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Reviewing smart metering costs in the default tariff cap

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have around five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy welcomes the opportunity to contribute to the development of Ofgem's approach to reviewing the smart metering costs and allowance in the default tariff cap. We believe the objectives of Ofgem's review should be the delivery of a model that is robust, transparent and accurate. The outcome of the model should deliver a smart metering allowance that enables the recovery of efficient smart costs and ensures that the tariff cap does not impede the smart meter roll out programme.

Two staged approach

Ofgem now expects the updated Smart Metering Implementation Programme Cost Benefit Analysis (SMIP CBA) to be published in the summer resulting in it not being available in time for Ofgem to use in updating its model for Period 3 of the default cap. On that basis, we note Ofgem proposes to adopt a two-staged approach for updating the non-pass through allowance of the Smart Metering Net Cost Component (SMNCC) with no change to its existing approach for Period 3. We agree that given the timing implications of the revised CBA, using an unadjusted version of the current model for Period 3 is a sensible approach and provides certainty for suppliers.

Period 4 onwards

We note that Ofgem plans to consult on its proposed approach for the fourth cap period and beyond later in the year following the publication by BEIS of the updated SMIP CBA. We look forward to Ofgem progressing to this next stage of its review and we are keen to work with Ofgem to develop an approach which meets the objectives set out above.

We would however like to take this opportunity to comment on the following matters issues which at a high level have been included within this consultation:

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Retrospective Correction

Throughout the consultation Ofgem make numerous references to it considering introducing some form of retrospective correction mechanism within its model for setting the allowance for period 4 and beyond to reflect where the allowance was somewhat different to the actual efficient costs in the previous three periods. However, Ofgem was very clear in its decision documents when implementing the default cap that it opposed the inclusion of an error correction mechanism. Most notably in Appendix 3 of the decision document that dealt with updating the cap methodology, Ofgem stated:

Para 3.7 "We have not included any mechanism to allow the level of the cap to be modified mid-period (given this frequency of updates that will in any event be taking place) - nor a mechanism to retrospectively correct for forecast error (which would risk distorting competition). In reaching this position, we have given regard to:

- *concerns that using an error correction mechanism would create a further distortion to the market. In particular, a negative adjustment (to correct for the cap being set too high in the previous period) could lead to a cap being set beneath an efficient level of costs. This would distort customers' incentives to engage in the market, suppliers' incentives to offer competitive tariffs, and the incentives of new suppliers considering entering the market*

We therefore disagree with Ofgem moving away from its policy decision in respect of smart metering costs, particularly considering such a decision was only made some six months ago. Ofgem should adopt a consistent approach across all elements of the cap in terms of retrospective adjustments. Ofgem has clearly identified concerns with adopting such a corrective approach, as highlighted above. These risks are likely to rise considerably if an inconsistent arbitrary approach was adopted.

Transparency

As a means of providing transparency to stakeholders on its approach to smart metering costs, Ofgem proposes to make its updated model available in a confidentiality ring. While in principle we are supportive of such a proposal, it is important that this provides sufficient transparency to stakeholders to allow them to fully understand the model and the underlying assumptions and data used to populate it in order to have confidence in the model and its outputs are robust and accurate.

To be of value to stakeholders this process would need to be an improvement on the previous data room arrangements that were in place as part of the final proposals for the default cap. Within the data room, access to data and underlying assumptions was limited which restricted the necessary insight that could be gained. We would like to see Ofgem provide a commitment that it will revisit the access restrictions that were imposed previously and that appropriate transparency and insight will be granted to stakeholders.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre on 0208 186 1356 or myself on 01483 489576.

I confirm that this letter may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in blue ink that reads "Paul Delamare".

Paul Delamare
Head of Customers Policy and Regulation