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Reviewing Smart Metering Costs in the Default Price Cap: May 2020 Statutory Consultation

EDF Energy is the UK's largest producer of low carbon electricity. We operate low carbon nuclear power stations and are building the first of a new generation of nuclear plants. We also have a large and growing portfolio of renewable generation, including onshore and offshore wind, as well as coal and gas stations and energy storage. We have around five million electricity and gas customer accounts, including residential and business users. EDF Energy is committed to building a smarter energy future that will support delivery of net zero carbon emissions, including through digital innovations and new customer offerings that encourage the transition to low carbon electric transport and heating.

EDF Energy welcomes the opportunity to provide comments on Ofgem's proposals to update the allowances in the Default Tariff Cap (DTC) that reflect the net impact that the smart meter rollout has on the operating costs of an efficient energy supplier during the cap periods. We are fully supportive of Ofgem undertaking a robust and accurate review of the smart metering allowance within the DTC, with the aim of ensuring that for the duration of the cap suppliers are able to recover the efficient costs of their roll-out programme.

A number of detailed points in respect of the methodology adopted by Ofgem and its review of efficient costs/benefits and underlying model, can be found in the attachment to this letter. These views have been informed by our access (including that of our appointed advisors) to the Ofgem model and underlying data through the confidentiality ring set up by Ofgem. In addition to these detailed comments, we would also like to make the following observations regarding Ofgem's proposals and the policy approach that it intends to adopt.

Overall Approach

We are generally supportive of Ofgem's overall approach to its review of smart metering costs in the DTC. Following the publication of Ofgem's initial proposals in October 2019, it was right for Ofgem to delay the implementation of any changes. There was a clear need for Ofgem to undertake further stakeholder engagement, including through a number of formal supplier requests for information (RFIs), in order to obtain a more robust and comprehensive understanding of the efficient net costs and benefits of the smart metering roll-out. Using as a basis of its review the most recent BEIS cost benefit analysis and making appropriate adjustments based on the supplementary data it has obtained from suppliers (through the RFIs and consultation responses) in order to update its modelled cost assumptions, is in principle an appropriate approach.

We note that in many areas Ofgem has looked to adopt a conservative approach as a means of addressing uncertainty around the future rollout, costs and benefits and in approximating the initial impact of COVID-19 on installations and sunk costs. We are supportive of this approach and agree that to guard against unintended consequences Ofgem should use conservative assumptions when setting allowances.

One of the outcomes of the COVID-19 crisis has been to further highlight the benefits of smart meters for consumers, particularly those who are supplied through a prepayment meter. A successful restart of the smart metering programme will form a fundamental part of a UK COVID-19 recovery plan that prioritises the environment and the UK's net zero ambitions. EDF with other suppliers are actively working with BEIS as part of its smart metering remobilisation workstream, and we would urge Ofgem to engage in this process in order to ensure that its SMNCC allowance proposals reflects the near-term policy ambition of the programme and avoids the risks of underestimating the costs that will result from a remobilisation of the programme.

Rollout Profile

We acknowledge that given the design of the DTC and the requirement to set the same allowance for all suppliers, Ofgem must set the non-pass-through SMNCC by reference to efficient costs assuming a single rollout profile. The consequence of this is that for individual suppliers the impact, and the extent to which their costs match the allowance provided under the cap, will be highly dependent on their own rollout progress. This is an inevitable consequence of the tariff cap design and methodology.

In setting a single rollout profile, we are supportive of Ofgem moving away from its original proposal (as set out in its October 2019 consultation) of simply using the rollout profile in the BEIS CBA, unmodified. Taking in to consideration actual supplier progress to date is a vital aspect in developing an assumed single rollout profile in future cap periods.

However, undoubtedly the future pace and costs of the rollout are uncertain. It is therefore important that in setting a smart allowance that Ofgem does not inadvertently constrain suppliers rollout progress. Either by impacting on what suppliers' can achieve in accordance with their all reasonable steps licence objectives or introducing a disincentive for suppliers to go above and beyond the weighted average rollout profile assumed in the smart metering allowance.

In this context there is also a need to reflect the uncertainty around the post 2020 regulatory framework and in particular the future absolute target obligations that BEIS is expected to introduce in 2021. In the event that the final BEIS decision on a post 2020 regulatory framework, including the setting of annual absolute targets, largely reflects the original proposals published in 2019, Ofgem's proposed assumed rollout profile under the tariff cap is likely to be adrift of the smart regulatory framework suppliers will be operating to. We also consider that the form of obligation BEIS is proposing will certainly have the effect of driving up suppliers' roll-out costs, including for example through financial incentives to promote customer acceptance, in order to have any prospect of achieving the level of installs required. These additional costs are inconsistent with the roll-out costs included within the BEIS CBA.

Advanced Payments Carried Forward

In our responses to previous consultations on reviewing smart metering costs we have signalled our opposition to the use by Ofgem of any retrospective correction mechanism within its model for future cap periods. We continue to hold this view. Adopting a policy of adjusting the allowance to address any instances where Ofgem subsequently considers that the allowance was somewhat higher than the actual efficient costs in earlier periods distorts competition and will mean suppliers are not able to recover the efficient costs of their roll-out programme within future cap periods.

We would encourage Ofgem to have consideration for the distortive effects that such under-funding will have on market dynamics. To the extent that any supplier has been overcompensated for their costs in the smart programme in the past this is most likely to have led to that supplier offering lower prices than they would otherwise have been able to, and as such any overpayment has already been returned to customers. This view would appear to be supported by the most recently published Consolidated Segmental Statements by the large suppliers which illustrate that any over-funding has not resulted in profit. The review of the SMNCC is an opportunity to avoid future unintended market distortions by allowing efficient costs.

However, in the event that Ofgem continues with its proposals to adjust the allowance to take account of its assessment of advanced payments, we are supportive of the approach that spreads the carry forward over the maximum possible remaining cap periods up to the end of 2023. We agree that this would be the least disruptive approach to SMNCC in each future cap period. We also agree that, if the proposals are to be implemented, they should focus on any assumed advanced payments since Cap Period 3 (1 October 2019) and not from the introduction of the DTC.

Future Reviews of the SMNCC Allowance

We appreciate that at this point of time, Ofgem is unable to form a robust and accurate view of smart meter costs and set an appropriate SMNCC allowance for the remainder of the default tariff cap period. Not only does there remain uncertainty as to the future policy framework that will be put in place by BEIS and the impact any such policy will have on the costs faced by suppliers, there is much uncertainty around the speed, scope and costs of remobilisation of the programme as we move through the current COVID-19 crisis.

On this basis we are supportive of Ofgem conducting a further review of the SMNCC allowance in 12 months, in time for Cap Period 7 (commencing 1 October 2021). This should allow for an appropriate assessment of the implemented post 2020 regulatory framework and the costs suppliers are exposed to under such an approach, and that of the default tariff cap and the setting of an allowance that allows suppliers to recover their efficient costs. It will also allow Ofgem to appropriately reflect the exceptional impacts faced by suppliers as a consequence of COVID-19 and ensure that any additional efficient costs incurred by suppliers as a consequence of the crisis are accounted for in any future smart metering allowance. Furthermore, COVID-19 has had and continues to have broader impacts (over and above smart metering) on suppliers' operational costs and as such we would like to see Ofgem commit to undertaking a full and timely review of COVID-19 impacts and seek to introduce wider adjustments to the price cap to ensure that it remains reflective of a suppliers efficient costs.

While supporting a further review in 12 months, we are unclear on the need for Ofgem at this stage to commit to undertaking reviews of the SMNCC allowance every 12 months. We acknowledge that further reviews beyond the next planned review may be required to address any exceptional circumstances, but we do not believe that Ofgem should be committing to undertake regular annual reviews. This would be a policy shift in how the DTC was originally developed and implemented; such that annual reviews would lead to a price cap that was set using a retrospective approach rather than the prospective approach that looked to make assumptions about supplier costs going forward and set an allowance accordingly. A retrospective approach introduces further regulatory risk on suppliers and could not only lead to future allowances being set at levels below average efficient costs for suppliers, but also negatively impacts the ability of suppliers to effectively plan and budget their smart metering programmes. As such the proposal for annual reviews would introduce continued uncertainty for suppliers and leave suppliers with limited ability to mitigate the risks of their operational decisions.

Contingency

It is essential that an SMNCC allowance is set for the next cap period commencing in October 2020. As such, there is a clear need for appropriate contingency arrangement to be in place so that Ofgem is able to set an SMNCC allowance in the event that it is not in a position to make a final decision on its current proposals set out in this consultation.

Previous contingency arrangements have in effect involved the rolling over of the methodology in place for the preceding cap period, as was the case for cap periods 3 and 4. We note that Ofgem is now proposing an alternative contingency arrangement for the next cap period which involves implementing all of the proposals in this consultation except for the adjustment for any advanced payments. To an extent this appears to prejudge the outcome of this consultation process. Putting to one side the matter of adjusting for advance payments, which many stakeholders including ourselves have consistently expressed opposition to, it remains the case that other elements of Ofgem's proposals may also be opposed by respondents through this consultative stage. This could include fundamental inputs such as the assumed average rollout profile used to set the allowance. We therefore encourage Ofgem to remain open to alternative contingency options for the cap period from October 2020.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre or myself. I can confirm this letter is not confidential and may be published. However, please treat the attachment as confidential.

R. Beresford

Yours sincerely

Rebecca Beresford
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