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**2 March 2021**

Dear Anna

We are writing in response to your working paper on smart meter rollout and the default tariff cap. This submission is non-confidential and may be published on your website.

The working paper poses two substantive choices regarding what smart meter rollout profile should be used in setting the Smart Metering Net Cost Change (SMNCC) allowance within the cap:

- Whether the starting point for the allowance should be based on the average supplier, or a market leader supplier (eg the supplier whose rollout profile generates the highest SMNCC)
- Whether the rate of rollout from that point should be estimated based on BEIS's policy ambition of 100% rollout by June 2025 (a 'target approach'), or in line with suppliers' minimum installation requirements (a 'tolerance' approach)

In combination, these two choices give four possible options for setting the SMNCC, with the average supplier and tolerance approach combination ('Option A') resulting in the lowest costs to consumers, and the market leader supplier and target approach combination ('Option D') resulting in the highest costs.

We have a strong preference for Option A, and do not think that any of the other three options is justifiable.

**The choice of whether to base the starting point on the average supplier or a market leader (in the rollout of smart meters) supplier**

We recognise that the Domestic Gas and Electricity Tariff Cap Act 2018 only allows Ofgem to set a single cap for all suppliers, and does not allow it to reflect their individual circumstances. Because of this, it will imperfectly reflect the efficient cost base of any given supplier.

Within those constraints, the average supplier is, by definition, more likely to be representative of the market than those at either extreme. The average may under-estimate the costs of some, and over-estimate those of others, but it is not

systematically biased in either direction. Choosing to use a market leading supplier would be.

The case for using a market leading supplier appears to be predicated on a concern that suppliers may be discouraged from exceeding the average rollout if funding does not exist for doing so. There is some logic to this argument, but it is arguable on a number of grounds.

Firstly, because, as you acknowledge, smart meter rollout is more advanced among the large legacy suppliers who are likely to have significant volumes of price-capped consumers than it is among smaller suppliers who are likely to have fewer price-capped consumers.<sup>1</sup> This suggests that the price cap is not acting as a handbrake on smart meter rollout.

Secondly, because the decision to exceed the average profile is a voluntary one. While the consultation document frames doing so solely as a disadvantage to suppliers because it may result in them incurring higher costs, it fails to recognise that there may be advantages in doing so, for example, improvement in customer service (and the associated branding advantages that has)<sup>2</sup>, efficiencies in terms of billing and meter reading, and early growth in smart markets before they become more crowded.

Thirdly, as you highlight, 'there is no guarantee that suppliers would spend any additional revenue on smart metering.' A higher allowance may simply be spent elsewhere, or not spent at all.

Finally, the price cap is meant to be challenging. Its implementation was intended to tackle the significant detriment that the CMA found in its 2014-16 energy market investigation. It does not seem credible to base the costs of any component of the cap upon the highest levels incurred in the market. That will not protect consumers. It would be unwelcome at any time, and would be particularly unwelcome as the economy, and households, are trying to recover from the unprecedented economic distress caused by the pandemic.

We note that the existing cap methodology uses a rollout profile reflecting average installation progress across suppliers. While you have set out a theoretical case for why this might discourage smart meter rollout, you have provided no evidence to support that case. You also have not quantified the consumer impact of changing from an average supplier model to a market leader model. In our view, you have not made the case for moving away from that model.

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<sup>1</sup> Paragraph 2.5.

<sup>2</sup> [Research conducted by Accent on behalf of Ofgem and Citizens Advice](#) suggests consumers with smart meters report consistently higher satisfaction than those without.

**The choice of whether to base the end point on an assumption that smart meter rollout will reach 100% by June 2025 (the 'target' approach), or in line with suppliers' minimum installation requirements (the 'tolerance' approach)**

In our view, the tolerance approach is far more credible than the target approach.

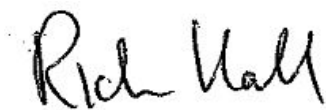
The principal reason for this is that the minimum annual targets that BEIS has set for its new smart meter policy framework are legally enforceable - but the 100% target is not. We think it is more likely that suppliers will work towards a legal compliance target than towards a departmental aspiration. In and of themselves, the existence of the minimum annual targets is a recognition that 100% rollout may be very challenging, and possibly impossible under the current rollout framework.

Put simply, the tolerance approach is more likely to reflect what suppliers actually do than the target approach is. It is therefore more reasonable to base consumer funding on that model.

We recognise that considerable uncertainty remains on the smart meter rollout and that suppliers may exceed their minimum targets (although equally they may fall short, notwithstanding their legal obligations). But we think the way to allow for the possibility of outperformance that needs to be funded would be to conduct a further review of progress in perhaps one year's time, rather than setting a target of working towards 100% rollout now. As previously highlighted, we do not consider that Ofgem has demonstrated evidence within this consultation that the price cap is hampering smart meter rollout, and we would expect any future review to provide significantly better evidence to substantiate such an argument than has been brought forward on this occasion if a case for lifting the allowance is to be made.

We trust that this submission is helpful, and would be happy to discuss the issues that it raises further.

Yours sincerely



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Chief Energy Economist