offset potential optimism bias embedded in modelling assumptions which are either unevidenced or inappropriately evidenced.<sup>7</sup>

A key concern remains the uncertainty engendered by Ofgem's proposals to claw back what it perceives as 'advance payments' for historic cap periods retrospectively. We remain strongly of the view that the concept of 'advance payments' is misconceived, and that Ofgem cannot lawfully prejudge future decisions as to the approach it will take following necessary substantive consultation. As noted in our response to the May consultation, concern over clawback would

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<sup>6</sup> Centrica response to Ofgem's May 2020 consultation, Annex A

<sup>7</sup> Ofgem has so far refused to provide access to underlying evidence and input data to support material assumptions about the quantum of benefits it assumes. See Centrica response to Ofgem's May 2020 consultation, Annex B, pp5-6

be compounded if Ofgem persisted with rolling retrospective reviews based on an average outturn. Such a mechanism makes it impossible for suppliers to plan and budget with necessary confidence.

We reiterate that funds that have already been invested in past periods cannot also contribute to rollout in future periods. If Ofgem's concern is that some suppliers have failed to invest available allowances appropriately in past periods, it should address this through targeted enforcement action, not adjust future allowances in a way which perversely penalises those suppliers who have invested their allowances efficiently and appropriately.

The concept of advance or lagged payments is strongly linked with the approach Ofgem ultimately adopts on rollout, which we understand will be addressed in a separate working paper. For now, we simply note that different considerations apply in the event further analysis reveals material underfunding for cap periods impacted by the exceptional Covid-19 adjustment, in which case Ofgem would need to consider upward adjustment.

We note Ofgem's suggestion that provisional future values it calculated in August 2020 might serve as a contingency option. However, our current view is that the allowance implied by Annex 5 will be insufficient to fund the minimum volumes foreseen in BEIS current consultation. We therefore agree that Ofgem will need to consider this issue further in subsequent stages of consultation.

#### *Other issues*

We request confirmation that additional costs incurred due to ongoing delays related to the enrolment programme will be incorporated into any future iterations of the SMNCC model.

## Appendix 2 – comments on PPM working paper

### *Meter asset life and premature replacement charge (PRC)*

We agree with Ofgem's initial proposal to increase meter asset life and maintain the 10-year assumption for amortisation of traditional PPM.

### *PPM cost to serve benefit*

We broadly agree with Ofgem's initial proposal to use ASR data to update its estimates and apply a 12% reduction to the cost to serve benefit to address concerns of inconsistency between the benefit and the 2017 operating cost benchmark in line with the methodology used credit SMNCC.

### *Other costs*

We note that Ofgem states it 'intends to consider' various items under this heading but are unable to comment without further indication as to how Ofgem intends to consider these matters. We therefore reserve our position pending further information.

### *Cost differential*

We broadly agree with Ofgem's proposal to unwind under-recovery of PPM cost to serve by offsetting against any reduction in SMNCC without changing opex allowances.

### *Carry forward*

We continue to disagree with Ofgem's proposals relating to 'carry forward' for the same reasons we object to clawback of credit SMNCC. Allowances that have already been invested – however determined – are not available to suppliers to 'carry forward' and invest a second time. Nor can suppliers plan and budget with reasonable certainty if allowances are subject to retrospective revision based on complex modelling that is not even available to suppliers for business planning purposes.

For credit SMNCC this is due to a combination of i) Ofgem's overly restrictive disclosure rules which preclude any use of its SMNCC model other than for a narrowly defined 'permitted purpose' and ii) the fact that data updates mean that model outputs at one point in time cannot be relied on for future reference. In the case of PPM SMNCC, suppliers cannot even draw on past model outputs as a rough guide – because Ofgem's decision to adopt a contingency approach means there are no past model outputs.

Notwithstanding our opposition to carry forward in principle, to the extent Ofgem continues to pursue it this can only be done on a net basis – reflecting the proposal to offset potential SMNCC reductions with increases in PPM uplift.