Department for
Business, Energy
& Industrial Strategy

Smart Meter Targets Framework:

Churn adjustment

Closing date: 20 January 2022

November 2021

Any enquiries regarding this publication should be sent to us at:
smartmetering@beis.gov.uk

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General information

Why we are consulting

In June 2021, the Government confirmed the tolerance levels for the first two years of a new four-year smart metering Targets Framework, which will start on 1 January 2022. The Government also confirmed the intention to bring forward proposals on an adjustment to mitigate the impact of customer-driven smart churn on energy suppliers' minimum installation requirements for the second year of the new Framework. We are now consulting on proposals for this adjustment.

Consultation details

Issued: 25 November 2021

Respond by: 20 January 2022, 12:00

Enquiries by email only to: smartmetering@beis.gov.uk

Consultation reference: Smart Meter Targets Framework: Consultation on a churn adjustment

Territorial extent:

This consultation applies to the gas and electricity markets in Great Britain. Responsibility for energy markets in Northern Ireland lies with the Northern Ireland Executive's Department for the Economy.

How to respond

Responses should be emailed to: smartmetering@beis.gov.uk

When responding, please use the consultation reference above in the subject line. Please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. We would advise you to follow the summary of consultation questions at the end of this document.

Please do not send responses by post to the department.

We will provide an email acknowledgment for each response received.

Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential please tell us, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our privacy policy.

We will summarise all responses and publish this summary on GOV.UK. The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details.

Quality assurance

This consultation has been carried out in accordance with the government's consultation principles.

If you have any complaints about the way this consultation has been conducted, please email: beis.bru@beis.gov.uk.

Interpretation

In this document:

“the Government” refers to the UK Government;

“we” refers to the UK Government;

“BEIS” or “the Department” refer to the Department for Business, Energy and Industrial Strategy, that has published the consultation on behalf of the UK Government;

“the Programme” refers to the Smart Metering Implementation Programme, which includes the Department’s Smart Metering Team and the wider group of partners and stakeholders responsible for delivering the rollout;

“the existing all reasonable steps (ARS) obligation” or “the existing obligation” refers to the legal obligation on energy suppliers to take “all reasonable steps” (ARS) to install smart meters. This obligation initially required installations to take place by the end of 2019 and, in 2013, it was extended to the end of 2020 (“the 2020 rollout duty”). In June 2020, due to the disruption caused by the COVID-19 pandemic, it was extended to 30 June 2021. In June 2021, it was extended by a further six months to 31 December 2021;

“the Targets Framework”, “the new Framework”, “the Framework” and “the new obligation” refer to the smart meter installation obligation which has been implemented and is due to take effect from 1 January 2022;

“customer-driven churn” refers to consumers switching between energy suppliers voluntarily, as a result of the consumer’s active choice.

Executive Summary

1 Smart meters are a vital upgrade to our national energy infrastructure and underpin the cost-effective delivery of the Government's net zero commitment. They are a critical tool in modernising the way we all use energy and support the transformation of the retail energy market, to make it work better for energy consumers.

2 The Government is committed to ensuring that households and small businesses can benefit from smart meters as soon as possible. To meet this ambition and drive completion of the rollout, the Government confirmed in June 2020 that a new four-year Framework would set energy suppliers annual, individual installation targets on a trajectory to 100% coverage, subject to an annual tolerance level. In June 2021 the Government confirmed the tolerance levels for the first two years of the new Framework.[1]

3 In the June 2021 decision, the Government committed to consult on proposals for a modification in the calculation of Year 2 installation requirements to mitigate the impact of smart meter customers switching their energy supplier ("churn") during Year 1. In committing to consult on proposals for an adjustment, we accepted that the current methodology for calculating minimum installation requirements, by not mitigating the impact of smart churn, may potentially result in unfair penalisation of energy suppliers that are furthest ahead in their smart meter rollout, as they are potentially more likely to lose smart customers than gain them. At the same time, it may reward other energy suppliers that increase their smart customer base through churn. In proposing an adjustment to mitigate the impact of customer-driven smart churn, we seek to fulfil the intention of the Targets Framework to focus energy suppliers' obligations on the number of smart meters that they install in each rollout year. We also seek to address the current position whereby a supplier may be disadvantaged by being above market average smart penetration and losing more smart customers than they gain through customer-driven churn.[2] We recognise the challenges of the current market situation and that customer-driven churn is likely to decrease in this context. However, we consider that bringing forward a proposal for a customer-driven churn adjustment remains justified on the basis of the intentions set out above, in particular looking beyond the current market challenges. For clarity, a restatement of our position in relation to churn occurring via the Supplier of Last Resort (SoLR) process and an explanation of how it will be treated under the churn adjustment is included in Section Two of this document.

4 We are proposing to implement the churn adjustment through an amendment to the formula used to set the minimum installation targets referred to in licence conditions.

[1] Smart meter policy framework post 2020: minimum annual targets and reporting thresholds for energy suppliers – government response

[2] While we use the term 'customer' through this document for ease of reference, supplier installation requirements under the new Framework are based on metering systems and this will remain unchanged under the proposed adjustment. One customer may represent multiple metering systems, particularly in the non-domestic sector.

The revised formula would introduce a churn adjustment parameter. This parameter can be set at increments from 0 to 1, to vary the extent to which customer-driven smart churn affects supplier installation requirements. A value of 1 will have the largest effect, so that smart meter customers gained through customer-driven churn will not contribute to lowering suppliers' installation requirements in the following year. A value of 0 will apply no adjustment for smart churn. Any value in between will set a more partial adjustment, whereby the extent to which smart churn impacts on a supplier's installation requirements in the following year will depend on the exact value to which the parameter is set. For Year 2 of the Framework, we propose to set this parameter at 1. We consider this approach will most effectively deliver the intentions set out above.

5 This consultation proposes to set the churn adjustment for Year 2 of the new Framework only. The level of any churn adjustment for Year 3 and Year 4 will be considered and consulted on as part of the mid-point review of the Targets Framework, due to take place in 2023.

6 In the June 2021 Government response, we also committed to bring forward proposals on an alternative approach to driving rollout activity for energy suppliers where tolerance levels are not applicable (for example, if a supplier has such high smart penetration levels that they have installation requirements of zero). Following further consideration, we no longer intend to bring forward proposals at this time. This decision is discussed further in Section Three of this document.

Introduction

Delivering market-wide rollout

7 Smart meters are replacing traditional gas and electricity meters in Great Britain as part of an essential infrastructure upgrade to provide a more flexible and resilient energy system fit for the 21st century. Smart meters play a critical role in modernising the way we all use energy and are already aiding the transformation of the energy retail market to make it work better for consumers. The ability to record half-hourly consumption and price data from smart meters is unlocking new and innovative approaches to managing demand. Such approaches include smart 'time-of-use tariffs' that reward consumers for using energy away from peak demand times and allow new technologies such as electric vehicles and smart appliances to be cost-effectively integrated with renewable energy sources. This transformation to make the GB energy system smarter and more flexible will play a critical role in decarbonising the energy sector and in delivering in a cost-effective manner our commitments to net zero greenhouse gas emissions by 2050. This underlines the Government's determination that the UK will be a leader in the development of the new technologies, goods and services that will be needed for this successful transition.

8 Therefore, it is a Government priority to deliver market-wide rollout of smart meters as soon as possible. The Energy White Paper, published in December 2020, outlines our firm commitment to achieve the goal of a market-wide rollout that will enable homes and small businesses to be put in control of their energy use and bills through the innovative digital energy services available to them.[3] Thanks to the continued endeavours of industry, the rollout continues to make good progress. As of 30 September 2021, there were 26.4 million smart and advanced meters in homes and small businesses across Great Britain.[4]

9 Government wants to ensure that households and smaller non-domestic sites can benefit from smart meters. In June 2020, the Government confirmed a new four-year policy Framework with fixed annual installation targets for energy suppliers, subject to tolerance levels, that will continue to drive the investment and momentum needed to achieve this goal.[5] This Targets Framework builds on the progress made under the current "All Reasonable Steps" (ARS) obligation, which has been in place since 2012 and to which all energy suppliers remain subject until the start of the new Framework. In June 2021, the Government confirmed the tolerance levels that will apply for the first two years of the new Framework. The new Framework will apply to all domestic and non-domestic energy suppliers and is due to take effect from 1 January 2022.

[3] Energy white paper: Powering our net zero future.
[4] Smart meter statistics
[5] Smart meter policy framework post 2020

Policy context

10 The Targets Framework ensures that energy suppliers' investment in individual smart meter installations are recognised each year. This represents a development from the "all reasonable steps" obligation, where annual milestones were set and assessed on levels of smart coverage and under which energy suppliers may be more adversely impacted by in-year churn.

11 It is the case, however, that customer-driven smart churn continues to have an impact on a supplier's installation requirements under the new Framework. Whilst under the new Framework an energy supplier can only meet their licence obligation by installing at least the minimum number of smart meters within a given rollout year, churn within the year is accounted for in the difference it makes to the supplier's year-end smart coverage. When calculating their Year 2 target, a supplier's net smart churn at the end of Year 1 will be counted as part of the total metering points. Churn may therefore increase or decrease a supplier's smart meter coverage at the beginning of Year 2. A change to the proportion of smart customers in their portfolio as a result of churn will have an impact on the calculation of a supplier's minimum installation requirements for Year 2.

12 In the BEIS consultation on Minimum Annual Targets published in November 2020, we proposed not to make an adjustment for churn in the methodology used to calculate energy suppliers' minimum installation requirements under the new Framework.[6] This proposal was made on the basis that the proportion of smart metering customers that an energy supplier loses or gains through customer-driven churn will depend on a range of factors including the overall level of smart coverage in the market at a point in time, pricing, customer service levels and innovative tariffs offerings linked to smart meters. In a business-as-usual market, energy suppliers can influence switching volumes through their pricing and customer retention strategies to seek to dampen the impact of customer-driven smart churn on their level of smart meter coverage. In addition, we considered that the impact of losing or gaining customers with smart meters through churn will lessen as the rollout progresses as a higher proportion of energy suppliers' customers have smart meters.

13 In their response to the November 2020 consultation, some energy suppliers objected to this proposed approach and asked that the calculation of installation requirements for Year 2 be adjusted to account for the impact of churn amongst customers with smart meters.

14 Customer-driven churn is the reflection of a dynamic energy market that encourages consumers to shop around for the best deal and energy suppliers have influence over the proportion of smart metering customers that they lose or gain through customer-driven churn. However, we recognise the challenge that customer-driven smart churn represents for energy suppliers that are more advanced in their rollout. The evidence

[6] Smart meter policy framework post 2020: minimum annual targets and reporting thresholds for energy suppliers

provided in the feedback to the November 2020 consultation demonstrated that while these energy suppliers were likely to lose smart meter customers in proportion to their penetration levels, they would likely only regain them at the market average (i.e. a lower) penetration rate. This would result in these suppliers having a lower year-end smart penetration level than they would expect to have based on their smart meter installation numbers during the year and, consequently, higher minimum installation requirements than if they had not experienced this churn. As the current methodology for calculating minimum installation requirements does not adjust for smart churn, this may result in penalisation of energy suppliers that are furthest ahead in their smart rollout whilst rewarding other energy suppliers that increase their smart customer base through churn.

Consultation proposals

15 In our response to the November 2020 consultation, published in June 2021, we proposed to make an adjustment in the calculation of Year 2 minimum installation requirements. This adjustment would seek to mitigate the effect of customer-driven churn of smart meter customers between energy suppliers and focus installation requirements on installation numbers only, while at the same time continuing to support the Government's overall aim of reaching market-wide rollout of smart meters as soon as possible. We proposed that this adjustment would address both:

- Positive smart churn (when more smart meters are **gained** than lost through churn).
- Negative smart churn (when more smart meters are **lost** than gained through churn).

This consultation sets out how we propose such an adjustment is achieved.

16 In proposing this adjustment, we seek to fulfil the intention of the Targets Framework to focus energy suppliers' obligations on the number of smart meters that they install in each rollout year. This represents a change that we consider best measures in-year installation performance for this stage of the rollout. This is in comparison with the annual milestones under the "all reasonable steps" obligation, where targets were assessed on levels of smart coverage. It is our view that focussing on smart meter installations will most effectively support the Government's aim for the new Framework to continue to drive the investment and momentum needed to achieve the overall ambition of market-wide smart rollout as soon as practicable.

17 We also acknowledge that the current approach for calculating minimum installation requirements may be potentially detrimental to those energy suppliers that are above market average smart penetration and, therefore, more likely to experience negative smart churn. It is contrary to the intention of the new Framework to penalise those energy suppliers that are furthest ahead in their smart rollout. Neither do we wish to reward energy suppliers with lower installation requirements simply as a result of gaining smart customers through customer-driven churn. By mitigating these impacts,

the proposed churn adjustment is consistent with the principles of the Targets Framework.

18 We recognise that current market conditions are likely to limit business-as-usual customer-driven churn patterns at the present time. However, we consider that introducing an adjustment for customer-driven smart churn remains justified in order to focus the Targets Framework on smart meter installations and to prevent potentially unfair penalisation of energy suppliers further ahead in their smart rollout.

19 **Section One of this document concerns the proposed revision to the formula used to set minimum installation requirements.** In order to implement an adjustment that would mitigate the impact of customer-driven smart churn, we propose to introduce a churn adjustment parameter into the formula used to calculate targets referred to in paragraphs 33A.2 and 39A.2 of the Standard Licence Conditions for Gas and Electricity respectively. This churn adjustment parameter would determine the level of mitigation for the impact of customer-driven smart churn applied in the calculation of energy suppliers' installation requirements. We propose to set this parameter in a similar way to the tolerance value for each rollout year (Ty), in a document published and issued by the Secretary of State following consultation with all holders of Gas Supply and Electricity Supply Licences.

20 **Section Two concerns our proposal for the level of the churn adjustment parameter in Year 2 of the new Framework.** We propose that this parameter be set at the highest level possible for the second year of the Framework, representing the most complete mitigation of the impact of customer-driven smart churn on supplier installation requirements. We consider that this most effectively meets our intentions for the churn adjustment at this stage of the Framework. The level of any churn adjustment for Year 3 and Year 4 will be considered and consulted on as part of the mid-point review of the Targets Framework, which the Government has confirmed will take place in 2023.

21 **Section Three details our decision not to bring forward proposals on an alternative approach where tolerance levels are not applicable.** In June 2021, we committed to bring forward proposals on an alternative approach to driving rollout activity for energy suppliers where tolerance levels are not applicable. However, following further consideration of the feasibility and proportionality for an alternative approach, we no longer intend to bring forward proposals at this time. The present document outlines our considerations in arriving at this decision.

Section One: Proposed revision to the formula for calculating minimum installation requirements

22 To implement the churn adjustment, we are proposing an amendment to the formula used to define the minimum installation requirement 'Ny' referred to in paragraphs 33A.2 and 39A.2 of the Standard Licence Conditions for Gas and Electricity respectively. We propose that the revised formula will be in effect from the second Rollout Year (2023) onwards for the duration of the Targets Framework. It will not apply to the minimum installation requirements for Year 1 (2022).

23 The proposed revised formula functions by introducing a variable churn adjustment parameter (β). This parameter applies a level of mitigation of the impact of customer-driven smart churn on a supplier's installation requirements and can be set at a value from 0 to 1. Setting this parameter at a value of 1 represents the most complete churn adjustment, whereby a suppliers' minimum installation requirements are based on their smart meter installation levels in the previous year. This means, in effect, that any smart customers gained or lost through customer-driven churn in Year 1 of the new Framework would be counted within a supplier's overall portfolio size for the following year (Year 2), but would not contribute to a supplier's smart penetration level in Year 2. A churn parameter of 0 represents no adjustment for churn. Any value in between will set a more partial adjustment, whereby a supplier's minimum installation requirements will reflect not only their smart meter installation levels in the previous year, but also to a degree the impact of smart churn during the previous year. The extent to which smart churn impacts on a supplier's installation requirements will depend on the exact value to which the churn adjustment parameter is set. As with the tolerance level for each rollout year (Ty), we propose to set the churn adjustment parameter through a document published and issued by the Secretary of State following consultation. Our proposal for the level of the churn adjustment parameter in Year 2 of the Framework follows in Section Two of this document.

24 The current formula, included in paragraphs 33A.5 and 39A.5 of these Standard Conditions is as follows:

$$\mathbf{Ny} = \left(\frac{\mathbf{1}}{\mathbf{a_y}}\mathbf{RSMS_y}\right) - \mathbf{Ty}$$

Definitions of the formula terms are provided in **Table 1** (paragraph 27) below.

25 In order to include an adjustment for churn, we propose to replace the formula in paragraphs 33A.5 and 39A.5 of the Gas and Electricity Supply Licences respectively with the following from the second Rollout Year onwards:

$$\boldsymbol{Ny} = \left(\frac{\mathbf{1}}{\boldsymbol{a_y}}\left\{\boldsymbol{\beta_y} * \left(\boldsymbol{TMS_y} - \left(\boldsymbol{S_1} + \boldsymbol{NQ_y}\right)\right) + \left(\mathbf{1} - \boldsymbol{\beta_y}\right) * \left(\boldsymbol{RSMS_y}\right)\right\} - \boldsymbol{T_y}\right)$$

Definitions of the formula terms are provided in **Table 1** (paragraph 27) below.

26 For the avoidance of doubt, the document referred to in **Table 1**, confirming the value of βy for the second Rollout Year, is intended to be the Government Response to this consultation.

27 An explanation of the components of the proposed revised formula is provided in **Figure 1** below. A simple worked example of how the new formula will function is provided in Annex A: Analytical Evidence (paragraph 26).

Table 1: Definition of terms in the current and the proposed revised formula to define an energy supplier's minimum installation requirements

Term	Definition
Ny	means the minimum installation requirement for the Rollout Year "y"
ay	means a number used to calculate a proportion which for Rollout Year "y" is equal to the number specified below: **Rollout Year** **Value of a**y First Rollout Year 4 Second Rollout Year 3 Third Rollout Year 2 Fourth Rollout Year 1
RSMSy	means the number of Qualifying Relevant Premises[7] at the beginning of the Rollout Year.
y	means each Rollout Year within the Framework
Ty	means a number representing a tolerance level, which shall have the value that is determined, or calculated in accordance with a methodology specified in a document published and issued by the Secretary of State for the purposes of Conditions 33A and 39A, following a consultation with all holders of Gas and Electricity Supply Licences.
βy	means a number representing a **churn adjustment parameter** in a range of 0.00 to 1.00 which will apply a level of mitigation of the impact of smart meter customers switching supplier on supplier installation requirements and which

[7] Qualifying Relevant Premises are defined as Domestic Premises or Designated Premises in respect of which the licensee is the Relevant Electricity Supplier and at which there is installed neither: (a) a Smart Metering System; nor (b) an Advanced Meter installed in accordance with the requirements of standard condition 39 (Smart Metering System – Roll-out, Installation and Maintenance), Energy supply licence conditions.

	shall have the value that is determined in a document published and issued by the Secretary of State for the purposes of Conditions 33A and 39A, following a consultation with all holders of Gas and Electricity Supply Licences.
TMSy	means the total number of premises (domestic and designated) (smart and non-smart) supplied by a supplier at the start of Rollout Year “y”
S1	means the total number of premises (domestic and designated) with a Qualifying Metering System (i.e. smart and advanced) that are the responsibility of the supplier at the start of the First Rollout Year
NQy	means the total number of premises (domestic and designated) at which a supplier has installed a Qualifying Metering System from the start of the First Rollout Year up to the date which immediately precedes the start of Rollout Year “y”

Figure 1: Revised formula to define an energy supplier's minimum installation requirements

$$Ny = \left(\frac{1}{a_y}\left\{\beta_y * \left(TMS_y - \left(S_1 + NQ_y\right)\right) + \left(1 - \beta_y\right) * \left(RSMS_y\right)\right\} - T_y\right)$$

Ny	Beta	Churn adjustment	Existing formula	Ty
A supplier's minimum installation requirement for Rollout Year y	β_y is a value between 0 and 1 determining the level of the **churn adjustment parameter**. This applies a level of mitigation of the impact of smart meter customers switching supplier on supplier installation requirements.	This section of the formula makes an adjustment for churn, whereby a supplier's minimum installation requirements are a function of their total portfolio minus the number of Qualifying Metering Systems that the supplier held within its portfolio immediately before the start of Rollout Year 1 and minus the number of cumulative smart meter installations that they have made from the start of Rollout Year 1 to the beginning of the relevant Rollout Year.	This is the existing formula contained within licence conditions, whereby a suppliers' minimum installation requirements are a function of the number of Qualifying Relevant Premises (premises in which no smart meter is installed) within their overall portfolio.	The T_y value is the tolerance value.

Section Two: Level of churn adjustment parameter for Year 2

Options assessment for level of churn adjustment parameter

28 We have considered two options for setting the value of the churn adjustment parameter (β) in Year 2:

- **Option 1:** The value of the churn adjustment parameter (β2) in Year 2 is set at **1**.
- **Option 2:** The value of the churn adjustment parameter (β2) in Year 2 is set at **0.5**.

29 Both options make an adjustment for in-year customer-driven smart churn in the calculation of Year 2 minimum installation requirements and thus mitigate the effect of churn in smart meter customers.

30 Option 1 will do this to a greater extent by implementing an adjustment whereby a supplier's minimum installation requirements are a function of:

- their portfolio minus:
    - the number of Qualifying Metering Systems that the supplier held within its portfolio immediately before the start of Rollout Year 1; and
    - the number of cumulative smart meter installations that they have made from the beginning of rollout Year 1 to the beginning of Rollout Year 2.

31 Under Option 2, a supplier's minimum installation requirements are a function of an **equal combination** of:

- the number of Qualifying Relevant Premises (premises in which no smart meter is installed) in their portfolio; and
- their portfolio minus:
    - the number of Qualifying Metering Systems that the supplier held within its portfolio immediately before the start of Rollout Year 1; and
    - the number of cumulative smart meter installations that they have made from the beginning of rollout Year 1 to the beginning of rollout Year 2.

32 Implementing either option would lead to a reduction in the minimum installation requirements of a supplier experiencing negative smart churn compared to their requirements under the current formula contained within licence conditions. In parallel, both options would lead to an increase in the installation requirements of a supplier experiencing positive smart churn compared to the current formula. Of the two options, Option 2 would lead to a smaller reduction in installation requirements for suppliers experiencing negative smart churn relative to the current formula, and a smaller

increase in installation requirements relative to the current formula for suppliers experiencing positive smart churn.

Minded-to position

33 We have considered the above options against the following two criteria:

- The extent to which they focus energy suppliers' obligations on the number of smart meters that they install in each rollout year; and
- The extent to which they ensure that suppliers that have achieved the highest levels of smart penetration (and therefore are most likely to experience negative smart churn) are not unfairly penalised.

34 On the basis of assessment against these criteria, our preferred option is **to set the churn adjustment parameter (β2) at a value of 1 for Year 2 of the Targets Framework (Option 1).**

35 Setting the churn adjustment parameter at 1 will deliver the objective of ensuring that a supplier's minimum installation requirements for Year 2 reflect the level of their smart meter installations in Year 1 only. Whilst we recognise that churn is a condition of the market, we do not consider that gaining smart customers through customer-driven churn should facilitate energy suppliers meeting their smart rollout obligation or should lead to lower installation requirements than they would expect based on their smart meter installation levels in the previous year. Such a position would be contrary to the Government's aim for the Targets Framework to drive new smart meter installations to deliver market-wide rollout. Under Option 2, churn in smart customers, although mitigated, would still affect a supplier's installation requirements in the following rollout year. We therefore consider that Option 1 more fully meets the aim for the churn adjustment and more effectively delivers the objectives of the Targets Framework.

36 Option 2, by making a mid-point level of adjustment, would lessen the impact of the churn adjustment on individual suppliers. The result would be that, while suppliers experiencing negative smart churn would see a reduction in their installation requirements relative to their position under current licence conditions, these requirements may still be higher than they would have expected based on their in-year installation levels. As it can be expected that those energy suppliers more likely to experience negative smart churn will be those with the highest current smart penetration, Option 2 would still in effect be detrimental to those suppliers that have progressed the furthest in their smart rollout to date.

37 Implementing the more complete churn adjustment of Option 1, on the other hand, will ensure that energy suppliers that have achieved the highest levels of smart penetration are not penalised with higher installation requirements as a result of being more likely to experience negative smart churn. Similarly, this level of adjustment ensures that energy suppliers with lower smart penetration levels do not have lower installation

requirements as a result of being more likely to experience positive smart churn. As set out above, one of the aims for the proposed churn adjustment is to prevent the unfair penalisation of energy suppliers that are the furthest ahead in delivering their smart rollout. Option 1 will deliver this more effectively than the partial mitigation provided under Option 2 and is, therefore, our preferred option.

38 At this stage, we propose to set the churn adjustment parameter at 1 for Year 2 of the new Framework only. This decision reflects the current progress of the smart meter rollout and the differing levels of smart penetration between suppliers. As the rollout progresses under the Targets Framework, we expect that a higher proportion of customers will have smart meters and differences in smart penetration between suppliers will reduce. We therefore propose to consider the level of any churn adjustment for Year 3 and Year 4 of the Framework as part of the mid-point review that we have confirmed will take place in 2023. This is consistent with our decision to only set the tolerance levels for the first two years of the Framework at this stage. The churn adjustment parameter for years 3 and 4 of the Framework will be consulted upon following the conclusion of the mid-point review.

39 We recognise that any value we set for the churn adjustment parameter in years 3 and 4 will affect the proportion of churn from both years 1 and 2 that is adjusted for in years 3 and 4, and so would take that into account in formulating our proposals.

Impact of churn adjustment in practice

40 The proposed churn adjustment will lead to higher minimum installation requirements for suppliers experiencing positive smart churn than they could expect under the current formula in licence conditions. We consider this is justified on the basis of supporting the Government's aim to drive delivery of market-wide smart rollout. The Targets Framework seeks to normalise smart meters, so they are the default meter used across the whole of Great Britain by all energy suppliers. This approach seeks to put all energy suppliers on a common-track to market-wide rollout, reducing the current disparity in smart penetration between them. The proposed churn adjustment therefore resolves a current inconsistency whereby suppliers that are ahead of market average in their smart rollout may see comparatively higher installation requirements as a result of smart churn and those that are behind market average may see comparatively lower requirements. By redressing the balance of this impact, the proposed churn adjustment seeks to support the delivery of market-wide rollout of smart meters across all suppliers.

41 It is our assumption that in a business-as-usual market energy suppliers can, to a considerable extent, predict and plan for the volume of customers that they gain through customer-driven churn. This is because any gains made at scale, outside of the Supplier of Last Resort (SoLR) process, are likely to result from active consumer engagement strategies. We therefore expect that suppliers will be in a position to adequately predict and prepare for their minimum installation requirements in Year 2 after the proposed

churn adjustment has been implemented. The position of customers gained through the SoLR process under the proposed churn adjustment is outlined below.

42 Further details on our assumptions regarding customer-driven smart churn during Year 1 of the new Framework and the impact of the proposed churn adjustment on energy suppliers can be found in Annex A: Analytical Evidence. Feedback that we receive in response to this consultation will be used to inform our evidence base and our final approach for the churn adjustment. We will publish the analytical considerations informing our final approach alongside the Government Response to this consultation.

Questions

1. Do you agree that we should make an adjustment to mitigate the impact of customer-driven smart churn on an energy supplier's minimum installation requirements? Please provide rationale for your answer, supported with relevant evidence.

2. Do you agree that the proposed revised formula to calculate minimum installation requirements set out in paragraphs 25 to 27 implements the churn adjustment proposal described in this consultation? Please provide rationale for your answer, supported with relevant evidence.

3. Do you agree with our proposed approach to make the more complete churn adjustment in Year 2 of the new Framework (i.e.to set the churn adjustment parameter (β2) at a value of 1)? If not, what level of adjustment do you think is appropriate? Please provide rationale for your answer, supported with evidence.

4. Do you agree with the assumptions made in Annex A: Analytical Evidence about levels of customer-driven smart churn during Year 1 of the new Framework and the impact of the churn adjustment in Year 2? Please provide rationale for your answer, supported with relevant evidence.

The Supplier of Last Resort (SoLR) process

43 The proposed churn adjustment seeks to mitigate the impact of customer-driven churn of smart meter customers. Whilst business-as-usual churn results from customer choice in a dynamic energy market, customer acquisition can also take place via the Supplier of Last Resort (SoLR) process. We recognise that there has been a significant number of supplier exits following the recent rise in wholesale gas prices and several suppliers have taken on customers through the SoLR process.

44 Customers gained through the SoLR process prior to the start of the new Framework (up to and including 31 December 2021) will be counted within a suppliers' overall portfolio and their number of Qualifying Relevant Premises (RSMSy), affecting Year 1 minimum installation requirements. We are not making any changes to this approach.

45 The same approach would apply within the revised formula set out above. Therefore, customers gained through the SoLR process in Year 1 of the new Framework would be counted within a supplier's overall portfolio (TMSy) for the following year (Year 2). Similarly, under the churn adjustment, any smart metering points (Qualifying Metering Systems) that were the responsibility of a failed supplier at the start of Year 1 of the Framework (S1) would be included within the equivalent figure for the gaining supplier in the following rollout year (Year 2). Smart meters (Qualifying Metering Systems) installed by a failed supplier (NQy) would be included within the relevant installation total for the gaining supplier in Year 2. We would, however, welcome views on this position.

46 We recognise that gaining customers through SoLR will continue to influence energy suppliers' minimum installation requirements for subsequent years, as it will increase their overall customer base. Whilst any supplier failing to meet its minimum installation requirements under the new Targets Framework will be in breach of its licence, Ofgem's subsequent decisions on enforcement action, and any resulting penalty, will be taken in line with their enforcement guidelines. Ofgem will, as set out in their guidelines, assess a wide range of factors in making those decisions. For example, in deciding whether to pursue action against suppliers who missed their annual milestones under the ARS framework, Ofgem had overall regard to:

- The point at which the supplier became aware that it was tracking behind in terms of meeting one or both of its milestones;
- What actions the supplier took to try to mitigate the impact of the issues the supplier was experiencing; and
- The extent to which the issue was within of the supplier's control.

47 In recent years, under the ARS obligation, Ofgem has considered this issue when energy suppliers, as a result of taking on SoLR customers late in the year, have missed their annual milestones. In those instances, Ofgem has engaged with the energy suppliers in question to find a pragmatic approach to reporting and has taken their specific circumstances into account when making any decisions on enforcement. Ofgem will continue to enforce the new Framework in line with its enforcement guidelines.

Legal text

48 Implementation of the proposed churn adjustment will require amendments to the formula included in conditions 33A and 39A of Standard Licence Conditions for Gas and Electricity respectively. Annex B sets out our proposed amendments to the Standard Licence Conditions for Gas and Electricity in order to implement the policy proposals outlined in this consultation.

Questions:

5. Do you agree that the legal drafting in Annex B implements the policy intention proposed in Section One and Section Two of this document? Please provide rationale for your answer.

Section Three: An alternative approach where tolerance values do not apply

49 In the June 2021 Government response, we noted that we would bring forward proposals on an alternative approach to driving rollout activity for energy suppliers where tolerance levels are not applicable.[8] For instance, for energy suppliers with smart coverage sufficiently high that they have annual minimum installation requirements equalling zero in the first two Framework years (2022 and 2023).

50 We have since investigated the feasibility and proportionality of options for an alternative approach to drive rollout for energy suppliers in the circumstances outlined above. We are now confirming that we will not be bringing forward proposals to consultation at this time. This follows careful consideration of the options available and analysis of the number of energy suppliers likely to be affected by an alternative approach and the implications of introducing an approach that would apply market wide. Based on this analysis, we expect only a small number of energy suppliers to be in a position to have zero installation requirements in the first two years of the Framework. Consequently, we expect that an additional regulatory obligation for such suppliers would provide limited benefit in driving the rollout at this time. We therefore consider it would be disproportionate to bring forward proposals at the current moment. The New and Replacement Obligation will continue to apply to all energy suppliers, including those that have zero installation requirements under the Targets Framework.[9] Suppliers in this position will, therefore, continue to have obligations regarding smart installations throughout the duration of the Framework.

51 It should be noted that this decision reflects the position of the market at the current time. We will continue to consider the proportionality and desirability of an alternative approach for suppliers where tolerance levels are not applicable as the rollout progresses under the new Framework and will retain the option to bring forward proposals at a later stage should evidence suggest it would be prudent to do so.

[8] Smart meter policy framework post 2020: minimum annual targets and reporting thresholds for energy suppliers
[9] The New and Replacement Obligation requires energy suppliers to take all reasonable steps to install a compliant smart metering system where a meter is replaced or installed for the first time. Electricity Supply Standard Licence Condition (SLC) 39.7 to 39.9; Gas Supply SLC 33.7 to 33.9.

Summary of questions

1. Do you agree that we should make an adjustment to mitigate the impact of customer-driven smart churn on an energy supplier's minimum installation requirements? Please provide rationale for your answer, supported with relevant evidence.
2. Do you agree that the proposed revised formula to calculate minimum installation requirements set out in paragraphs 25 to 27 implements the churn adjustment proposal described in this consultation? Please provide rationale for your answer, supported with relevant evidence.
3. Do you agree with our proposed approach to make the more complete churn adjustment in Year 2 of the new Framework (i.e.to set the churn adjustment parameter (β2) at a value of 1)? If not, what level of adjustment do you think is appropriate? Please provide rationale for your answer, supported with evidence.
4. Do you agree with the assumptions made in Annex A: Analytical Evidence about levels of customer-driven smart churn during Year 1 of the new Framework and the impact of the churn adjustment in Year 2? Please provide rationale for your answer, supported with relevant evidence.
5. Do you agree that the legal drafting in Annex B implements the policy intention proposed in Section One and Section Two of this document? Please provide rationale for your answer.

Next steps

52 Stakeholders and other interested parties are invited to provide their views on the Government's proposed approach and, more specifically, the questions set out above.

53 This consultation closes at 12:00 on 20 January 2022. Details on how to respond to this consultation have been provided in the General Information section of this document.

54 Once the consultation closes, we will consider all responses before publishing the Government Response in due course. The Government Response will be published to provide sufficient notice to energy suppliers of their minimum installation requirements for Framework Year 2 (2023).

Annexes

Annex A: Analytical Evidence

Annex B: Proposed Amendments to Electricity Supply Standard Licence Condition 39A and Gas Supply Standard Licence Condition 33A

This consultation is available from: www.gov.uk/beis

If you need a version of this document in a more accessible format, please email enquiries@beis.gov.uk. Please tell us what format you need. It will help us if you say what assistive technology you use.