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# Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

## Policy decision

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### Overview:

In December 2011 we completed our consultation on the Review of Metering Arrangements (ROMA) and also consulted on our proposed changes to the regulatory framework for gas traditional metering to facilitate an efficient transition to smart meters. We are now confirming plans to proceed with our preferred approach to a) place an obligation on National Grid to offer terms to provide metering services to other GDNs in certain circumstances and b) to initiate a process to review, and if necessary amend, the associated regulated metering tariffs.

These plans relate to the regulation of certain 'traditional' gas meters, ie the meters that will be replaced over time by smart meters. It therefore complements the work of the Department of Energy and Climate Change (DECC) Smart Meter Implementation Programme (SMIP), and the work of Ofgem in developing the regulatory framework for early, voluntary rollout of smart meters by some energy suppliers.

## Context

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The government is mandating the rollout of smart meters to all domestic and smaller non-domestic gas and electricity customers in Great Britain. This will be achieved via licence obligations on suppliers to install smart meters in respect of such customers by a specified date, currently expected to be in 2019.

The rollout of smart meters will result in the replacement of all existing traditional (non-smart) meters and therefore will change the dynamics of this market. It is important to ensure that the regulatory framework for traditional meters is fit for purpose in light of smart metering which is due to be complete by the end of 2019.

The provision of traditional meters is likely to continue up until a point when the suppliers are required to install smart meters under the new and replacement licence conditions. It is also likely that traditional metering services (mainly in the form of maintenance) will continue to be required even when suppliers are rolling out smart meters. Therefore in the transition to 2019 it is important that traditional metering services remain available as the economies of scale to serve these meters will change.

## Associated documents


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- Consultation responses to the Review of Metering Arrangements: Decision and consultation on transition to smart meters (175/11)  
[Published alongside this document](#)
- Review of Metering Arrangements: Decision and consultation on transition to smart meters (175/11)  
<http://www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/ROMA%20Final%20Decision.pdf>
- Review of Metering Arrangements - Initial Findings and consultation on proposed metering industry remedies (162/10):  
<http://www.ofgem.gov.uk/Markets/RetMkts/Metrng/Comp/Documents1/ROMA%20Consultation%20Document.pdf>
- Review of Metering Arrangements Open Letter and Scope Letter:  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Markets/RetMkts/Metrng/Comp>

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## Executive Summary

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This document sets out our final decision, following our December 2011 consultation<sup>1</sup>, to place an obligation on National Grid to offer to provide metering services to other GDNs in certain circumstances. It also sets out our decision to review whether the current regulated gas metering tariffs are appropriate and to invite National Grid to develop, in consultation with stakeholders, initial proposals for these tariffs. We are also consulting on specific issues that we consider it appropriate for National Grid to address during its consultation.

The decision is intended to support an efficient transition away from traditional meters (ie the meters that will be replaced over time by smart meters) in respect of the role played by regulated providers of gas metering services. It therefore complements the work of the Department of Energy and Climate Change (DECC's) Smart Meter Implementation Programme (SMIP), and the work of Ofgem in developing the regulatory framework for early, voluntary rollout of smart meters by some energy suppliers.

### **Objective**

The government has mandated that suppliers roll out smart meters to all domestic and small non-domestic customers by the end of 2019. This decision will be implemented through the inclusion of new obligations in the gas and supply licences.

The objective of this related work is to ensure that the regulatory framework that affects how traditional metering services are provided continues to be fit-for-purpose. The obligation for electricity distribution networks operators to provide meters at the regulated tariffs were lifted in 2006. However, at that time we were not convinced that the market conditions supported gas metering competition. Although competition has been successfully established in the market for electricity meters, the majority of gas meters are still owned and operated by the Gas Distribution Networks (GDNs) and subject to price controls.

### **Transition from traditional to smart meters**

The rollout of smart meters will change the nature of some of the activities undertaken under the current regulatory framework in relation to gas meters. We have therefore considered whether the current arrangements will continue to operate in the interests of consumers as the provision of traditional metering services becomes a smaller, more marginal activity.

For regulated gas meters, we have decided that customers will be better protected through some changes to the regulatory framework around the provision of metering

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<sup>1</sup> Review of Metering Arrangements: Decision and consultation on transition to smart meters (175/11)  
<http://www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/ROMA%20Final%20Decision.pdf>

services by Gas Distribution Networks (GDNs). These changes are appropriate to reflect that the provision of traditional metering is a declining activity. We are not proposing any changes to the regulatory framework for electricity meters.

## Final decisions

In the December 2011 document we consulted on our preferred approach for managing the transition, and we now set out below our decisions following on from this consultation.

- **The introduction of a national back stop metering provider of last resort (B-MPOLR):** We have decided to place a licence condition on National Grid to offer terms to provide traditional metering services to other GDNs, This obligation will operate for a defined period of time to ensure that a) meters are available during the transition to smart meters and b) at an efficient price.
- **Gas metering price controls:** We have decided to initiate a process to review the regulated metering tariffs that have operated since 2002 and will be asking National Grid to develop initial proposals for this review in consultation with stakeholders. We have also identified key questions and factors that we expect National Grid to address in developing their overall proposal, based on our analysis of the current arrangements.
- **Emergency metering services:** We have decided that the existing arrangements for traditional meters are appropriate and that market based solutions are likely to deliver the best outcome for consumers. We have decided to disaggregate Post Emergency Metering Services PEMS into two distinct policy areas. These are a) the provision of PEMS for traditional metering and b) the provision of PEMS for smart meters.

We have analysed a range of options, including continuation of the prevailing regulatory arrangements – and our analysis has taken account of responses to our December 2011 document. We have also carried out financial analysis of National Grid’s metering business which has formed an important part of our evidence base; this can be found in Chapter 3.

## Next steps

We are seeking views on the implementation of our final decisions as set out in Chapter 2 of this document, by 5th September 2012. In parallel to this consultation we formally invite National Grid to set out a clear plan for taking this review forward such that any necessary changes can be implemented in a timely manner.

# 1. Update on policy development

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## Introduction

1.1. This document sets out our final policy decisions associated with managing the regulatory framework in the transition to smart metering. In our December 2011 document<sup>2</sup> we identified and consulted on a series of policy questions and recommendations relating to the efficient functioning of the gas metering market in the transition to smart meters. This document focuses on the decisions we have taken to change elements of the regulatory framework to facilitate an efficient transition to smart meters.

1.2. In particular this document sets out the obligation on National Grid to manage certain metering functions and services that are important in ensuring that:

- a. traditional meters remain available throughout the transition; and
- b. to conduct a review of the gas metering tariffs that have operated since 2001.

1.3. We also set out our decision with respect to emergency metering services.

## Background

1.4. Metering competition was introduced in 2006 for the electricity market and has been slow to develop in the gas metering market. A key feature of the gas metering market is that meters are provided by the GDNs under regulated obligations and price control, with National Grid holding a significant market share. We therefore need to ensure that the regulatory framework and obligations are fit for purpose in the transition to the rollout of smart metering.

1.5. In our December 2011 document we set out a number of proposals which included three main options (summarised below) for managing the transition with respect to the provision of regulated metering services. As the economies of scale decline the number of traditional meters will be more costly to provide.


- **A - Status Quo:** No changes to the regulatory framework; therefore GDNs would continue to provide and maintain meters<sup>3</sup> at the regulated tariffs<sup>4</sup> as set in 2001. They would continue to be required to provide a meter (domestic credit and pre-payment meters) when requested to do so by a supplier – this is known as the meter provider of last resort (MPOLR) obligation.

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<sup>2</sup><http://www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/ROMA%20Final%20Decision.pdf>

<sup>3</sup> Standard Special Condition A10: Provision and Return of Meters

<sup>4</sup> Special Condition E19: Restriction of prices in respect of tariff capped metering activities



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- **B - Sunset MPOLR:** Under this option the MPOLR obligation on GDNs would be removed as of a specified date. The date on which this obligation would cease to have effect would be linked to the point in time when suppliers are obliged to install smart meters for all new and replacement meters.
- **C - Backstop MPOLR:** This option involves placing an obligation in the licence of one GDN to provide meters on request of another GDN. The GDN on whom this obligation relates would be known as the 'National Metering Manager'. The meters installed under this obligation would then be owned and maintained by the back-stop MPOLR (B-MPOLR) in line with regulated tariffs. In addition, Ofgem considered that it may be appropriate for the B-MPOLR to be obliged to offer terms to GDNs for maintenance of GDNs existing meter stock. We also considered whether the obligations on the B-MPOLR should extend to the provision of post emergency metering services (PEMS).

1.6. The December 2011 document further consulted on a range of options for ensuring that the metering services were delivered in an efficient manner, which included.

- **Option 1 – Charging consultation:** This option proposes that NGG continues to operate under the existing metering price control tariff, whilst also taking on the additional responsibility of providing the B-MPOLR service.
- **Option 2: Price control review of tariff cap:** This option would include a full metering price control. This could result in the resetting of the parameters of the price control or the inclusion of an adjustment mechanism that would change NGG's price control in certain circumstances.

1.7. In the December document we set out that our preferred policy option was for the B-MPOLR to be coupled with a detailed pricing consultation.

## Outline of our decision

1.8. We have carefully considered the response to the consultation and also carried out further analysis of National Grid's financial performance to ascertain their performance in understanding how this relates to the scale and scope of the B-MPOLR role.

1.9. We have decided to place an obligation on National Grid to operate the B-MPOLR and also to undertake a review of the regulated metering tariffs. We consider that these changes to the current regulatory model will facilitate an efficient transition to smart meters for the regulated gas metering market. We set out our



supporting evidence and rationale for making the final decisions in greater detail within Chapter 3.

## **Related Work Areas**

1.10. In the 2011 December document we also sought views on the future of Post Emergency Metering Services (PEMS). We sought views on whether it was appropriate to require the B-MPOLR to carry out these services for traditional metering and also on the future of PEMS as smart meters are rolled out.

1.11. We have decided to disaggregate PEMS into two distinct policy areas a) the provision of PEMS for traditional metering and b) the provision of PEMS for smart meters.

1.12. We set out the financial supporting evidence and our rationale for making the final decisions in greater detail within Chapter 3.

## **Structure of this document**

1.13. Chapter 2 sets out Ofgem's final decision with respect to the regulatory framework for managing the transition, and also defines the scope and duration of key functions for the B-MPOLR. It also sets out the role for GDNs and how any new metering tariffs are to be applied.

1.14. Chapter 3 sets out the background to the financial regulation of GDNs with respect to metering services. It also provides our analysis of the current tariffs and implications for domestic and industrial and commercial (I&C) metering services into the transition to smart metering. This analysis identifies key questions and factors that we expect National Grid to address in developing their overall proposal.

1.15. Chapter 4 sets out the respondents views to the questions that we raised in our December 2011 document and Ofgem's position. This is an important part of the evidence base for us taking forward our final decisions.

1.16. Chapter 5 sets out the next steps for taking forward the metering price control review and features of the B-MPOLR role. It highlights the key milestones, roles and responsibilities in providing the industry with certainty and transparency about how we will take this work forward.

## 2. Final decisions

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### Chapter Summary

This chapter sets out our final decisions and reasoning in respect of the regulatory framework for the transition to smart meters and highlights the key points that stakeholders raised.

These decisions relate to the obligations on GDNs to provide metering services and the regulation of charges for these services.

### Summary of decisions

2.1. In this section we set out the following final decisions for the transition to smart metering in the following areas:

- **Operation of the B-MPOLR** – We have decided that National Grid shall provide meters on behalf of other GDNs (the B-MPOLR<sup>5</sup>). We have decided to invite National Grid to operate the B-MPOLR<sup>6</sup> for metering services through the transition to smart metering. We also set out key features of their service obligations.
- **GDNs' MPOLR Obligation** – The existing obligations for GDNs to provide meters under the MPOLR obligation will be switched off when the suppliers' obligation to provide smart meters for new and replacement meters is activated by the Secretary of State.
- **Detailed charging consultation** – We invite National Grid to undertake a review of the metering tariffs in consultation with interested parties, prior to making a recommendation to Ofgem.
- **Emergency metering services** – We have decided that the existing commercial arrangements are appropriate for traditional metering and that we will consider emergency metering separately for smart meters.

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<sup>5</sup> This new obligation would enable GDNs to contract with the regulated National Metering manager, to discharge their MPOLR obligations.

<sup>6</sup> The GDNs are obliged by their licence to provide meters at the regulated tariff when requested to do so by a supplier.

## Operation of the B-MPOLR

### Decision

2.2. We have decided to place a licence condition upon National Grid to operate the B-MPOLR.

2.3. The B-MPOLR obligation would require National Grid to meet any reasonable request by a relevant GDN to provide, install and maintain a domestic traditional gas meter. We intend to time limit the obligation and include a sunset clause to be compatible with the suppliers New and Replacement Obligation to install smart meters<sup>7</sup>. This approach would therefore limit the numbers of meters that the B-MPOLR would be required to install throughout the transition period.

2.4. We have decided not to require the B-MPOLR to install meters under the post emergency metering service arrangements. However if the B-MPOLR decides to offer this service it is free to do so under commercial terms. We have decided that the meters that have been installed under a PEMS activity should be eligible to be enrolled into the B-MPOLR portfolio for the purpose of ongoing maintenance and we would expect the costs associated with such activity to be in accordance with the regulated price tariffs.

2.5. We recognise that certain market participants may wish to transfer their metering assets to the B-MPOLR for the purpose of maintenance activities and would expect the B-MPOLR to facilitate such a transfer on a fair market commercial rate and non-discriminatory basis.

2.6. We have decided that the charges for services provided for under the B-MPOLR should be subject to a maximum tariff cap. We will continue to monitor this activity to ensure that the licensee does not set charges for each of its metering activities above this tariff cap.

2.7. We propose to set out these obligations in a special licence condition which will be consulted upon in the summer 2013 as a part of the ongoing price control consultation. The process and timing for conducting this consultation is set out in Chapter 5.

### Our reasoning

2.8. In the context of the transition from traditional to smart metering our proposed actions provide clarity with respect to the GDNs' obligations to provide meters. We consider that this is important for investors and stakeholders. It also removes a risk of GDNs being obliged to carry out activities that (e.g. provides and

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<sup>7</sup> <http://www.decc.gov.uk/assets/decc/11/consultation/smart-metering-imp-prog/4965-gov-resp-cons-tech-spec-smart-meters.pdf>

maintain a diminishing portfolio of meters) they are not in a position to do efficiently, which in turn could inflate costs to consumers due to diseconomies of scale.

2.9. Creating the B-MPOLR is a better solution than the current arrangements because it will provide an alternative option for GDNs with respect to the provision of metering services in the transition to smart meters. In particular it will benefit those GDNs that do not have significant metering capability. This will also benefit consumers because it will ensure that traditional meters are provided (up until a point) and maintained effectively throughout the rollout of smart meters.

2.10. This is a proportionate step to take because it:

- a. creates an efficient mechanism for the provision of metering services;
- b. creates certainty within the market for the provision of such metering services; and
- c. ensures that consumers continue to receive metering services at efficient cost.

### **Key points raised by stakeholders**

2.11. A number of respondents welcomed the consultation and see consolidation of traditional metering services as a key step towards delivering an efficient transition to smart metering. There was also strong support for creating the backstop MPOLR service; the respondents noted that it was important that Ofgem should be clear on timing for switching on, and the duration for such an obligation. The GDNs recognised that there are benefits in transferring meter assets to help manage ongoing costs whilst ensuring that meters remain available at a reasonable price on a national basis.

2.12. There was also broad agreement that National Grid are well placed to operate the B-MPOLR scheme, although some argued that it would create a natural monopoly. Whilst GDNs were supportive of the B-MPOLR they did not want to be compelled to use their services; rather they considered that this should be left to the industry to decide how best to deliver metering services in the transition.

2.13. We note the broad industry support for taking forward our preferred policy proposals and the support for National Grid to operate the outlined scheme. We also agree that it is important that the duration of the obligation is timed such that it is compatible with the rollout of smart meters and suppliers obligations.

### **GDNs' current MPOLR obligations**

## Decision

2.14. We have decided to maintain the current obligation on GDNs to provide traditional meters<sup>8</sup> at the regulated tariffs<sup>9</sup> in the run up to mass smart meter rollout. We recognise that it is important to time limit this obligation and therefore we will introduce a sunset clause that is linked to the suppliers new and replacement obligation to install smart meters. As a result of Ofgem removing the MPOLR obligation, gas suppliers will not have access to a metering provision and maintenance service at a regulated maximum price from a GDN. For the avoidance of doubt, the meters that were installed prior to the obligation being lifted will continue to be maintained by the GDN at the regulated tariffs, unless they contract with other parties for these services.

2.15. We propose to raise a licence modification to introduce the sunset clause, as a part of the ongoing review in the summer 2013. The process and timing for conducting this review is set out in Chapter 5.

## Our reasoning

2.16. Whilst competition has continued to develop in electricity metering this is not the case for gas metering. The majority of gas meters continue to remain under National Grid's control with other GDNs also providing meters under the MPOLR obligation, subject to the regulated tariff caps. We are therefore of the view that it is not appropriate to reduce regulation for the provision of gas metering services at this stage. We recognise that when suppliers' obligations to install smart meters are switched on, it would not be appropriate to require GDNs to install meters and therefore we consider it appropriate to introduce a sunset clause.

2.17. We believe that this is proportionate action given that suppliers will be able to discharge this responsibility to National Grid under the terms of the B-MPOLR, which will create efficiencies. We believe that this approach provides an appropriate balance of risk and provides certainty in the future of GDNs' role for the provision of traditional meters, whilst ensuring that customers requiring traditional meters during the transition to smart metering are protected.

2.18. We consider that introducing a sunset clause for the provision of meters will provide certainty for the GDNs with respect to their obligations for provision of regulated gas metering services. After the New and Replacement obligation comes in, meters being installed will need to be smart meters. The decision has been taken to place the obligation for smart meter rollout on suppliers and there is a market developing for provision of these meters. We therefore do not consider it appropriate for GDNs to be obliged to install smart meters.

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<sup>8</sup> Standard Special Condition A10: Provision and Return of Meters

<sup>9</sup> Special condition E19: Restriction of prices in respect of tariff capped metering activities

## **Key points raised by stakeholders**

2.19. The GDNs welcomed the decision to set a date when the MPOLR obligation would be lifted. This was also supported by the majority of suppliers who supported retention of MPOLR in the short term and recognised that any sunset clause would need to be carefully managed and coordinated with the suppliers new and replacement obligations to install smart meters.

2.20. Furthermore, respondents agreed that this provides a well defined and clearly signalled point to introduce such changes. One supplier considered that traditional meters would be required beyond 2019 for customers who have decided not to have a smart meter installed.

2.21. We note that industry broadly agrees with our proposals and agree that Ofgem should develop clear proposals around the timing of when this obligation will be switched off. We also note the concerns that traditional meters will be required in the long term in the event that customers do not decide to have a smart meter installed. We intend to monitor suppliers' progress for rolling out smart meters and will therefore monitor such issues as the rollout of smart meters progresses.

## **Detailed charging consultation**

### **Decision**

2.22. We have decided to conduct a detailed charging consultation of the regulated metering tariffs and develop initial proposals for any changes to the regulated tariff caps. As a result of this consultation the tariffs will apply universally which will include meters provided by GDNs.

2.23. The first phase of this consultation will be delivered by National Grid who will consult with their customers and other interested parties to provide evidence to inform and support its development on initial proposals. In general, we would look to National Grid to provide sufficient information in its consultation process to allow and encourage stakeholders to provide informed responses.

2.24. National Grid will then submit its proposals to Ofgem to inform our decisions on whether a) the tariffs are appropriate, and b) assess whether it is based upon sound evidence. We consider that the tariffs should apply universally to regulated meters which are provided under the current GDNs Standard Special Condition A10 and the new B-MPOLR obligations.

2.25. National Grid will start its consultation process in August, which will inform proposals being submitted to Ofgem in December 2012. We will consult on our decision early in 2013 and seek to implement consequential licence changes thereafter.

## Our reasoning


2.26. We are mindful that the regulated metering tariffs have not been reviewed since 2001 and therefore that it is prudent for Ofgem to ensure that they remain fit for purpose and accurately reflect the level of risk and reward.

2.27. We have carried out detailed financial analysis of National Grid's metering business (see Chapter 3). Our analysis has reviewed their historical financial performance and highlights some key questions that we would expect National Grid to consult on within their price consultation. The key areas are:

- **Rate of return** - We are proposing to utilise the same financial regulatory model as that used in 2001; however given that the rate of return explicitly drives the revenue requirement we consider it appropriate for National Grid to consult on an appropriate methodology in calculating the rate of return.
- **Allocation of the regulatory asset value** - The allocation of the RAV is a key factor in establishing appropriate metering tariffs for domestic and I&C metering. Therefore, we look to National Grid to set out and outline the effects of the different methodologies for the RAV allocation, on domestic and I&C tariffs.
- **Assumptions for domestic metering** - We look to National Grid to set out its assumptions for all forecast rental and activity volumes (installation and maintenance), revenues and efficient levels of expenditures relating to the domestic business through to the conclusion of the smart meter rollout.
- **Assumptions for I&C metering** - We look to National Grid to develop proposals for a basis for price consultation that maintains a link to the legacy of regulation (mainly the link to domestic tariffs via a non-discrimination obligation, resulting in a business value consistent with its proposed allocation of the RAV.
- **Uncertainty mechanism** – Finally we will require National Grid to identify potential areas of uncertainty and consult upon an appropriate mechanism for managing this within the price control period.

2.28. In light of our analysis we consider that doing nothing is not sustainable or prudent, conversely we do not consider that it is appropriate to conduct a full review of the price control methodology / tariffs. We consider that our decision is appropriate given that a full review of the methodology will be significantly more expensive, take much longer to deliver and will only be required for the transition period (ie until smart meters are rolled out at end December 2019).

2.29. We consider that our decision:



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- a. will address our concerns;
- b. sets an appropriate balance between the GDNs' risk and reward; and
- c. ensures that meters are delivered effectively in the transition to smart meters, which is in the best interest of consumers.

### **Key points raised by stakeholders**

2.30. The majority of respondents supported a detailed review of the metering tariffs. The suppliers suggested that any review of tariffs would need to focus on the maintenance element of the current metering charges as this is likely to have the most impact on suppliers in the transitional period.

2.31. Stakeholders made a general comment that there is a clear delineation in metering services for domestic and I&C customers and that they remain confident that these services will be available at the market rate in the transition to smart metering.

## **Emergency metering services**

### **Decision**

#### ***PEMS for traditional meters***

2.32. We have decided not to require the B-MPOLR to install meters as a part of PEMS because the existing commercial arrangements appear to be acting in consumers' best interests. We have also decided that the transfer of existing metering assets to the B-MPOLR will be subject to commercial contracts.


2.33. The existing PEMS arrangements will continue, and be subject to commercial contracts between the GDNs and suppliers. This provides a greater certainty around the role of the B-MPOLR and also enables the market to consider how best to deliver PEMS in the future.

2.34. We will give effect to this obligation when considering the design of the licence conditions for the B-MPOLR obligation as a part of the wider ongoing review.

#### ***PEMS for Smart meters***

2.35. We have not taken any decisions with respect to smart metering PEMS, however we note the broad industry support for market led solutions.





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2.36. We will continue to work with DECC to consider the potential options that have been put forward by industry and will consider whether they are sufficient to protect consumers and support the rollout of smart meters.

2.37. We expect to consult and develop our proposals in advance of mass rollout to give the industry sufficient clarity regarding the future of PEMS for smart meters.

### **Our reasoning**

2.38. The existing arrangements for PEMS are a commercial contract between GDNs and suppliers. As such, suppliers are free to consider alternative market solutions. The scale of PEMS remains at around 150,000 interventions per annum; therefore it is important that these issues are addressed economically and in a timely manner.

2.39. We do not consider it is appropriate to provide a regulatory solution at this time because the existing market mechanism is clearly resolving the identified issues in a time when the metering sector is transitioning from that of regulation to competitive metering.

2.40. We have decided to consider PEMS separately for traditional and smart meters because we consider that the drivers for a decision are different. We are working with DECC to consider the specific issues for smart PEMS to ensure that solution provides appropriate market signals, whilst protecting consumers and supporting the rollout of smart meters. We recognise that PEMS provides the necessary consumer protection. Therefore we need to ensure that regardless of the smart PEMS solution it should not deteriorate or compromise safety and should continue to provide a high degree of customer satisfaction.

2.41. We believe that this is an appropriate approach to take at this stage because we need to consider how the market will develop as suppliers roll out smart meters.

### **Key points raised by stakeholders**

2.42. There is broad consensus amongst stakeholders that GDNs should continue to provide PEMS up and until the mass rollout of smart meters commences. Furthermore there was awareness that certain GDNs would not be offering PEMS for meters beyond mass rollout and that suppliers would need to put in place alternative arrangements.

2.43. The majority of respondents consider that PEMS services should continue to be provided on a commercial basis when smart meters are rolled out, whereas some suggested that there would be a need for regulation and possible role for the Data Communication Company (DCC) to provide a national service and charge this back to the suppliers.

## 3. Metering price control review

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### Chapter Summary

This chapter sets out the background to the existing price control mechanism and our financial analysis of National Grid's metering business with respect to the regulated tariffs.

We identify some critical issues relating to the balance between tariffs in the domestic and I&C metering markets. In particular we consider that any future I&C tariff proposals should maintain a link to price regulation (via non-discrimination obligation) and that the methodology for allocating the regulatory asset value (RAV) to the domestic and I&C activities needs to be consulted upon further.

We also identify a number of regulatory objectives, in particular relating to the promotion of competition in the I&C metering market, which should guide the development of National Grid's proposals. We anticipate providing further guidance to National Grid throughout their consultation process on this area and welcome your views on the issues and questions that we have raised.

**Question 1:** In respect of the methodologies for allocating the RAV between domestic and I&C businesses, have we properly identified the policy objectives that should inform the balance between domestic and I&C tariffs?

**Question 2:** How should the question of discrimination between domestic and industrial and commercial metering tariffs be considered?


**Question 3:** What are the relevant factors that should be considered before determining an approach that helps promote competition in the I&C market and facilitates the rollout of smart meters?

**Question 4:** Are any of the methodologies that we have identified for allocating the current RAV particularly appropriate or inappropriate?

**Question 5:** Do you consider if there are there any other methodologies we should consider?

**Question 6:** Please comment on whether we have outlined a reasonable basis for conducting the tariff consultation exercise.

**Question 7:** Provide any evidence or views that would usefully inform the exercise or our review of the metering price control as a basis for setting a new basis for regulating metering services.



## Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

3.1. As discussed in Chapter 2 we have decided that National Grid should lead on a review of the regulated metering tariff caps. We have undertaken some initial analysis of their financial performance and identified some areas that National Grid should consider as part of its review.

3.2. In this Chapter we set out an explanation of:

- a. the existing regulatory regime;
- b. our financial analysis of National Grid's performance;
- c. the areas that we expect National Grid to consider further in establishing revised tariffs; and
- d. the form of price control for domestic and I&C metering.

## Current regulatory regime

### Background to the current price control

3.3. Ofgem established the current tariff cap regime for gas metering in its review of Transco's price control from 2002. Our final proposals document, published in September 2001<sup>10</sup>, explained that the new metering price control regime was part of a wider strategy designed to promote effective competition in metering and meter reading services across both gas and electricity.

3.4. The Ofgem 2002 review separated price controls for gas metering from Transco's other businesses. The allocation of the overall RAV for Transco to the separate businesses was a critical component of this decision. We determined the metering RAV at £1,492 million at 31 December 2001 in 2000 prices. This allocation reflected the 'unfocused' approach adopted for Transco's RAV by the Monopolies and Mergers Commission in 1993. This approach recognised the fact that the market's valuation of the company at that time represented a substantial discount against the current cost book value of the company's assets and applied that discount to the constituent parts of the business, both regulated and unregulated, to derive a regulatory asset value. Ofgem extended this approach to the allocation of the RAV to the metering business. At the time, Transco expressed its view that the allocation did not allow for certain stranded metering costs and that the resulting RAV was higher than the true depreciated replacement costs of the assets.

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<sup>10</sup> [http://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01\\_pub1.pdf](http://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01_pub1.pdf)

## Depreciation profile

3.5. Ofgem further adopted a policy for the 2002 review depreciating existing assets over a 20-year period using a sum-of-a-digits method and depreciating new assets over 15 years.

3.6. The sum-of-the-digits method provided for a front-end loaded depreciation profile. In the early years, depreciation on existing assets would represent nearly 10% of the RAV (equivalent to an average asset life of a little over 10 years) but would decline linearly over a 20 year period. Table 5.5 of the 2001 final proposals document<sup>11</sup> indicated a 10-year average asset life for existing metering assets.

## Cost of capital

3.7. Ofgem allowed for a higher cost of capital allowance of 7% per annum on the RAV, on a pre-tax basis, rather than the 6.25% allowance for Transco's network business. A new form of price control was introduced: three of Transco's metering services would be subject to tariff caps while other metering services (uncapped tariffs for domestic and I&C) would be regulated through a new non-discrimination condition<sup>12</sup>.

3.8. Ofgem anticipated at that time that the development of competition would mean the price control may not need to last beyond 2004. Accordingly, the tariff caps were specified at a level that would be consistent with generating sufficient revenue to make the allowed rate of return on the RAV over the two year period 2002/03 and 2003/04. The review used the traditional building blocks of operating expenditure, regulatory depreciation and allowed return on the RAV to compute required revenues.

3.9. The licence provisions that implemented these gas metering price controls applied in due course to National Grid and, in respect of MPOLR, all independent GDNs.

3.10. Since 2002, capped tariffs have been revised annually to reflect RPI inflation in line with licence conditions, subject to adjustments in April 2005 to reflect a transfer of formula rates on metering assets to the networks business<sup>13</sup>. Compliance with the licence condition has been monitored through annual statements of metering charges submitted to Ofgem.

3.11. Although we have reviewed our policy on gas metering since 2004, notably in our 2006 'Decision on Future of the Metering Price Controls, we have until now decided to continue with the existing price controls for domestic gas metering. In part, this was due to the Competition Act 1998 investigation into National Grid's

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<sup>11</sup> [http://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01\\_pub1.pdf](http://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01_pub1.pdf)

<sup>12</sup> See appendix for details of the relevant licence conditions

<sup>13</sup> [Rates on Gas Meters - Decision Document - More Document Information](#)

meter service agreements for domestic-sized gas meters and more recently due to the timetable for, and policy development relating to; the introduction of smart meters.

## Financial performance since 2002

3.12. In this section we:

- a. summarise our analysis with respect to National Grid's historical performance to identify the extent to which they have made profits in line with the regulated rates of return; and
- b. discuss the financial outlook for domestic and non-domestic metering in the transition to smart metering and beyond.

### Historical performance

3.13. We recognise that the current tariff control has continued for a longer period than was anticipated when it was set. Tariffs were set at a level consistent with the revenue requirement calculated using projections for the two years 2002/03 and 2003/04. There was no guarantee that those tariff levels would continue to be consistent with underlying costs for a further eight years and as such the regulatory tariffs could be over or understated.

3.14. We have therefore carried out some initial financial analysis of National Grid's metering profits and costs. The analysis has identified that from 2002 until 2008 they experienced lower rates of return than the 7.0% allowed for by Ofgem in 2002. Since 2008 they have experienced a higher rate of return than 7%. We therefore conclude that the rate of return has broadly run at the anticipated regulated level.

3.15. Table 1 (below) presents the results from the audited regulatory accounts in regulatory terms, taking into account regulatory depreciation and the allowed rate of return on the RAV.

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**Table 1: National Grid's metering business financial performance**

*£ million, nominal*

	<u>02/03</u>	<u>03/04</u>	<u>04/05</u>	<u>05/06</u>	<u>06/07</u>	<u>07/08</u>	<u>08/09</u>	<u>09/10</u>	<u>10/11</u>
<b>Revenues</b>									
Revenue per accounts	367	369	339	316	318	320	331	328	310
less: revenues in RAV	(9)	(9)	(13)	(11)	(14)	(19)	(15)	(15)	(12)
Metering revenues	358	360	326	305	304	301	316	313	298
<b>Operating expenditure</b>									
Operating costs	280	281	263	219	215	225	207	181	174
less: depreciation	(126)	(149)	(130)	(143)	(138)	(129)	(113)	(102)	(104)
less: disposal loss	(10)					(4)	(9)	(8)	(6)
Total opex	144	132	133	76	77	92	85	71	64
<b>Regulatory depreciation</b>									
1 April 2002 assets	137	134	130	126	123	121	116	108	105
New assets		5	11	15	20	25	30	35	40
Total	137	139	141	141	143	146	146	143	145
<b>Returns</b>									
Return (rev-opex-dep)	77	89	52	88	84	63	85	99	89
Return at 7% of RAV	98	97	95	91	89	87	84	79	76
Surplus/(deficit)	(21)	(8)	(43)	(3)	(5)	(24)	1	20	13

*Source: Regulatory accounts and National Grid*

3.16. Our analysis suggests that the main features of the business's financial performance over this period are:

- Revenues in 2002/03 were significantly below the revenue requirement calculated by Ofgem in 2001 of £393m in 2000 prices (Table 7.3 of Ofgem's September 2001 'Review of Transco's Price Control from 2002 – Final Proposals' document, equivalent to £410m in 02/03 prices).
- A reduction in the tariff cap from 1 April 2005 (by way of a modification to Special Condition 31 of the licence, now Special Condition C12) mirrored a similar reduction in operating expenditure due to a change in the responsibility for business rates on meter equipment.
- Company initiatives resulted in other significant reductions in the level of operating expenditure, in particular in 2003/04 and 2005/06.

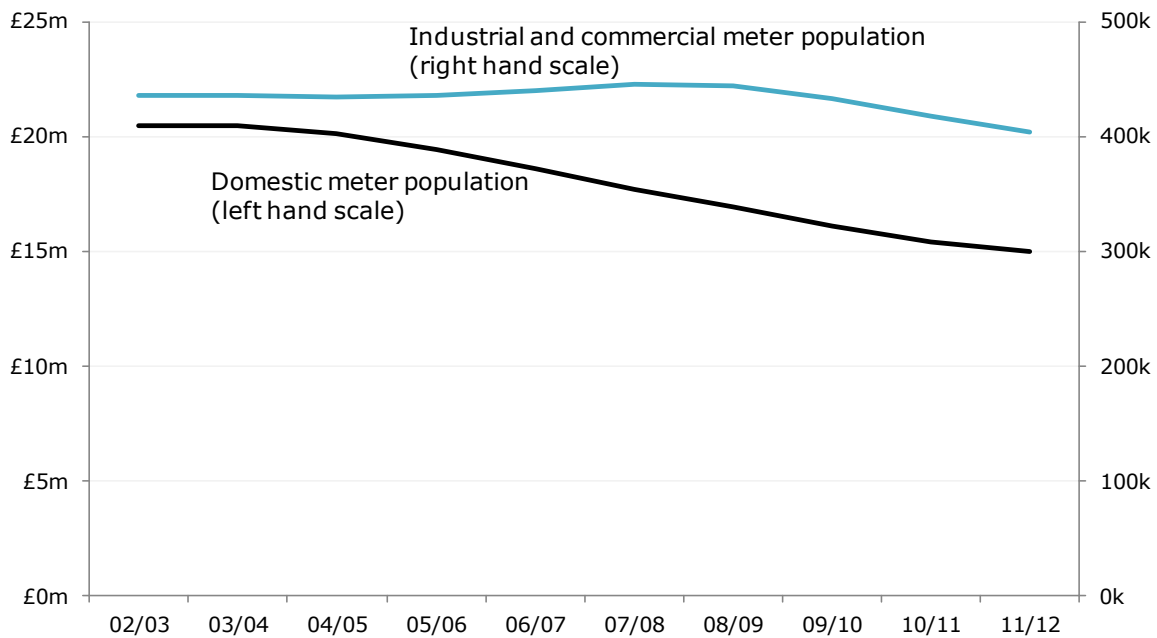


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- A broad coincidence between a downward slope (in constant price terms) in the RAV and regulatory depreciation profile and a downward slope in the company's share of the meter population.

3.17. The relationship between the RAV/depreciation and market share profiles is particularly relevant. The population of National Grid's meters has reduced over the period; however this is more prevalent in the domestic market.

**Figure 1: Meter populations served by National Grid**



Source: National Grid

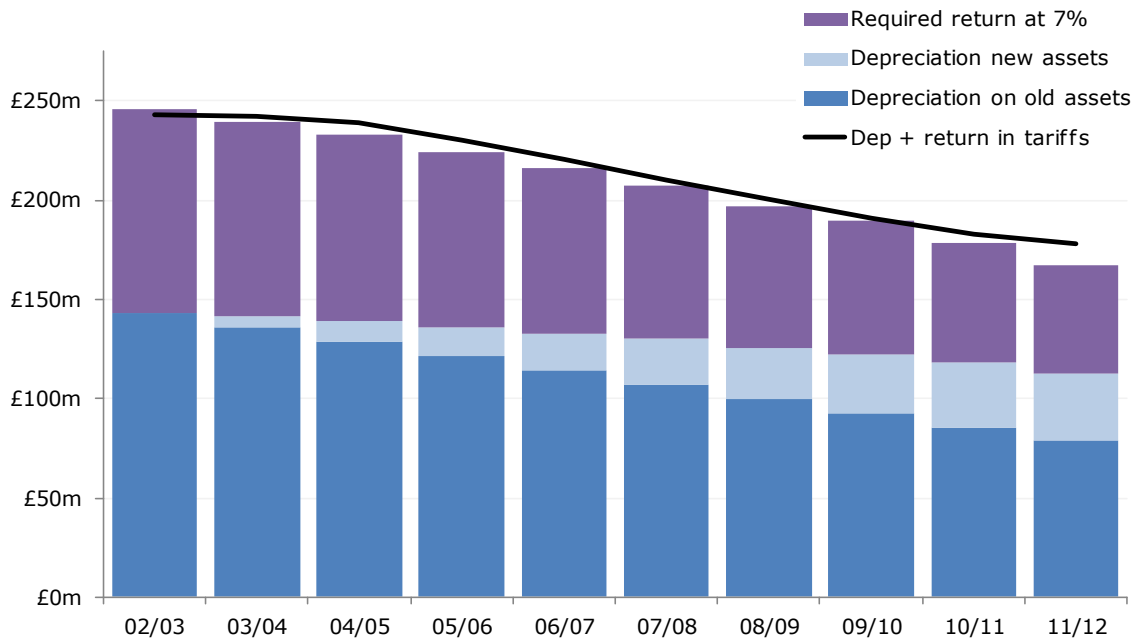
3.18. As the underlying tariff control has been to set maximum tariffs in real terms, there has been a fixed per-meter contribution to capital costs (depreciation and returns). The reducing populations of meters means this contribution has fallen over the years.

3.19. The profile of capital costs (depreciation and required annual returns calculated as 7% of the RAV) has also been reducing. This was mainly driven by the front-end loaded depreciation policy adopted by Ofgem in the 2002 price review, coupled with relatively low levels of expenditure on new meters. The following chart illustrates the combined relationship between these two profiles.



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**Figure 2: Recovery of depreciation and required returns**



Source: National Grid, Ofgem RAV calculations, RPI09/10 prices

3.20. The profiles have been remarkably closely aligned, but by coincidence rather than by design. We can conclude that there has not been a net influence on the levels of profitability to drift far from regulatory norms.

### Outlook to 2019 and beyond

3.21. Under Ofgem’s existing regulatory depreciation policy, the RAV would continue to reduce rapidly. The RAV balance at 1 April 2002 would be fully depreciated by 2022, as would meters more than 15 years old, while many of the meters acquired before then would still be physically serviceable.

3.22. If National Grid was expected to maintain its market share in the long term, it is likely that we would be proposing that the underlying cost base of the metering business had reduced far enough to permit significant tariff cuts. Although the implementation of smart meters is expected to impact on National Grid’s domestic meter portfolio it is not expected to have a substantive effect on National Grid’s I&C portfolio. It is appropriate therefore to consider the extent to which price regulation is appropriate for these distinct markets.

### Domestic metering

3.23. The domestic component of National Grid’s metering business will come to a natural end at the conclusion of the smart meter rollout, in Q4 2019.





Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

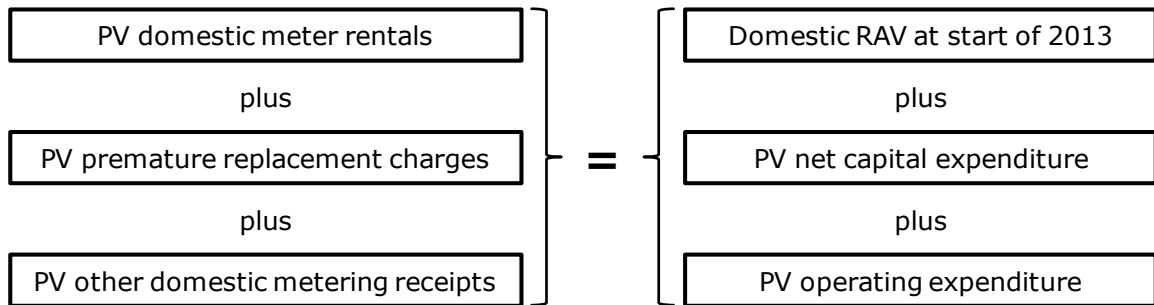
3.24. We anticipate that National Grid’s domestic market share will diminish quickly as the pace of the smart meter rollout increases resulting in a rapid loss of the business’s customer base. The financial cost of the future domestic metering portfolio will be mitigated by a largely depreciated RAV, and by the receipt of premature replacement charges under Meter Services Agreements for some meters.

3.25. At the same time, National Grid will need to manage its expenditure on operations as its activity levels diminish. It is not clear at this stage how these factors will combine to influence National Grid’s revenue requirement from its domestic meter base but our initial analysis leads us to believe there should not be a need for very substantial changes in tariff levels through to the end of the business.

3.26. The rollout of smart metering by 2019 provides certainty with respect to the GDNs’ domestic metering business. This certainty makes a traditional build-up of the revenue requirement, referring to annual levels of depreciation, more complex than usual for a price control review. An alternative and wholly equivalent approach is to consider the revenue requirement in discounted present value terms. This method refers to the value of the RAV at the beginning and end of a control period and the cash flows during the period. This approach is a more natural one for this review as we know the RAV should be zero when the business closes.

3.27. Accordingly, we can describe National Grid’s revenue requirement from its domestic metering business in present value (PV) terms, from the start of 2013 through to cessation of the business shortly after 2019, with the equation in figure 3.


Figure 3: Domestic revenue requirement equation



3.28. An appropriate tariff level would be one that balances the revenue requirement of this equation.

3.29. We anticipate relatively low levels of continuing net capital expenditure (expenditure on new installations or the replacement of meters or meter components, less any fees or charges arising). The revenue requirement is therefore likely to be driven mainly by:

- a. the balance between the RAV attributed to the domestic market;



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- b. the continuing requirements for operating expenditure; and
- c. the level of receipts that can be expected from premature replacement charges under Meter Services Agreements and other receipts.

### **Industrial and commercial metering**

3.30. National Grid has indicated that it intends to continue to provide metering services to the I&C market. The provision of National Grid's metering services to that market will continue to be subject to regulation through the non-discrimination condition in its licence, which ensures there is a link with the tariffs controlled under Special Condition E19 of its licence. The controlled tariffs relate to domestic sized meters only. When their portfolio is fully replaced by smart meters the link between the regulatory tariff controls will be severed.

3.31. Figure 1 above indicates that the pattern of market share loss for I&C meters has been different to that for domestic meters: the cumulative loss of market share has been relatively limited. In part, this is because the long lives of these metering assets mean infrequent opportunities for suppliers to change their meter provider when existing meters are due to be replaced.

3.32. There may be grounds for regulation to be lifted altogether from metering services for the I&C market, but we are not convinced that the conditions for deregulation yet exist. National Grid continues to have a substantial market share and we will continue to monitor how competition develops. We consulted on proposals to lift regulation in the electricity metering market in 2006, but we are not currently satisfied that it is appropriate to do so for gas metering.


3.33. We would look to National Grid to develop proposals for a sustainable and cost-related level of tariffs in that market that maintain a link to the legacy of regulation. In particular, we would look to National Grid to demonstrate that its proposals are consistent with a suitable allocation of the total metering RAV.

### **Allocation of the regulatory asset value**

3.34. In recognition of the different trajectories between domestic and I&C metering we have:

- a. Considered the implication for the regulatory regime; and
- b. An approach for accurately reflecting this split (of the RAV) in financial terms and set out several candidate methodologies.

3.35. A commitment to the RAV is a core principle of incentive-based regulation, and underpins Ofgem's approach to regulation across its network sectors.



## Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

3.36. An allocation of the total RAV for Transco to the metering business was determined for the 2002 price review, specified as £1,492 million as at 31 December 2001 in 2000 prices. That value, rolled forward in accordance with the regulatory depreciation policy established in 2002, currently stands at around £1 billion (in 2012 prices).

3.37. We are aware that the depreciation policy was only applied in regulatory calculations for the two-year period 2002/03 and 2003/04 and, in principle, may not have been consistent with tariff levels set thereafter. However, the degree of coincidence between the profile of capital costs, calculated on this regulatory basis, and the profile of meter populations, illustrated in Figure 2 above, leads us to conclude there is no case for inferring a different depreciation profile.

3.38. We explained above why we believe it will be necessary to further allocate the metering RAV between the domestic part and the I&C part of the metering business. The domestic RAV will be a key component in the required revenue calculation for the determination of a new tariff cap for the domestic metering business; the I&C RAV will be a key component in the justification of a sustainable and cost-related level of tariffs for the I&C metering business.

3.39. The allocation of the metering RAV will therefore have important, though equal and opposite, implications for tariff levels for both parts of the business. This zero-sum character of the allocation means that it will be about the balance between domestic and I&C tariffs.


3.40. We consider that the right balance should be informed by three broad policy objectives:

1. Avoidance of undue discrimination between domestic and I&C customers;
2. Promotion of effective competition in the I&C market; and
3. Facilitation of smart meter rollout programme

3.41. We recognise that the divergence of the business models and cost profiles for domestic and I&C metering triggered by the rollout of smart meter makes discrimination more difficult to assess.

3.42. We have identified a number of possible methodologies for allocating the current RAV for the metering business between domestic and I&C businesses:

1. An allocation that preserves the current relationship between tariffs for domestic and I&C metering services;
2. A pro rata allocation based on the current depreciated replacement cost values of the domestic and I&C meters;



## Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

3. A pro rata allocation of the 2002 metering RAV based on the depreciated replacement cost values of the domestic and I&C assets in 2002, and rolled forward separately using the same depreciation and capitalisation policies adopted for the metering RAV as a whole;
4. An I&C RAV consistent with the depreciated replacement cost value of I&C meters, taking into account realistic depreciation lives, leaving the residual RAV with domestic; and
5. An allocation consistent with tariffs for I&C metering services being at a competitive level, neither too high to compete nor so low that competitors will be unable to compete, leaving the residual RAV with domestic metering.

3.43. We note that methodology 3 above was used to inform the decision to transfer the element of rates associated with metering from the metering to the transportation price control (see 'Rates on Gas Meters – Decision Document', September 2003). Although this represents a precedent for the use of methodology 3, the choice of methodology for that purpose was not informed by the broader policy issues relevant to separating the two parts of the business for price control purposes. Furthermore, the date of 2002 would have been practically contemporaneous at the time of carrying out the analysis for that decision, whereas it is not contemporaneous for the present purpose.

3.44. We note that methodology 5 above may be an appropriate one to consider in the event that we were to decide that price regulation could be lifted from the I&C metering business. It would be equivalent to accounting for a disposal (outside the regulatory boundary) at fair value. This would be consistent with the current treatment of retired metering assets, where the fair value of net proceeds has been used to reduce the RAV rather than any accounting book value.

3.45. In its consultation exercise, we would look to National Grid to outline the effects of these different methodologies on the RAV allocation, on domestic tariffs, on I&C tariffs and on the market for I&C metering services for consultation with interested parties.

### **Form of price control**

3.46. In recognition that the domestic business is diminishing and that National Grid is to remain in the I&C market, we would expect National Grid to consult on the factors we have identified below to ensure that metering tariffs are set at an appropriate level.

### **Domestic metering**

3.47. The current price control for domestic metering takes the form of tariff caps for specified services and a non-discrimination condition for other services. Other forms of price control might be possible, including revenue caps and tariff baskets,

but we see some advantage in continuing with a tariff cap approach. It would be open to National Grid to consult on options.

3.48. It will be necessary to specify a service or services that would be subject to tariff cap(s) and to define the relationships between the tariffs for those services and other domestic metering services and activities, including premature replacement. Those relationships would be guided by relative costs, but we recognise the question of cost is complicated by the economic lives of the metering assets.

3.49. We would look to National Grid to demonstrate that tariff cap proposals would be consistent with the overall revenue requirement illustrated in Figure 3.

3.50. We would expect National Grid to consult on what it considers an appropriate rate of return is for its metering business going forward. The pre tax rate of return of 7% for metering and 6.25% for networks which was set in 2001 appears to be favourable compared to pre tax return of 5.99% for the Gas Distribution Price Control (GDPCR1) 5 year control ending March 2013.

3.51. We look to National Grid to set out its assumptions for a) forecast rental and activity volumes, b) revenues and efficient levels of expenditures relating to the domestic business through to the conclusion of the smart meter rollout, and c) an appropriate cost of capital to use as a discount rate for discounted present value calculations.


3.52. We consider that it is also important to set out the key dependencies in those assumptions (ie pace of meter rollout and other uncertainties, including the scope for cost reductions).

### **Industrial and commercial metering**

3.53. The current price control for I&C metering is based on the non-discrimination condition and is dependent on a link with tariff caps for certain specified services, none of which will be provided after the conclusion of the smart meter rollout. This means that a new methodology will be required.

3.54. We note that National Grid has lost some of its market share and would expect competition to have an effect on National Grid's future share of the market and the prices it can sustain. The company may continue to have some price setting power for rental of its stock of traditional meters, while it will be exposed to strong competitive forces when existing meters reach the end of their economic lives.

3.55. There will therefore be a complex dynamic between the basis of control, the price level for that control (affected by or affecting the allocation of the metering RAV to the I&C business) and the ability of the company to contain the loss of or maintain its market share.



Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

3.56. I&C customers will clearly be interested and we would look to National Grid to describe the dynamics of the business as part of its consultation exercise to ensure its proposals are supported by effective and informed consultation. We would also look to National Grid to demonstrate how its proposals are consistent with the allocation of the RAV.

3.57. We recognise that potential competitors will also be interested. Accordingly, we invite responses from potential competitors and other interested parties on the conditions that will be necessary to achieve our objective of effective competition in the I&C market.

3.58. We look to National Grid to develop proposals for a basis for price consultation that maintains a link to the legacy of regulation, resulting in a business value consistent with its proposed allocation of the RAV. We would also expect that any proposals give due consideration of the responses to the consultation paper in respect of the methodology for allocating the RAV, with particular reference to the relevant factors that should be considered before determining an approach that helps promote competition in the I&C market.

## 4. Summary of responses

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### Chapter Summary

In our 2011 December document we sought views from industry on a range of questions to help develop our evidence base and also to test whether our policy for managing the transition is robust and considered all the relevant factors.

This chapter discusses the respondents' views to each of the questions that we raised in our December 2011 consultation document; we also set out Ofgem's views on the issues that have been raised.

### Responses to December consultation and Ofgem's views

4.1. We received 19 responses to the December 2011 consultation. We received responses from 4 GDNs, all of the large suppliers, two small suppliers, meter asset providers, the Association of Meter Operators, Energy Services and Technology Association and Energy UK. Those responses not marked confidential may be found on the Ofgem website. A detailed summary is included in annex 3.


### Discussion of responses

**Question 1:** What do you consider are the pros and cons of our approach to managing traditional metering in the transition to smart metering?

4.2. A number of respondents welcomed the consultation and see consolidation as a key step towards delivering an efficient transition. The backstop national meter provider of last resort (MPOLR) is supported by the majority of respondents in the transition to smart meters.

4.3. There was a broad consensus that that the backstop MPOLR coupled with a pricing consultation is a sensible and pragmatic approach to managing an efficient and economical transition to smart metering. GDNs recognised that the meter asset transfer from other GDNs is likely to help manage ongoing costs and ensure that meters remain available at a reasonable price on a national basis. They also welcomed the decision to set a date when the MPOLR obligation would be lifted.

4.4. Several respondents considered that the current arrangements have deterred competition within metering due to cross subsidisation of pre-payment meters. NPower are of the view that the B-MPOLR would create a natural monopoly and deter new entry, but did recognise that National Grid are well placed to operate the B-MPOLR which would provide a consistent and uniform customer experience.




## Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

- 4.5. Certain GDNs expressed a concern that the consultation did not set out an approach to deal with stranded metering assets and suggested that any residual value should be returned to the networks regulatory asset value.
- 4.6. Respondents recognised that any sunset clause would need to be carefully managed and coordinated with suppliers' new and replacement obligations to install smart meters and that the MPOLR obligation would not be expected to remain in place post 2014. Furthermore, this provides a well defined and clearly signalled point to introduce such changes.
- 4.7. Suppliers suggested that any review of tariffs would need to focus on the maintenance element of the current metering charges, as this is likely to have the most impact on suppliers in the transition. Stakeholders identified a clear delineation in metering services for domestic and I&C customers and remain confident that these services will be available at the market rate in the transition to smart metering.
- 4.8. A number of suppliers agree that in the short term the GDNs' MPOLR obligation should remain to protect consumers. One supplier was of the view that traditional meters would be required beyond 2019 for customers who decide not to have a smart meter installed. One supplier raised an issue with respect to the arrangements for PEMS as they understood that GDNs would not be offering a smart PEMS service.
- 4.9. The community of meter asset providers commented that tracking assets was essential for a meter asset provider business and that the existing market process arrangements did not provide the required visibility for recovering rental charges where there is customer churn and change of supplier. The CMAP commented that this issue would need to be addressed prior to the mass rollout of smart meters and called for Ofgem to require suppliers to pay meter rentals until the meter is removed. This issue is particularly evident where the Meter Asset Provider (MAP) and Meter Asset Manager (MAM) are separate entities.

### **Ofgem Views**

- 4.10. Ofgem welcomes the broad support to our proposal for introducing the B-MPOLR as a part of the transition into smart metering. We appreciate the need to set a clear timetable with respect to the sunset clause and will seek to ensure that this is compatible with the rollout of smart meters.
- 4.11. We also note the broad support for maintaining the MPOLR obligation upon GDNs until such a point that suppliers roll out smart meters. We also recognise that there are two distinct markets for gas meters (domestic and non-domestic) and that the industry considers that I&C meters will be available at the market rate during the transition.





## Decision and further consultation on the regulation of traditional gas metering during the transition to smart metering

4.12. We note the broad support for conducting a price consultation to ensure that traditional metering services remain available during the transition at a regulated tariff. Given that traditional meters will need to be maintained during the transition to smart we recognise that this is likely to form a significant part of suppliers' meters costs in the short to medium term and therefore appreciate that maintenance activities will need to be provided at an efficient cost.

4.13. We accept that as the rollout of smart meters progresses, it is likely at some point in the future that GDNs may seek to exit the metering market which will have an impact upon non-regulated services such as PEMS. We consider that the existing arrangements for PEMS are effective and recognise that alternative commercial solutions may be required in the future. We do not see a role for regulation of traditional PEMS. However, we will keep this issue under review, and plan to consider PEMS for smart meters separately.

4.14. We recognise the importance of MAPs being able to accurately track their assets to recover rental charges and are aware of recent industry proposals to amend industry data flows to address these concerns; as such we will monitor the development of these proposals.

4.15. We note the GDNs request for Ofgem to consider the impact of meters being replaced prematurely and their proposal for the residual value to be transferred to the network RAV. We consider that GDNs are free to structure their metering contracts as such to mitigate such risks and therefore are not convinced that this is a matter for regulation or network price control. Furthermore as a part of the regulatory framework, we have decided to establish the B-MPOLR service which will enable GDNs to transfer existing assets subject to commercial agreement.

**Question 2:** Do you consider that our assessment of the related issues within the metering market is accurate?

4.16. Whilst the majority of respondents agreed with our assessment of the issues associated with traditional metering, respondents also raised specific issues with respect to efficient functioning of the market, in particular specific to the transition to smart metering.

4.17. A limited number of respondents commented that tracking metering assets is essential to support a well functioning market, which will become even more critical as smart meters are rolled out. There is a concern that the current arrangements did not provide sufficient clarity with respect to data flows on change of supplier, which could result in MAPs not being able to recover rental charges.

4.18. One supplier requested that Ofgem provide clarity around the existing electricity meter recertification scheme and how it will be applied in the transition to smart meters. They were concerned that under the existing scheme traditional meters could be replaced with a traditional meter, and subsequently replaced by a smart meter before it had fully depreciated.

4.19. One of the network companies commented that when a smart meter is installed additional remedial works may be required and sought clarification on how the costs for such activity should be recovered.

### Ofgem Views

4.20. We note that industry broadly agreed with our assessment, albeit they have raised specific questions with respect to the metering market consequent to smart meters being rolled out. We appreciate that it is important that MAPs can accurately track their assets to recover rental charges and are also aware of recent industry proposals to amend industry data flows<sup>14</sup> to address these concerns; as such we will monitor the development of these proposals.

4.21. On the point raised by a supplier regarding clarity of the meter certification process, Ofgem notes that meter certification is a legal requirement applicable to the vast majority of domestic electricity meters. As such, suppliers have an obligation to ensure that meters remain accurate. The National Measurement Office (NMO) operate the national sample survey and in-service testing methodology (IST) which has been used to extend the certification life of two meter types - thereby enabling the meters to remain in-service until replaced by smart meters. This has resulted in a significant cost saving to the industry while maintaining consumer protection and confidence.

4.22. The IST is one way in which a supplier or asset owner may demonstrate the continuing conformity which was originally developed for meters approved under the European Measuring Instruments Directive<sup>15</sup> (MID). NMO have agreed, at the request of stakeholders, that it may also be used for pre-MID meters. The IST is a statistically based, national sampling scheme that is significantly cheaper for stakeholders than any preceding scheme.

4.23. Ofgem recognises that not all smart metering installations will be identical and that in some cases the installation will be more complicated than others, resulting in higher installation costs, as raised by a network company. We are aware that DECC is considering issues associated with 'non-standard' installations through open consultation with industry working groups to identify how such installations should be treated.

**Question 3:** How should emergency metering services be provided for in the transition to smart metering?

4.24. There is broad consensus amongst stakeholders that GDNs should continue to provide Post Emergency Metering Services (PEMS) up until the mass rollout of smart meters. The respondents generally favoured market led solutions for the provision of such services, as opposed to regulation.

<sup>14</sup> UNC MOD 0422 - Creating the permission to release data to Meter Asset Provider organisations

<sup>15</sup> <http://www.bis.gov.uk/nmo/about/faqs/mid>

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4.25. One respondent commented that market based solutions provide the right market signals and complements the transition to a competitive rollout of smart meters. Furthermore, there was awareness that certain GDNs would not be offering PEMS for smart meters beyond mass rollout.

4.26. There was a view that the existing PEMS framework creates a perverse incentive for GDNs to find faults with metering installations and one of the big six suppliers commented that this PEMS should be the responsibility of the supplier, who should also offer a 24/7 customer contact service.

### Ofgem Views

4.27. We recognise the benefit of the GDNs operating a PEMS service because this creates efficiencies and maintains supply for the consumer. We are aware that the number of PEMS activities has been consistent for several years and that any service needs to be effective and efficient.

4.28. We recognise that the market based solution appears to be working effectively and therefore do not consider it appropriate to regulate this activity. The suppliers have commercial pressures to operate effective solutions. but we will continue to monitor their ongoing effectiveness.

### Question 4: How should emergency metering services be provided, for smart meters?

4.29. The majority of respondents consider that PEMS services should continue to be provided on a commercial basis when smart meters are rolled out. A number of potential options were suggested which included the supplier contracting with commercial service providers, which may also include networks.

4.30. One of the large suppliers suggested that PEMS should be a part of MPOLR and that Network Operators should install credit meters or smart meters operating in traditional "dumb" mode. One of the networks considers that existing arrangements could work, and be extended to smart metering and include HAN / WAN issues.

4.31. A number of respondents suggested that a centralised service may be appropriate with the DCC procuring national services on behalf of suppliers. A number of respondents also suggested that PEMS services should have a national contact 24/7 contact number.

### Ofgem Views

4.32. The future arrangement for PEMS should not have a negative impact upon safety or the customer experience. We can see merit in the suppliers contracting with a range of commercial providers, which could include network companies, to deliver such services. We do not consider that it is appropriate for the PEMS and MPOLR to be coupled because:

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- a. because the PEMS activity is in response to an emergency and therefore the GDNs first call operative will already be on site and dealing with the emergency as a priority; and
- b. as MPOLR obligations are lifted this would leave a vacuum for PEMS services and send the wrong signal to suppliers who are responsible for rolling out smart meters.

4.33. We note that certain GDNs have suggested that they could extend their services to also include smart metering services. We have not reached any firm decision regarding PEMS for smart metering and therefore have decided to consider this further and separately from this consultation, as this does not impact upon the other decision we have set out in this document.

**Question 5: Which is your preferred option for managing the transitions and why?**

4.34. All of the GDNs support our preferred option of creating a B-MPOLR and suggested that National Grid would be well placed to deliver this function. Several respondents noted that this obligation should be clear on timing and switched off at some point in 2014.

4.35. One of the GDNs commented that they did not consider it appropriate that they should be mandated to use the B-MPOLR and that this should be a commercial decision. One of the GDNs suggested that the obligation upon the B-MPOLR should be direct with the supplier and not with the GDNs.

4.36. A large supplier suggested that whilst it supported our preferred option, the creation of a B-MPOLR would create a natural monopoly and would not be in the interest of metering competition. One of the other large suppliers suggested that meter provision and meter maintenance should be unbundled so that third parties could carry the maintenance activities on assets that they do not own.

**Ofgem Views**

4.37. We note the broad support for our preferred option to create a B-MPOLR and recognise the importance of time limiting this such that it is compatible with the rollout of smart meters. We agree that the GDNs should not be required to use the B-MPOLR, and that this is an alternative to providing meters under their own licence conditions.

4.38. We do not agree that it is appropriate for the B-MPOLR to contract directly with suppliers as we are not proposing to switch off GDNs MPOLR obligation at this point. We do not agree that the B-MPOLR will be a monopoly as there will be other commercial and regulatory providers available within the market. We are aware that gas metering has tended to operate as a bundled service (MAP/MAM) however we are aware that industry is progressing reforms to industry data flows to account for different MAP and MAM responsibilities.

**Question 6: Under option C, is it appropriate to carry out a price control review?**

4.39. The majority of respondents supported a consultation of the metering tariffs on the basis that they have not been reviewed since 2001 and that functions associated with regulated metering services are changing in the transition to smart.

4.40. A small supplier did not agree that it was appropriate to conduct a review of the tariffs because it would divert resources away from the rollout of smart meters.

**Ofgem Views**

4.41. We note the support for conducting a consultation of the tariff caps a) because they have not been reviewed since 2001 and b) that consumers need protecting in the transition to smart meters. We consider that consolidation will provide an opportunity for the transition to be performed efficiently and effectively.

4.42. In response to this consultation National Grid has signalled that it will not be rolling out smart meters and therefore plan to exit the domestic metering market. They will continue to operate in the non-domestic metering market, which is also currently regulated as a part of the overall price regulation regime. We are mindful that the domestic and non-domestic portfolio will need to be decoupled with respect to the regulatory asset value for the respective metering activities; therefore it will be necessary to undertake a formal assessment of the financial performance so that the RAV can be appropriately allocated.

**Question 7: Which of our revenue restriction options do you consider is appropriate and why?**

4.43. The majority of respondents agreed with Ofgem that Option 1 (charging consultation) is the most appropriate form of price review because a full review would take a significant amount of time and would only be a relatively short lived control. National Grid supported Ofgem's view but would expect that any MPOLR obligation and the tariff caps on rentals for new meters would be lifted following the mandate to commence the mass rollout.

4.44. One of Energy UK's members suggested that the time was right to conduct a full price control review due to the time that has elapsed since the last control, whereas the AMO argue that moving towards a competitive metering market would remove the need to price control metering services.

**Ofgem Views**

4.45. The GDNs currently review their tariff caps each year in line with the licence obligations, which effectively adjusts the tariffs for RPI. We consider that it is appropriate for these tariffs to be examined more closely to ensure that the

fundamental principles underpinning the tariffs were still valid. In Chapter 3 we have identified some key areas that should be considered in a review. We would expect that this can be achieved within the current regulatory tariff structure.

4.46. Whilst we are proposing a thorough review of the tariff mechanism we do not consider that it is appropriate to undertake a full price review which would involve reviewing fundamental financial parameters such as cost of debt and cost of equity.

4.47. We do not agree with National Grid that tariff caps should be lifted following the mandate for mass rollout of smart meters; however we will keep this policy under review. The tariff caps cover installation and maintenance therefore we are seeking for the consultation pricing review to establish new tariffs to cover meters that will need to be maintained until they are replaced with a smart meter.

**Question 8** If you are a GDN, would you prefer to transfer MAP ownership of your traditional meters (ie full transfer), or to subcontract new requests and the management of historical stock (ie partial transfer) or continue to manage your own meters?

**Question 9** If you are a commercial meter operator (CMO), do you envisage a point in the smart meter rollout where you would be interested in consolidating your traditional meters?

4.48. The responses to question 8 and 9 were limited, so they have been grouped together given the direct linkages with respect to asset transfer.

4.49. National Grid stated that it was content to operate either a full or partial transfer scheme for GDNs and commercial meter operators. Most of the GDNs were supportive of having a mechanism for transferring assets; however, respondents would like to understand in more detail how this scheme would work in practice.

4.50. One of the large suppliers commented that it didn't currently have any plans to consolidate or transfer their assets but said that it would keep this under review. The AMO and National Grid suggested that asset transfer should be based upon a commercial contract and not subject to regulation.

### Ofgem Views

4.51. We can see merit in the B-MPOLR providing a service to manage the assets throughout the transition into smart metering. This provides a mechanism for market participants to exit traditional metering and develop a capability and focus for rolling out smart meters. There is currently a mechanism within the meter asset managers code (MAMCoP) to support asset transfer; however, we do not see a role for regulation to govern/finance assets transfer. We would expect the B-MPOLR to support asset transfer, but for this to be subject to commercial contracts.

## 5. Next Steps

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### Chapter Summary

This section sets out the next steps for taking forward this review, identifying the key dates, roles and responsibilities. We understand that National Grid are content with our decisions and intend to publish a formal acceptance letter in August 2012.

We welcome views by 5th September 2012 from interested parties on our decisions and the questions that we have raised with respect to the metering price control as set out in Chapter 3.

### Roles and responsibility

5.1. This next phase of the review will be led by National Grid in consultation with stakeholders. National Grid will be asked to develop and consult on initial proposals for the tariff caps and in doing so enable full consideration of the issues identified by Ofgem in Chapter 3 of this document.


5.2. Ofgem intends to engage with National Grid through the next stages of the review process and will monitor progress and stakeholder engagement throughout. We will consider the responses to the questions that we have raised in this decision document to assist us with the subsequent phases. We intend to publish a summary of our analysis alongside the non-confidential responses to this consultation in advance of National Grid's publication of their Approach document in September 2012.

5.3. The complete timetable for taking this review forward can be found in appendix 4 which also details the process that Ofgem will adopt once it has received National Grid's final proposals.

### National Grid Timetable for next phase

5.4. We look forward to National Grid's formal response to our invitation to develop initial proposals for the tariff cap and its plan for consulting with stakeholders during this review. We have set out below an indicative timetable for the next steps resulting in the implementation of the revised tariffs in 2013.

- **Early August - Acceptance Document:** Publication of the National Grid acceptance document which would confirm National Grid's position and views with respect to the NMM role & pricing consultation requirements. It would also notify interested parties of the launch event and request stakeholder preferences on the engagement strategy for the consultation process. We would expect this document to set out further project planning (ie key dates for publication / response to consultation).



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- **Early September - Approach Document:** This document would set out the detailed pricing methodology and modelling assumptions. It would also present a financial summary which would form the basis of the indicative tariff caps. We would also expect the key points with respect to treatment of RAV split (domestic and non-domestic) to be discussed.
- **Mid November - Initial Proposal Document:** This document would consider the response to the consultation of the Approach document and set out stakeholder responses. It would make initial proposals regarding the RAV split and detail refinements to the modelling assumptions. We would also expect National Grid to share with Ofgem the detailed pricing model and set out to stakeholders a summary of the financial analysis and implication for metering tariffs.
- **Mid December - Final Proposal Document:** This document would consider stakeholder responses to the initial proposals and set out how the views have been considered and incorporated. We would also expect the detailed pricing model to be shared with Ofgem and a financial summary to be presented to interested stakeholders within the consultation document.

5.5. We would expect National Grid to consult on the issues that we have raised in our financial analysis. We would also expect that the final proposals fairly reflect the level of risk and activity for the NMM and balance this against an appropriate rate of return such that consumers remain protected in the transition to smart metering.

### **Ofgem's decision and next steps**

5.6. On receipt of National Grid's initial proposals we will carry out analysis of its financial models and proposals to ascertain whether we are minded to approve or reject the proposal. Subject to any delays, we will aim to set out our Decision by the end of January 2013 which will also include any consequential licence changes that will be required to give effect to this reform. This will be followed by a four week consultation period.

5.7. Following the Ofgem Decision document we are required to publish a statutory consultation document detailing the legal licence drafting. This will be followed by a six week consultation period. Finally, once we have considered the responses to the statutory consultation we will make a final decision which will set out changes to the licence(s) and which will come into effect 56 days after publication (subject to consultation).

5.8. The GDNs currently review their metering tariffs around December of each year (for the purpose of RPI adjustments), and any changes take effect from 1 April the following year. National Grid has suggested that any reduction to the tariff caps as a result of this review could be reflected in the GDNs' December review and that the licence amendments could be made retrospectively to reflect the new charges.



## Appendices

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## Appendix 1 - Consultation Response and Questions

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Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

Responses should be received by 5 September 2012 and should be sent to:

- Steve Rowe
- Smarter Markets
- 020 7901 7468
- smartermarkets@ofgem.gov.uk

Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted preferably electronically but hard copies in writing will also be accepted. Respondents are specifically asked to put any confidential material in the appendices to their responses.

Ofgem intends to invite National Grid to become the National Metering Manager, to provide backstop metering services as a provider of last resort when requested to do so by suppliers or other gas distribution networks.

We will also invite National Grid to conduct a consultation of the metering price control tariffs, which will involve then consulting with interested parties. Following the consultation, National Grid will make a recommendation to Ofgem setting out their justification for their proposed tariffs.

On receipt of National Grid's proposal, Ofgem will consult on our analysis with interested parties to help inform our final decision.

Any questions on this document should, in the first instance, be directed to:

- Cemal Huseyin
- Smarter Markets
- 020 7901 7033
- cemal.huseyin@ofgem.gov.uk

### **CHAPTER: Three**

**Question 1:** In respect of the methodologies for allocating the RAV between domestic and I&C businesses, have we properly identified the policy objectives that should inform the balance between domestic and I&C tariffs?

**Question 2:** How should the question of discrimination between domestic and industrial and commercial metering tariffs be considered?

**Question 3:** What are the relevant factors that should be considered before determining an approach that helps promote competition in the I&C market and facilitates the rollout of smart meters?

**Question 4:** Are any of the methodologies that we have identified for allocating the current RAV particularly appropriate or inappropriate?

**Question 5:** Do you consider if there are there any other methodologies we should consider?

**Question 6:** Please comment on whether we have outlined a reasonable basis for conducting the tariff consultation exercise.

**Question 7:** Provide any evidence or views that would usefully inform the exercise or our review of the metering price control as a basis for setting a new basis for regulating metering services.

## Appendix 2 – Regulatory framework

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The GDNs provide metering services which are regulated and defined in the following licence conditions:

**Standard Special Condition A10:** Provision and Return of Meters, places an obligation upon the licensee to meet any reasonable request by a relevant supplier to provide and install at the premises of a domestic customer a gas meter owned by the licensee and of a type specified by the supplier.

**Standard Special Condition A43:** Provision of Metering and Meter Reading Services. This Licence condition places an obligation upon the licensee to provide a relevant supplier with the terms (ie costs and timelines) for the provision of meters. It requires the licensee to prepare a statement detailing the basis of providing all its services.

**Standard Special Condition A46:** Non Discrimination in the provision of metering activities. This Licence condition places an obligation upon the licensee so that shall not make differing charges for the provision of metering activities unless such differences reasonably reflect differences in the costs associated with such provision. In addition the Licence condition stipulates that the licensee must not to any supplier or class or classes of supplier restrict, distort or prevent competition in the supply or conveyance of gas through the setting charges in respect of metering activities

**Special Condition C12:** Sets a restriction of prices in respect of tariff capped metering activities. This Licence condition sets the maximum tariff cap to ensure that the licensee does not set charges for each of its metering activities that exceed the maximum tariff cap in respect of that metering activity.

The GDNs Standard special conditions can be found at the following link:

- <http://oldepr.ofgem.gov.uk/index.php?pk=folder380871>

The GDNs Special conditions can be found at the following link

- [http://oldepr.ofgem.gov.uk/document\\_fetch.php?documentid=12152](http://oldepr.ofgem.gov.uk/document_fetch.php?documentid=12152)

## Appendix 3 – Summary of responses to consultation

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In our December 2011 ROMA document we consulted on our proposals and sought views from interested parties on the following questions. A list of respondents and a summary of their views can be found below.

**Question 1:** What do you consider are the pros and cons of our approach to managing traditional metering in the transition to smart metering?

**Question 2:** Do you consider that our assessment of the related issues within the metering market is accurate?

**Question 3:** How should emergency metering services be provided for in the transition to smart metering?

**Question 4:** How should emergency metering services be provided, for smart meters?

**Question 5:** Which is your preferred option for managing the transitions and why?

**Question 6:** Under option C, is it appropriate to carry out a price control review?

**Question 7:** Which of our revenue restriction options do you consider is appropriate and why?

**Question 8:** If you are a GDN, would you prefer to transfer MAP ownership of your traditional meters (ie full transfer), or to subcontract new requests and the management of historical stock (ie partial transfer) or continue to manage your own meters?

**Question 9:** If you are a commercial meter operator (CMO), do you envisage a point in the smart meter rollout where you would be interested in consolidating your traditional meters?

## Respondents to consultation

	Company	Respondent
1	Association of meter operators	Meter Operator
2	British Gas	Supplier
3	Calvin Asset Management	Meter Operator
4	Community of meter asset providers (CMAP)	Meter Operator
5	EDF	Supplier
6	Eon	Supplier
7	Energy UK	Trade Association
8	ESTA	Trade Association
9	First Utility	Supplier
10	N Power	Supplier
1	Northern Gas Networks	GDN
12	National Grid	GDN
13	Northern Powergrid	Network
14	Scotia gas Networks	GDN
15	Scottish Power	Supplier
16	Smartest Energy	Supplier
17	Scottish Southern Energy	Supplier
18	Wales and West Utility	GDN

## Summary of Views

Question	Summary of response
Question 1: What do you consider are the pros and cons of our approach to managing traditional metering in the transition to smart metering?	<p>Respondents views: Stakeholder responses to this question totalled 19 - consisting of 11 suppliers, 3 meter operators, 1 independent gas transporter, 2 trade associations, 2 gas distribution networks.</p> <p>A number of respondents welcomed the consultation and see consolidation as a key step towards delivering an efficient transition. The backstop national meter provider of last resort (MPOLR) is supported by the majority of respondents in the transition to smart meters.</p> <p>The Association Meter Operators (AMO) considered that there are two distinct markets to consider (domestic and industrial and commercial) in the transition and that they should be considered separately. They also call for the MPOLR obligation to be lifted in 2014 to allow suppliers and MAMs to develop appropriate commercial arrangements /</p>

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	<p>consequential changes.</p> <p>IGTs were broadly supportive of the strategy but have some concerns with respect to how the process applies to IGTs in the transition to smart meters. In particular they are concerned that there is no mechanism to recover stranded metering costs as smart meters are rolled out. Furthermore, they are concerned that review of IGTs has been delayed and altogether removed from the 2011-16 corporate strategy. IGTs argued that it is not economical to reuse traditional meters since the provision of new meters is around £30, and outweighs the recycling costs of old meters. Furthermore, they raised a concern that it is inappropriate for the National Measurement Office (NMO) and industry suppliers to develop in service testing regime which promotes circulation of old meters.</p> <p>National Grid (NG) considers that a backstop MPOLR coupled with a pricing consultation is a sensible and pragmatic approach to managing an efficient and economical transition to smart metering. They do believe that the timing is right to consider how the IGTs fit into the national MPOLR and transition. NG also recognised the asset transfer from other GDNs is likely to help manage ongoing costs and ensure that meters remain available at a reasonable price on a national basis.</p> <p>Northern Gas Network welcomed the decision to set a date when the MPOLR obligation would be lifted and also the concept of introducing the role of a national backstop MPOLR. They considered that the approach provided a clear delineation between tradition and smart metering. They did express a concern that the consultation did not set out an approach to deal with stranded metering assets and suggested that any residual value should be returned to the network regulatory asset value.</p> <p>Wales West Utilities (WWU) point out that cost of metering services will change as the market diminishes and that a number of traditional meters will be replaced before the end of their economic life. They also highlighted that suppliers continue to procure PPM meters under MPOLR arrangements because it is economical to do so – however, they argue that if the PPM charges were cost reflective they would not do so. They did not agree that current arrangements protected consumers as suppliers do not have an obligation to reflect the metering tariff caps within their charges to consumers.</p> <p>The community of meter asset providers (CMAP) commented that tracking assets is essential for a meter</p>
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	<p>asset provider business (MAP) and that the existing market process arrangements does not provide the required visibility for recovering rental charges especially on customer churn . The CMAP commented that this issue needs to be addressed prior to mass rollout of smart meter and called for Ofgem to require suppliers to pay meter rentals until the meter is removed.</p> <p>Several respondents (Calvin, Northern Powergrid and NPower) recognised that Ofgem is taking a “light touch” regulatory approach in developing the strategy for the transition to smart meters, which is in line with the principles of Better Regulation.</p> <p>The Energy Retail Association / Energy UK consider that the current arrangement have deterred competition within metering due to cross subsidisation of pre payment meters. They were largely supportive of National Grid becoming the backstop MPOLR and recognised that any sunset clause would need to be carefully managed and coordinated with suppliers new and replacement obligations to install smart meters. They also recognised that the MPOLR obligation would not be expected to remain in place post 2014. They were also of the view that there needs to be a focus on the maintenance element of the current metering charges as this is likely to have the most impact on suppliers in the transition.</p> <p>British Gas (BG) are of the view that there is no enduring requirement for a MPOLR and that this obligation should be lifted once smart metering is mandated as this provides a well defined and clearly signalled point to introduce such changes. They are of the view that many suppliers have chosen to contract with GDNs because new entrants have found it difficult to compete. BG do see a need for ongoing metering services for larger meters (U16 and above) due to the specialised skill set and low work density issues, and remain confident that these services will be available at the market rate.</p> <p>EDF supported the national gas MPOLR, under a detailed charging review as this will provide the most stable approach during the transition and have minimal impact upon supplier’s smart metering rollout plans. They do raise an issue with respect to the arrangements for PEMS as they understand that GDNs will not be offering a smart PEMS service.</p> <p>E.On agreed that competition in gas metering has not fully developed and that it is appropriate to consider the transition into smart metering and agree that to continue</p>
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	<p>with the existing price control regime is pragmatic. They agree that retaining the MPOLR for GDNs with a backstop MPOLR is sensible and are of the view that such an obligation should also include smart meters to be installed on a new and replacement basis.</p> <p>First Utility agrees that it is necessary to retain the MPOLR to ensure that new entrants are able to access these services. They also agree that National Grid Distribution is well placed to deliver the national MPOLR service.</p> <p>NPower are of the view that the MPOLR should remain with the GDNs / DNOs, and recognised that National Grid are well placed to operate the backstop MPOLR which would provide a consistent and uniform customer experience. They did suggest that this approach would create a natural monopoly and deter new entry. They also called for a review of the IGTs to address concerns with commercial contracts for MPOLR on IGT networks.</p> <p>Scottish Power (SP) agree that in the short term the MPOLR should remain and agree that it is not necessary to introduce licence conditions to ensure that small suppliers have access to smart metering services. SP commented that metering contracts on IGTs networks are between the IGTs and developers and that they have a number of concerns with contracts and termination charges.</p> <p>Smartest Energy supports the notion of a metering provision obligation on larger suppliers to mitigate the risk of not being able to gain access to metering services in the future. They are also of the view that traditional meters will be required beyond 2019 for customers who have decided not to have a smart meter installed.</p>
<p>Question 2: Do you consider that our assessment of the related issues within the metering market is accurate?</p>	<p>Respondents views: Stakeholder responses to this question totalled 18 consisting of 10 suppliers, 3 meter operators, 1 independent gas transporter, 2 trade associations, 2 gas distribution networks.</p> <p>ESTA disagreed with our assessment and in particular our view that commercial arrangements are sufficient to prevent premature replacement of meters. They also commented that suppliers metering costs are not transparent which could lead to consumer detriment in the event that a meter is replaced prematurely. The CMAP also disagreed with our assessment and stated that their members continue to experience issues with tracking their assets – which will be more material as more expensive smart meters are rolled out compared to traditional meters.</p>

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	<p>Wales &amp; West Utility commented that it is not clear what happens to traditional meters at the end of the smart metering rollout and suggested that Ofgem should consider how best to address this issue with the interested MAPs.</p> <p>Eon and EDF agreed that our consultation document addressed a number of relevant issues; however EDF suggested that it could have been extended to cover gas data flow associated with MAPs to ensure all relevant data is held in a centralised database.</p> <p>The AMO highlighted that there are two separate markets (domestic and non-domestic) to consider and that the non-domestic market is already competitive. They also commented that domestic meters do not normally receive any routine maintenance.</p> <p>First Utility agreed with our assessment and called for Ofgem to provide clarity on the future of the recertification scheme for existing electricity meters, as it would be inappropriate for a meter approaching the end of its certification life to be replaced with a traditional meter. They argue that the recertification programme should be suspended until the obligation to install smart meters under the new and replacement obligation is switched on.</p> <p>National Grid agreed with our assessment and in their experience has found that the contractual arrangements for commercial interoperability do not result in meters being replaced unnecessarily. They have observed an increasing trend of PPM meters being procured via MPOLR. Any future pricing of meters should reflect the shortened asset life and account for increasing cost to serve PPM.</p> <p>Smartest energy agreed with assessment, but commented that there will be an ongoing role for traditional meters well into the next decade.</p> <p>Northern Power Grid noted that the recent changes to the industry processes to improve MAP identity had not addressed all of the issues associated with tracking MAPs assets, and suggests that MAPs should be registered as a valid market participant. NPower consider that the bundled nature of MAM/MAP functions may inhibit MAP market entry.</p> <p>IGTs noted in their response that when a smart meter is being installed additional works may be required to the network / customers installation and have sought clarification on how this works should be charged.</p>
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	<p>Scottish Power urge Ofgem and DECC to align their thinking on how best to achieve a more effective switching process and suggest that this could be achieved via a single industry change.</p>
<p>Question 3: How should emergency metering services be provided for in the transition to smart metering?</p>	<p>Respondents views: There were 19 responses in total comprising the following stakeholders; suppliers 10, meter operators 3, independent gas transporters 1, trade associations 2, gas distribution networks 3.</p> <p>There is broad consensus amongst stakeholders that Gas Distribution Networks (GDNs) should continue to provide Post Emergency Metering Services (PEMS) until smart meter implementation. There is broad industry support for market led solutions as opposed to regulation; however a number of respondents are supportive of keeping the MPOLR obligation on GDNs.</p> <p>NGN are supportive of keeping existing arrangement for PEMS and will continue to provide the service under commercial terms as long as suppliers need it.</p> <p>First utility support this approach, as it currently facilitates commercial contracts.</p> <p>ERA supportive, but do recognise smaller suppliers may have different views. Do not see the need for regulation and consider that market currently delivers excellent customer service in this regard.</p> <p>Npower are supportive of this option and consider that PEMS and MPOLR should operate as one. They argue that it makes sense for emergency issues to remain with the network.</p> <p>AMO view that PEMS should be supplied through commercial contracts rather than licence obligation on GDNs</p> <p>Northern Power Grid consider that this should sit with suppliers and offer a 24/7 customer contact.</p>
<p>Question 4: How should emergency metering services be provided, for smart meters?</p>	<p>Respondents views: Stakeholder responses to this question totalled 16 consisting of 10 suppliers, 1 meter operator, 1 independent gas transporter, 2 trade associations, 2 gas distribution networks.</p> <p>The majority of respondents consider that PEMS services should continue to be provided on a commercial basis</p>



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	<p>when smart meters are rolled out. A number of potential options were suggested which included the supplier contracting as a part of the supplier hub principles.</p> <p>Supplier would have bilateral contracts with commercial service providers, which may also include networks.</p> <p>Suppliers may decided to in-source this function</p> <p>Big six providers may offer terms to smaller suppliers</p> <p>Networks would install a meter (traditional / smart) to keep the customer on supply or make safe as appropriate</p> <p>WWU consider that existing arrangements could work, and extend to smart metering and include HAN / WAN issues.</p> <p>NGG are not supportive of PEMS extending into smart metering.</p> <p>NPower consider that PEMS should be a part of the MPOLR when smart meters are rolled out. They suggest that due to a wide range of technology Network Operators should install credit meter or current SMETS in traditional mode.</p> <p>GDNs could continue to offer this service and make safe / maintain supply and contact the supplier if further works are required.</p> <p>A number of respondents suggested that a centralised service may be appropriate with the DCC procuring national services on behalf of suppliers. A number of respondents also suggested that PEMS services should have a national contact number – no detail was given on how this would operate in practice.</p>
<p>Question 5: Which is your preferred option for managing the transitions and why?</p>	<p>Respondents views: Stakeholder responses to this question totalled 15 consisting of 9 suppliers, 1 meter operators, 1 independent gas transporter, 2 trade associations, 2 gas distribution networks.</p> <p>The majority of the respondents support option c, with some calling for a) the separation of MAP and MOP services, and b) the back stop provider to contract directly with suppliers. BG argues that this option would create a natural monopoly and would not be in the interest of metering competition.</p> <p>ESTA consider that the ability for I&amp;C meters to opt out of the DCC will be a significant factor.</p> <p>WWU supports Ofgem’s option c; however they do not</p>

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	<p>consider that they are best placed to deliver the role of the B-MPOLR. They also contend that GDNs should have a one off decision to opt in /out of the service. They argue that it would be appropriate to remove the MPOLR obligation entirely on GDNs, whilst introducing a licence condition on the back stop MPOLR to offer a national service.</p> <p>EDF consider that option c is the preferred option as it will ensure that consumers are provided with traditional metering services at reasonable costs.</p> <p>EON are content with option c, however they are of the view that this should also include smart meters from a point when mass rollout commences, as this will reduce stranding risk and overall costs to suppliers.</p> <p>The AMO are of the view that Ofgem should issue a sunset clause (at some point in 2014), which would lift the obligation on GDNs to provide meters under MPOLR. This would give sufficient notice to suppliers to make alternative contractual arrangements.</p> <p>First Utility support option c, with NGG delivering this national service. NGG's prefer option c as this will deliver economies of scale by retaining the bundling of meter provision and maintenance. They are concerned that meters will be stranded and would seek a mechanism to achieve appropriate protection. They note that traditional meters may be required on an enduring basis given governments smart metering exceptions. NGG argue that consolidation will drive efficiencies, which may be facilitated by relaxing the requirements to separate National Grid's metering business from NGG – as set out in standard special condition A33.</p> <p>Smartest Energy also prefers option c as this would be the fairest option taking into consideration the needs of all parties. The majority of the ERA's members support option c – with the exception of one member.</p> <p>Northern Gas network strongly support option c, and suggest that the obligation should be on NATIONAL GRID to directly provide this service nationally to all suppliers, rather than providing the service to GDNs.</p> <p>NPower oppose the continuation of MOP/MAP bundling and would prefer an option which included an unbundled MPOLR service. They suggest that third parties should be able to operate on assets that they do not own and have a minimal level of regulatory oversight.</p>
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	<p>BG prefers option b as it provides continuity with a generous notice period in which alternative commercial services can be procured. They are of the view that option c would create a natural monopoly and counter intuitive to creating competition.</p> <p>Scottish Power and IGTS, consider that option c would be the most pragmatic and be in the best interest of consumers.</p>
<p>Question 6: Under option C, is it appropriate to carry out a price control review?</p>	<p>Respondents views: Stakeholder responses to this question totalled 14 consisting of 9 suppliers, 1 meter operator, 1 independent gas transporter, 2 trade associations, 1 gas distribution network.</p> <p>There is a broad consensus that the metering tariff caps need to be reviewed, albeit this is not a unanimous position as EON considers that this could divert resource and focus away from the rollout of smart meters.</p> <p>ESTA do not believe it would be appropriate to conduct a price control if suppliers published their meter charges as separate bill items.</p> <p>WWU utility considers that tariff caps should be reviewed, and have proposed alternative caps as a part of RIIO GD1. EDF - yes to ensure that metering charges are regulated in line with the charges of other metering services so that the market is not distorted.</p> <p>First Utility agrees that it is appropriate to examine the existing tariffs. National Grid agrees that a review of the tariff caps is appropriate. Smartest Energy concurs that the metering tariffs should be reviewed.</p> <p>The ERA's members agree that the tariffs should be reviewed.</p> <p>Northern Gas Network agree that the existing tariffs are out of date and any review should also consider the cross subsidy of PPMs.</p> <p>NPower recognise that the controls have not been reviewed since 2001 and therefore it is necessary to conduct a review.</p> <p>BG – Agree that a price control review is appropriate, given that it has not been reviewed for almost a decade. IGTS are silent on the point but recognise that any price control on GDNs is likely to form an artificial reference point for IGTs charges.</p>

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	<p>Scottish Power recognises that the price tariff should be reviewed.</p> <p>The AMO argue that the GDNs should not be able to vary there charges for meters already installed, however they recognise that under the backstop MPOLR there may be a case for increasing the tariff caps until such as point as the obligation to provide meters expires.</p> <p>EON – do not consider that a full price control is justified, as this would create further uncertainty in the market and divert resources away from delivering an efficient rollout of smart meters.</p>
<p>Question 7: Which of our revenue restriction options do you consider is appropriate and why?</p>	<p>Respondents views: Stakeholder responses to this question totalled 14 consisting of 9 suppliers, 1 meter operator, 1 independent gas transporter, 1 trade association, 2 gas distribution networks.</p> <p>EDF, EON, First Utility, IGTS , NGN and Scottish Power agree with Ofgem that Option 1 is the most appropriate form of price control review because a full review will take a significant amount of time and will only be a relatively short lived control.</p> <p>National Grid support Ofgem’s view but would expect that any MPOLR obligation and the tariff caps on rentals for new meters would be lifted following the mandate to commence the mass rollout.</p> <p>The majority of the ERA’s members agree with Ofgem’s preferred option to conduct a charging consultation as this would satisfy Ofgem and Industry that the tariff structure and charges are appropriately cost reflective. One of the ERA’s members is that the time is right to conduct a full price control review due to the time that has elapsed since the last control.</p> <p>WWU are silent on the precise nature of the price control and suggest that this is a matter for the backstop MPOLR. The AMO argue that moving towards a competitive metering market will remove the need to price control metering services.</p> <p>BG and NPower would prefer a full price control as this is likely to lead to a more robust process and satisfactory outcome. BG considers that it cannot be assumed that costs will reduce and therefore a full price control would be necessary.</p>
<p>Question 8: If you are a GDN, would you prefer to</p>	<p>Respondent’s views: Stakeholder responses to this question totalled 4 consisting of 1 independent gas</p>



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<p>transfer MAP ownership of your traditional meters (ie full transfer), or to subcontract new requests and the management of historical stock (ie partial transfer) or continue to manage your own meters?</p>	<p>transporter, 3 gas distribution networks. National Grid is supportive of either a full or partial transfer.</p> <p>The following are supportive of a full transfer WWU, NGN – but recognise that stranding would need to be addressed. iGTs would need to understand in greater detail how the value of the assets would be calculated, and also commented that they may wish to transfer MAM only functions.</p>
<p>Question 9: If you are a commercial meter operator (CMO), do you envisage a point in the smart meter rollout where you would be interested in consolidating your traditional meters?</p>	<p>Respondent’s views: Stakeholder responses to this question totalled 5 consisting of 3 suppliers, 1 meter operator, 1 gas distribution network.</p> <p>EDF does not have any plans to consolidate traditional meters however they will keep this under review. EON are considering internally how best to manage the transition from traditional to smart meters, and were silent on consolidating their meters to the backstop MPOLR.</p> <p>The AMO and National Grid commented that any transfer would be for the interested parties to resolve from a commercial perspective.</p> <p>NPower commented that they would be interested in transfer meter reading functions and that in the future they may consider consolidating their traditional meters.</p>



## Appendix 4 - Review indicative timetable

ID	Phase	Owner	Year	Month	Milestone
1	Ofgem decision	Ofgem	2012	July	Publish decision document
2	Consultation period (6 weeks)	Ofgem		August	Consultation closes to ID 1
3	Acceptance Document	National Grid		August	Publication of the National Grid acceptance document.
4	Summary of response to ID1	Ofgem		September	Publication of open letter
5	Approach Document	National Grid		September	Publication to include pricing methodology and modelling assumptions.
6	Initial Proposal	National Grid		November	Publication of document to initial proposal regarding the RAV split and detail and refinements to the modelling assumptions
7	Consultation period	National Grid		December	Consultation closes to ID 6
8	Final Proposal	National Grid		December	Final Proposal Document published
9	Decision	Ofgem	2013	February	Decision document
10	Consultation period	Stakeholders		March	Consultation closes to ID 9
11	Statutory licence consultation	Ofgem		April	Publication of licence modifications
12	Adjustment / existing tariff	National Grid		April	Publication of proposed tariffs (if lower than existing tariffs caps)
13	Consultation period	Stakeholders		June	Consultation closes to ID11
14	Implementation / standstill period (56 days)	Ofgem		July	Implementation paper / notice
		Ofgem		September	New price controls formally commence

## Appendix 5 - Glossary

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### **B**

#### Back stop meter provider of last resort (B-MPOLR)

An obligation upon the licensee to meet any reasonable request by a relevant GDN to provide and install at the premises of a domestic customer a gas meter owned by the licensee and of a type specified by the GDN.

### **C**

#### Commercial Arrangements

The entry into a contract for services between parties, for example such as suppliers and metering businesses.

#### Commercial Interoperability

The contractual terms on which a new supplier can use the meter and related equipment when a customer changes supplier.

#### Consumer

A person or organisation using electricity or gas at a meter point.

#### Contractual Terms

The offer of commercial arrangements.

#### Correspondence

includes any draft or final version of a letter, email, facsimile, or note of a telephone conversation.


### **D**

#### DataCommsCo (DCC)

New proposed entity which would be created and licensed to deliver central data and communications activities. DCC would be responsible for managing the procurement and contract management of data and communications services that will underpin the smart metering system.

#### Daily credit meter (DCM)

A standard domestic meter.



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### DCM price controls

DCM price controls relate to provision and maintenance of new and replacement daily credit meters, installed between the present and the mandate of smart meters.

### Distribution Network Operators (DNOs)

DNOs take electricity off the high-voltage transmission system and distribute this over low-voltage networks to industrial complexes, offices and homes. DNOs must hold a licence and comply with all distribution licence conditions for networks which they own and operate within their own distribution services area. There are 14 DNOs covering discrete geographical regions of Britain.

## E

### Energy Suppliers (suppliers)

A company licensed by Ofgem to sell energy to and bill customers in Great Britain.

## G

### Gas Act Owner (GAO)

The organisation or person responsible for providing and installing the complete metering installation for the measurement of gas consumption, and for maintaining the meter installation in good working order, as required by the Gas Act 1986 (as amended).

### Gas Distribution Network (GDN)

A company, licensed by Ofgem, which transports gas through its network on behalf of a gas shipper. There are four GDNs, each covering a separate geographical area of Great Britain.

### Gas Transporter (GT)

A company, licensed by Ofgem, which transports gas through its network on behalf of a gas shipper.

## L

### Licence

Transporting, shipping and supplying gas; and generating, transmitting, distributing and supplying electricity are all licensable activities. Ofgem grants licences which permit parties to carry out these activities in the GB market. The licenses require the establishment of a number of multilateral industry codes that underpin the gas and electricity markets. Licensees need to be signed up as parties to codes in order to operate in the gas and electricity markets.

## **M**

### Metering Agent

A person or undertaking which undertakes any or all of the MAP, MAM or Mop activities (and which are defined below).

### Metering Assets

the meter installation. In the case of gas this means the meter and associated components within the whole installation for the purpose of measuring volume of gas. In the case of electricity it means a measuring instrument that records the amount of energy which passes through it.

### Meter Asset Manager (MAM)

A person approved by the Authority as possessing sufficient expertise to provide gas metering services. A gas MAM essentially provides the services that would be provided by a MAP and MOP in electricity.

### Meter Asset Provision/Meter Asset Provider (MAP)

The ongoing provision of the meter installation at a meter point. In electricity the Meter Asset Provider is responsible for supplying electricity-metering equipment for the purpose of satisfying the electricity settlements process, the requirements of the relevant Use of System Agreement and the relevant primary and secondary legislation.

### Meter Operation/Meter Operator (MOp)

Meter operation comprises all work associated with the installation, commissioning, testing, repair, maintenance, removal and replacement of electricity metering equipment.

### Meter Provider of Last Resort (MPOLR)

The GDNs who are obliged to provide gas meters at the request of a supplier to customers.

### Metering services


The provision, installation, commissioning, inspection, repairing, alteration, repositioning, removal, renewal and maintenance of the whole or part of an installed gas or electricity meter.

### Metering work

The completion of some aspect of metering services on the metering assets.

## **P**

### Pre payment meter (PPM or DPM)



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The type of meters that require payment for energy to be made in advance of use or they will prevent the supply of gas or electricity. A PPM customer pays for energy by inserting electronic tokens, keys or cards into the meter.

#### PPM price control

PPM price controls relate to provision and maintenance of new and replacement prepayment meters, installed during the same period as DCM new and replacement.

#### PPM service

metering services associated with PPM meters.

### R

#### Regulatory Asset Value (RAV)

The [RAV](#) is a measure of the value of the capital employed in the regulated business, and is a key building block of the price control review. RAV is a financial construct based on historical investment costs and represents the value upon which the companies earn a return in accordance with the regulatory cost of capital (ie the weighted average cost of capital) and receive a regulatory depreciation allowance. In effect this rewards licensees for investing in the assets that make up the regulated businesses.

### S

#### Smart meter

A meter which, in addition to traditional metering functionality (measuring and registering the amount of energy which passes through it) is capable of providing additional functionality for example two way communication allowing it to transmit meter reads and receive data remotely.

### T

#### Traditional meter

Refers to those meters which are installed, and are on the wall. This refers to both DCM and PPM meter types.

### V

#### Vertically Integrated Company

A supply company whose business also includes at least one of: metering services and ownership of the metering assets.

## Appendix 6 - Feedback Questionnaire

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5.9. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

Do you have any comments about the overall process, which was adopted for this consultation?

Do you have any comments about the overall tone and content of the report?

Was the report easy to read and understand, could it have been better written?

To what extent did the report's conclusions provide a balanced view?

To what extent did the report make reasoned recommendations for improvement?

Please add any further comments?

Please send your comments to:

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