Peter Hill
Energy Prepayment Review
Competition and Markets Authority
Victoria House (6th Floor South East)
37 Southampton Row
London
WC1B 4AD

SSE
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Sent by email: Remedies.reviews@cma.gov.uk

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[redacted]

Dear Peter

SSE response to CMA provisional decision on review on the Energy Market Investigation (Prepayment Charges Restriction) Order 2016

SSE welcomes the opportunity to **help inform the CMA's decision** on the proposed variation of the Prepayment Charges Restriction (PCR) Order.

SSE is supportive of the majority of changes put forward to ensure that the Prepayment Meter (PPM) Cap more accurately reflects costs incurred by efficient suppliers. We agree with the **CMA's conclusion that the most effective way to vary the Order is to adopt Ofgem's Default** Tariff Cap (DTC) methodology and fully support having this change implemented in time for the October 2019 revision of the price cap.

While SSE welcomes this overall change to the PPM cap methodology, we have concerns in the following areas;

- The proposal to exclude non-pass through smart meter costs does not align to the approach taken by Ofgem for the DTC and we believe a restriction on the recovery of smart costs could have a detrimental impact on the pace of future smart meter rollout.
- The current prepayment meter uplift has been retained and SSE believes a further review would be appropriate after the methodologies have been aligned and in preparation for the introduction of any future PPM charge restriction.
- We are concerned that aligning EBIT/headroom methodology with DTC reduces this allowance and may reduce competitiveness in the market.
- Changes to the interoperability status of SMETS1 prepayment meters presents significant operational challenges and we request further consultation with the CMA on its proposed approach.

Additionally, SSE would like to raise recovery of BSUoS costs, whilst it may not be directly relevant to this consultation, if the objective of the change is to be more cost reflective then there is a further point to be raised. SSE is concerned that there has been an increase in the level of Balancing use of system (BSUoS) costs over the past 6-12 months that cannot be fully recovered under the DTC methodology and there should be mechanisms in the cap to take into account known changes to costs calculations.

Further information can be found in Annex 1. We would be happy to discuss the points made in our submission in more detail if helpful.

Yours sincerely

Brian Clark
Regulation Manager

Annex 1

Removal of non-pass through costs for smart metering

SSE does not see justification for excluding the costs incurred through smart rollout operations from the PPM cap and we believe the cost recovery from smart should be applied to all customer segments protected under a price cap. Ofgem's DTC methodology provides an allowance for these costs to be shared equally over the entire customer base that are covered by its cap and we believe this approach should be mirrored in the PPM cap methodology. For the DTC, Ofgem explained its view on including smart costs; "In the default tariff cap, we do not have any specific exemptions for default customers with a smart meter and therefore we consider the cost across all consumers under the default tariff cap."[1] Aligning cap methodologies will ensure that, regardless of having a smart or traditional meter, a customer will equally share the burden (as well as any future benefits) of the industry's smart costs and suppliers will be able to recover the specific costs associated with rollout operations from all customers protected under a price cap.

We would also urge the CMA to consider the impact that this proposal could have on future smart meter rollout and any disincentives it could have for customers to adopt a smart meter. The successful and timely completion of the smart meter rollout programme underpins a much wider regulatory energy strategy for Great Britain and the removal of this allowance places constraints on the activities a supplier can undertake to be able to demonstrate 'all reasonable steps' within the current framework. Given the wider importance of smart across the policy landscape and considering the delays and disruption to which the smart rollout programme has already been subjected, we believe it is now crucial to maintain momentum and for this reason include an allowance to recover future smart rollout costs for PPM customers within the PPM cap.

Furthermore, we are concerned that over time as smart rollout cost increases are reflected in the DTC but not the PPM cap, the cap levels will converge (as illustrated in tables 1 – 3 below). This is more evident with electric single rate meters and when a customer's consumption is higher. In the period examined, our forecasts predict that the consumption level at which (direct debit) DD and PPM cap levels cross moves

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This is a significant shift and as we have stated in previous submissions (SSE 15/03/19, annex 1, p 11-12), a lower cap for PPM creates a disincentive for customers to have a smart PPM fitted and potentially undermines smart take-up. As the CMA recognised during the Energy Markets Investigation (EMI), the installation of smart PPM will overcome the lack of competition (due to technical restrictions) for PPM customers. Therefore, to ensure there is effective competition for these customers it is essential that they are not disincentivised to install smart meters.

[1]https://assets.publishing.service.gov.uk/media/5c6adf7840f0b61a196aa83f/Ofgem_s_response_to_ITC_Redacted.pdf

The CMA will also be aware that Ofgem has started to review the smart metering cost component of the Default Tariff Cap and this could provide an opportunity for a more detailed assessment of the PPM smart meter cost allowances. If Ofgem were to take on this responsibility ahead of the cap period starting April 2020, it would have time to conduct additional information gathering and consultation required to ensure the allowance accurately reflects the costs suppliers incur in delivering this high profile and critical government programme.

Retaining the current PPM uplift

SSE fully supports the CMA's decision to align the PPM cap to the DTC methodology and agrees that this change should be implemented ahead of the next cap period. However, we note that the CMA has decided to retain the current PPM uplift and did not consider this an appropriate time to carry out an assessment of the uplift due to the delayed roll-out of smart meters. While we are understanding of the factors that have led to this decision, SSE remains of the view that the PPM uplift allowance should more accurately reflect the costs to serve this segment of customers (**please refer to SSE's response to the CMA's Statement of** Issues, annex 1, p11-12). For the reasons above, SSE believes that the value of the uplift should be kept under review and further consultation would be appropriate after the methodologies have been aligned and advance of any decision to extend protection beyond October 2020. **This could be undertaken in accordance** with **the CMA's provisional recommendation that** Ofgem consider any future changes in circumstances in light of the original aims of the PPM cap when setting the level of any replacement charge restriction.

Aligning EBIT/headroom methodology with DTC

The calculations of EBIT and Headroom differ between the two caps, as we have detailed in our previous responses (Appendix 1 to SSE CMA response page 14). By applying the DTC methodology, there would be a net decrease in the total allowance for a TDCV dual fuel customer of c £8. This will vary depending on both the level of consumption and the relevant costs within each cap period. This reduction may reduce the level of competition for these customers (which would go against the original rationale for the level included).

We believe that the EBIT and Headroom methodologies should be reviewed at a suitable time. **This could also be undertaken in accordance** with **the CMA's provisional recommendation** that Ofgem consider any future changes in circumstances in light of the original aims of the PPM cap when setting the level of any replacement charge restriction.

Treatment of SMETS1 meters

SSE notes that SMETS1 smart meters will be excluded from the PPM cap when the CMA considers that a particular category of SMETS1 satisfies the definition of being fully interoperable. We understand from the CMA's Explanatory Note that a direction will be issued by the CMA upon identifying any such category of meter as an "Excluded Smart Meter" and in cases where these customers remain on a default tariff, suppliers will have to apply Ofgem's direct debit cap (under the DTC).

SSE anticipates that this will be a very complex process to design, implement and manage. We feel very strongly that further consultation with the CMA and other key industry stakeholders is required so we can fully understand the operational risks and agree an approach that works for all concerned. Key points for us include; the process the CMA intends to follow when issuing a direction, impacts to the enrolment timeline if proposing to combine these processes, the immediate expectations upon DCC enrolment (both where successful and unsuccessful), the lead times for protecting customers under Ofgem's DTC and the most suitable approach for communicating this change to customers. First and foremost, we are committed to designing an effective and efficient process, that is fit for purpose and completely transparent for our customers. There are considerable complexities associated with DCC enrolment and we feel the most suitable approach is to allow an appropriate amount of time for successful enrolment onto the DCC before changing the status of the meter and applying the DTC.

Recovery of BSUoS Costs

As a separate point SSE would like to raise recovery of BSUoS costs. As discussed earlier this point may not be directly relevant to this consultation but if the objective of the change is to be more cost reflective then there is an additional issue to be raised. Over the past 6-12 months we have observed an upwards step change in BSUoS charges. We have seen a significant increase as a result of an update to the ROII-ET1 Price Financial Control Model; an increased expectation of RoCoF (Rate of Change of Frequency) costs; an increased forecast of thermal constraints over the next 2 years. We are concerned that this cost increase cannot be fully recovered under the DTC methodology given the lag in the recovery of BSUoS charges*. We believe a mechanism is required to take into account known changes to calculations that result in step changes to costs. This will align closer with the DTC cap principles ensuring transparency for customers and react to price moves both up and down which the current mechanism does not.

*For each cap period, prior year BSUoS charges are combined to calculate a weighted average annual BSUoS charge. For summer caps, BSUoS charges over the prior year running from 1 January to 31 December are used. For winter caps, charges over the prior year running from 1 July to 30 June are used.