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Dear Anna,

Setting the PPM smart meter cost allowance in the default tariff cap – working paper

Thank you for the opportunity to respond to this working paper. We set out our key points below and have provided more detail on these points in Annex 1.

We believe Ofgem should gather smart prepayment cost to serve data from a wider pool of suppliers to ensure that a more representative estimate of smart vs traditional cost to serve benefit is derived.

We disagree with Ofgem's proposed approach to carry forward, which we consider is unduly biased and not justified by Ofgem's principle of capping the 'net SMNCC' allowance at £0. If the 'net SMNCC' allowance in the period to which the carry forward adjustment is being applied is negative, it would be entirely appropriate to include the *full* shortfall from previous periods in the total carry forward amount.

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

**SETTING THE PPM SMART METER COST ALLOWANCE IN THE DEFAULT TARIFF
CAP- WORKING PAPER – SCOTTISHPOWER RESPONSE**

1. Introduction

We comment below on each of Ofgem's main proposals:

- the traditional meter age assumption
- PPM cost to serve benefit (smart versus traditional)
- setting the SMNCC at nil consumption
- the carry forward adjustment.

2. The traditional meter age assumption

Ofgem is proposing to increase the assumed traditional PPM asset life from 10 years to 12 years and 14 years for gas and electricity respectively. This appears to be reasonable.

3. PPM cost to serve benefit (smart versus traditional)

Potential sample bias in ASR data

Ofgem proposes to use the ASR data to update PPM cost to serve benefits¹. It proposes to reflect operational cost savings to suppliers by using ASR data to calculate the difference between the traditional PPM cost to serve and the smart PPM cost to serve for each supplier. However, suppliers with fewer than 10,000 smart prepayment customers (including ScottishPower) are not obliged to complete the ASR with PPM cost to serve information.

If large suppliers such as ScottishPower are omitted from the sample, this would be unrepresentative and could introduce a source of bias. Ofgem should discuss with BEIS whether the ASR can be modified to bring in cost data from a wider sample of suppliers. Failing that, Ofgem could issue an RFI to suppliers not covered by the ASR asking them to provide the relevant information.

We would note that ScottishPower and other suppliers have experienced technical² barriers to the installation of smart prepayment meters in the north of England and all of Scotland. This constraint has meant that suppliers with a high concentration of PPM customers in these regions have experienced a particularly severe lag in the realisation of such benefits. It will therefore be important that Ofgem uses an appropriate rollout profile assumption for prepayment meters so as to properly reflect this lag.

Consistency with the CMA's findings

Ofgem does not offer much quantitative analysis in concluding that it is plausible for the electricity PPM cost to serve benefit to be higher than for gas PPM customers³. Based on our experience we believe the opposite is true, ie cost to serve benefits are greater for gas PPM

¹ Paragraph 2.24

² Eg unavailability of fully functioning dual-band communications hubs from ARQIVA.

³ Paragraph 2.37

customers. Ofgem would have an opportunity in the RFI mentioned above to gather data directly from suppliers on the difference between fuels.

4. Setting the SMNCC at nil consumption

Ofgem is proposing to allocate the full (negative) SMNCC to nil consumption (ie to the standing charge) to ensure the PPM customers with low consumption derive the full benefit (reduction). Whilst we understand the policy intent to protect low consumption consumers, we believe Ofgem also needs to have regard to the principle of cost-reflectivity, and bear in mind that some vulnerable customers (eg on electric heating) may have higher than average consumption and therefore be worse off under Ofgem's proposals compared a situation where the amount was allocated to the unit rate.

5. Carry forward adjustment

Ofgem says it intends to apply 'carry forward' for the PPM SMNCC from the point at which PPM customers are protected under the default tariff cap, ie 1 January 2021. In other words, it will calculate the SMNCC allowance for historic cap periods (starting in January 2021) using the latest version of the SMNCC model and compare it against the SMNCC allowance provided in that period, and then include the difference in future SMNCC allowances.

Ofgem notes that this process is complicated by the fact that the original PPM-DD cost to serve uplift calculated by the CMA is likely to under-state the true amount, with the result that some of the cost-to-serve difference was smeared across other payment methods. Ofgem has previously consulted on its proposal to reinstate this element of the PPM-DD cost to serve uplift, but only to the extent that, in combination with changes to the NPT SMNCC allowance, it can do so without increasing the PPM tariff cap. In other words, Ofgem would include a 'net SMNCC' allowance in the tariff cap which is equal to the greater of £0 and the sum of the NPT SMNCC plus an 'offset' amount for the additional PPM-DD cost to serve uplift. In the context of the 'carry forward' calculation, Ofgem proposes to calculate the carry forward amount by reference to this net SMNCC allowance.

We disagree with Ofgem's proposed approach. Table 1 below reproduces Ofgem's Table 3.2 which illustrates this approach, with the addition of a fourth row showing the shortfall in the allowance resulting from the £0 cap.

Table 1 – Ofgem Scenario 1

		Cap in period X	Cap X (updated)	Carry forward amount
A	NPT SMNCC	-£15	-£7	£8
B	Offset	£10	£10	
C	'net SMNCC' allowance = Max(£0, A+B)	-£5	£0	£5
D	Shortfall in allowance (A+B-C)	0	£3	£3

In the example above, Ofgem is proposing that the carry forward amount should be £5, being the increase in the (capped) allowance, whereas the true shortfall in the allowance in period X is £5+£3 = £8. We consider that Ofgem's proposal introduces an unfair bias into the carry forward methodology.

If the principle of carry forward is accepted (ie ex post adjustments in future periods for under/over-allowance in previous periods), then we see no reason why the £3 shortfall should not be included in the carry forward adjustment applied in a future period, ie a carry forward for period X of £8. We accept that a possible exception arises if the effect of the overall carry forward⁴ is to take the allowance above £0 in the future price cap period. If that is the case, it would be consistent with Ofgem's principle to include the £3 for period X (and similarly for any other historic period) only to the extent that it does not take the allowance in that future price cap period above £0. But if the allowance in the future cap period is negative, the full £8 should be carried forward.

ScottishPower
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⁴ ie summed across historic cap periods and quantities subject to carry forward