Reviewing smart metering costs in the default tariff cap

Question 2.1

Do you agree with how we propose to consider an appropriate allowance for smart metering costs? Please explain your views.

We agree with Ofgem's proposal to consider efficient costs on average. As Ofgem acknowledges, different suppliers have different efficient costs, depending on differences in their customer portfolios and their progress with the smart meter rollout.

Question 3.1

Do you agree with how we propose to review efficient smart metering costs? Please explain your views.

We agree in principle with Ofgem's proposals.

We have previously recommended that Ofgem should address a number of issues in its review of the CBA's assumptions, including those Ofgem has noted in paragraph 3.14.

- Ofgem has factored in a lifecycle for SMETS1 meters of 15 years. A more accurate period would be ten years: this is the period of the warranty attached to the majority of SMETS1 meters. Additionally, meter asset providers drive churn agreements on ten-year terms which have been actively progressed over the last three years. Manufacturers of SMETS1 meters do not generally expect them to have an effective life beyond ten years. SMETS2 meters are widely expected to have a longer warranty period but that does not justify applying a 15-year lifecycle to SMETS1 meters.
- Ofgem's calculations assume amortisation of IT costs and system changes over 15 years. However, given the on-going technological changes and the fact that systems are normally upgraded or replaced on a more frequent basis, we do not believe this approach is consistent with the guidance given in International Accounting Standards (paragraphs 90 and 92, IAS 38). This guidance covers technological obsolescence and the likelihood of a short useful life for these types of intangible IT assets. We believe amortisation of IT assets should be three to five years.
- Ofgem has included termination fees for traditional meters but termination fees for SMETS1 meters do not appear to have been included. During 2018 and 2019, due to prepayment functionality, density and timing of availability of SMETS2 pay-as-you-go, termination fees are likely. There is also likely to be a large increase in costs of this nature through 2019 and 2020 through the enrolment and adoption process and certain meter types falling out of the enrolment process. Price Cap assumes this will be 100% successful, where as reality dictates that there will be a percentage error rate.
- Ofgem encouraged suppliers to install non-compliant smart meters prior to the introduction of SMETS1 and SMETS2 meters. Non-compliant smart meters were more expensive to buy than dumb meters and can also be more expensive than SMETS1 or SMETS2 meters; this is typically reflected in higher termination fees and ongoing Meter Asset Provider (**"MAP"**) rental charges. For those suppliers, like E.ON, who installed significant numbers of non-

compliant smart meters, these additional costs do not appear to have been taken into account.

- Ofgem's model for calculating the costs associated with smart metering allows a 6% cost of capital for the total asset cost of a smart meter. In practice this figure is not truly reflective of the cost of capital across the whole industry once churn has been taken into account. For a supplier financing the installation of a smart meter, either internally or externally, a figure of 6% is probably reasonable, however on a churn event the MAP will be exposed to a higher credit risk, as well as meter removals and will therefore increase its level of charges to the new supplier to reflect this.
- An obligated supplier is required to cover the capital element of the SEGB charges: this equates to £1.75 (84%) of the £2.11 cost allowed in the default tariff cap for SEGB costs. This therefore results in the lack of a level playing field in the market.

We welcome Ofgem's proposal to provide the non-pass-through model in a confidentiality ring; however, we would like some clarity around how this will work. If it is to be of any value to suppliers, it must be an improvement on what was available in the data room during the default tariff cap consultation period; there needs to be sufficient data to allow us to understand how the results have been reached. It should also be accessible directly to suppliers, to avoid the cost of employing consultants.

Question 4.1

Do you agree with how we propose to set the allowance for the third cap period? Please explain your views, and any alternative proposal if applicable.

We acknowledge Ofgem's reasons for setting the allowance for the third cap period using its original non-pass-through SMNCC model.

Question 4.2

Do you agree with how we propose to set the allowance for the fourth cap period and beyond? Please explain your views, and any alternative proposals if applicable.

We welcome Ofgem's approach, but would urge that the issues stated in paragraph 3.14 of the consultation and the additional points we have raised in our response to question 3.1 above be properly addressed.

Any adjustments Ofgem makes to the SMIP CBA should be addressed holistically, not as single elements.

We are extremely concerned that Ofgem proposes to give regard to any substantial advance or lagged payment in the first three cap periods. Ofgem has consistently refused to make use of a correction mechanism to retrospectively correct for forecast error; in the interests of consistency, Ofgem should not undertake retrospective corrections if assumptions for previous cap periods were inaccurate.

There is a possibility that there may be delays to the release of the new SMIP CBA; we believe Ofgem should consider what alternative methodology it could use for the fourth cap period and beyond should this be the case.

For periods beyond the end of 2020, Ofgem may need to undertake further consultation once the Government's plans for delivery of any shortfall in the smart meter rollout is clear. As a minimum, account should be taken of the latest supplier annual returns.