

Steve Rowe
Smarter Markets
Ofgem
9 Millbank
London
SW1P 3GE

Paul Whittaker
UK Director of Regulation

paul.whittaker@uk.ngrid.com
Direct tel +44 (0)1926 653190
Direct fax +44 (0)1926 656520

www.nationalgrid.com

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Review of Metering Arrangements (Consultation Reference 175/11, published 15/12/11): decision and consultation on transition to smart meters

National Grid Gas (NGG) welcomes the opportunity to respond to Ofgem's consultation regarding the review of metering arrangements in the transition to smart metering. National Grid Metering (NGM) is a subsidiary of NGG, providing metering services to around 15 million of NGG's traditional gas meters within the regulated gas market. NGG therefore has a significant interest in current and future developments of the metering market and National Grid plc supports the orderly transition from traditional to smarter metering.

We understand Ofgem's rationale for a proposal to appoint NGG as the National Meter Manager providing traditional metering services and would be willing to undertake such a role if other Gas Network Owners chose to use this service. However, we believe that it is for individual Network owners to determine whether this is appropriate for their business. Similarly, NGG will only provide such a service on the basis that its costs are fully recovered and any stranding risk arising from transferring assets is mitigated.

While we agree that it is vital that customers are protected from any failure of the supply market to provide domestic meters, we have seen no evidence of problems arising in the electricity sector which has no equivalent of MPOLR. However, given that the planned start date of smart metering roll-out is two years away, we recognise why Ofgem may wish to retain the obligation on GDNs to maintain stability in the transitional period.

In recognising Ofgem's proposal in relation to MPOLR, we support the concept of a sunset clause in the licence, which should be linked firmly to the start date of smart metering roll-out.

We support Ofgem's preference for a pricing consultation over that of a full Price Control Review as the most pragmatic approach to establishing the basis of charging arrangements for conventional domestic meters. We do not see any justification to reduce the level of the regulatory tariff caps, especially as the installed asset base is certain to suffer premature value stranding as smart roll-out progresses. In addition, the continuation or extension of the MPOLR obligation (through the NMM role) could bring additional costs that should be properly remunerated to ensure undertaking the obligation is not detrimental and includes appropriate protection against stranding. We do have a concern that the cross-subsidy between credit and

prepayment meters could become distorted if the ratio of meter types becomes skewed as smart meter roll-out progresses.

We provide some additional comment and proposals in our full responses to the consultation questions 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?

A pragmatic approach is needed to protect consumer interests whilst recognising the cost of obligations on GDNs. We believe the Backstop MPOLR proposal coupled with a pricing consultation to set future charging thresholds is sensible for traditional metering, having the following positives and negatives:

Positives:

- Quicker delivery of change, establishing a national approach by December 2012, thereby reducing levels of uncertainty currently seen in the transition to smart metering.
- Pricing certainty regarding future MPOLR installations, creating national uniformity of pricing, single-source provision of service and a simpler, more transparent model for the transitional period.
- Potential consolidation of traditional meter stocks, thereby offering the possibility of economies of scale up to and during the early stages of mass roll-out.
- Increased visibility of traditional populations, enabling greater clarity of their distribution and increased cost to serve as the population declines.

Negatives:

- Ambiguity over sunset and what the necessary triggers should be for the relevant licence clause, given the current uncertainty over technical specification confirmation and the likely commencement of smart mass roll-out. This is likely to create challenges in assessing the likely duration of any Backstop MPOLR obligation, making appropriate funding more difficult to assess.
- Impact of continued increased ratio of PPM fits seen under MPOLR, considering these meters are more complex and expensive to maintain and the decline of traditional meter populations will exacerbate this as population densities decrease.

If coupled with asset transfer or maintenance of other GDN's existing traditional stocks, the possible economies of scale which could be realised could help to ensure that traditional metering services remain available at a reasonable cost. However, the likely ratio of PPMs to DCMs must be considered and the impact of providing and maintaining a larger proportion of more expensive PPMs. Distortion of the cross-subsidies under a tariff-capped structure will be further increased if the current trend of greater levels of PPM fits continues under MPOLR. We would also encourage Ofgem to complete the metering consultation relating to independent Gas Transporters to establish a clear and consistent national position for the transition of metering.

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

We generally agree with Ofgem's assessments and support the recommendations proposed but make some observations against each area:

- Commercial Interoperability – unnecessary exchanging of traditional meters is not currently being seen and can be adequately managed through commercial terms.
- Accessing MPOLR – Evidence showing the increased proportion of PPMs to DCMs being requested via MPOLR is of concern and we expect a similar mix of requests to continue.

Future pricing should reflect both the shortened asset life of meters, the increased cost to maintain PPMs and the diseconomies of scale the transition to smart will increasingly create.

- Small Supplier Access To Smart – current proactive fitting of smart meters by some small suppliers as a market differentiator supports the view that access to smart is not being restricted. We also believe that the current DECC exemption consultations reinforce the capability of suppliers of any size to offer a sustainable smart meter solution. Regulatory intervention at this time would not be justified.

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

We support the continuation of existing arrangements for Post Emergency Metering Services (PEMS), through commercially agreed contracts, rather than the imposition of a licence obligation on each GDN. PEMS is a commercial service provided when gas transporters have resource and materials to undertake the work - there is no requirement to undertake any specific volume of jobs or percentage of faulty meters per year nor is it mandatory for a supplier to take the service. Mandating PEMS would require gas transporters to provide additional emergency engineers, training and logistics to comply with any obligation to undertake this activity, resulting in further costs to consumers. Pre-emptive regulation may also interfere with any commercial development of a meter operator provided service, thus restricting competition in the market and potentially increasing cost.

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

We do not envisage that gas transporters will provide PEMS once suppliers have mobilised for smart roll-out. Preparing to manage smart meter faults is likely to require different software, telemetry, tools and communications equipment for the different meters involved. Costs to train and equip engineers for this range would reduce commercial viability, given the relatively small volume of meterwork involved. We therefore do not expect NGG to extend its PEMS arrangements to cover smart metering. Suppliers should be expected to secure sufficient metering resources through either their own mobilisation for smart or through service provider contracts for the resulting smart repair or replacement.

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

It is essential to the success of smart metering that transition is effectively managed and does not introduce any perverse incentives. The Backstop MPOLR/ NMM option is therefore our preference, providing opportunities for economies of scale by retaining the bundling of meter provision and maintenance. We acknowledge that consolidation could allow a clearer assessment of the total picture for traditional metering. Risk of stranding remains a concern, given the assumed shorter asset life of meters fitted under MPOLR, and we would seek agreement on a mechanism to achieve appropriate protection against this.

Recent smart metering exemption consultations and confirmation that consumers will not be forced to accept a smart meter may result in a demand for traditional metering activities continuing until some time beyond the mandated roll-out period. As traditional meter volumes decline and economies of scale reduce, NGM would seek operational efficiencies to offset anticipated increases in the cost to serve. This might include the relaxation of the requirement to separate NGM's domestic metering activities from NGG, detailed in the Gas Transporter Licence under Standard Special Condition A33. Typically, we see this as the utilisation of common systems and buildings to reduce overheads whilst restricting access to confidential information.

Question 6 – Under Option C, is it appropriate to carry out a price control review?

We support Ofgem's view that a Pricing Consultation in conjunction with the NMM appointment is the most suitable way to achieve the proposed December 2012 implementation date. Ofgem's December 2011 RoMA consultation identified that a full PCR would take up to nine months to complete. This could delay any possibility for NMM implementation until well into 2013. In our view, a pricing consultation enables an appropriate level of scrutiny of costs and prices to ensure customers' interests are adequately protected. At a time when the industry faces considerable uncertainty and change in its operations, plans and timelines, a clear and early confirmation regarding the Backstop MPOLR arrangements will be beneficial to suppliers and consumers alike.

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

The retention of tariff caps following a pricing consultation provides pricing surety for customers and consumers, balancing a requirement for service against a fair remuneration for the GDN. Although the retention of tariff caps makes sense whilst the volume of traditional meters remains high, we would expect that any MPOLR obligation and the tariff caps on rentals for any new meters would be lifted following the mandate to commence mass roll-out.

Our view is that any consultation should follow an approach which recognises the sunk investment already made under previous obligations and addresses likely operational costs of future service provision in the context of loss of scale economies. Delays to the confirmation of a final technical specification now imply a later start to mass roll-out than the April 2014 date originally anticipated. As it is likely to be difficult to tie roll-out to specific dates (which would be preferable), other criteria may need to be set to trigger a sunset clause and the likely timing of the removal of the MPOLR obligations.

Protection against stranding and a shortened asset life could be achieved through any of three methods:

- a) Meters fitted under commercial terms, offering a rental price based on a full life depreciation but including premature replacement charges – provides suppliers with choice in the management of displacement to smart but protects the recovery of the asset value, should displacement occur shortly after installation.
- b) Use of a high rental rate recognising depreciation over a short period e.g. five years, with no premature replacement charges – incentivises a faster roll-out programme by suppliers to minimise rental costs but does not fully recover asset values until the rental period expires and does not protect the NMM from an accelerated smart meter installation rate. This could also create a strong perverse incentive for suppliers to displace young meters.
- c) Pricing based on estimated levels of MPOLR activity and smart roll-out. This approach would rely on the making of a number of significant assumptions and might thus need an ex-post correction mechanism which clearly adds complexity and uncertainty

The aggregation of MPOLR to one NMM seems sensible as a way to mitigate rising costs for the provision and management of traditional installations, including their ongoing maintenance, which will suffer from diseconomies of scale as smart roll-out progresses. We propose an approach to pricing which correctly signals to customers the costs of the services being utilised. Should NGG be appointed the NMM, we would prefer the first option suggested above, so that the charges incurred by suppliers are more directly related to their individual smart meter roll-out programmes.

Recognising the benefit of engagement with all stakeholders, we would progress a consultation by means of a series of industry workshops and bi-lateral meetings. We would

also seek confirmation from Ofgem at the outset stating the basis of any assumptions or context to be used in the consultation.

We would suggest that the use of NGM's Holistic Asset Management (HAM) approach to determine the end of an asset's life would be helpful to suppliers. It could assist in managing the most effective transition to smart whilst minimising disruption to consumers. It would allow resources to be targeted to prioritise proportionately higher risk traditional assets requiring exchange, thereby maintaining asset integrity without incurring disproportionate cost.

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

Ensuring the most effective method of managing residual volumes of traditional meters in independent GDN areas remains in the best interests of both the supplier and consumer. We agree partial or full transfer could allow clear exit strategies in all network areas in the transition to smart metering but would be unwilling to support the transfer if terms were likely to be prejudicial. Transferring MAM ownership of residual independent GDN traditional assets to the NMM may increase the NMM's exposure to stranding risk but could provide some economy of scale and a consistent national approach.

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?

We welcome Ofgem's desire to raise this issue in an attempt to provide further clarity to a situation of ongoing change and uncertainty. We would suggest that any decisions regarding consolidation should be as a result of commercial choices and a common agreement regarding the "tipping point" of traditional metering.

If you have any queries regarding the above responses, please do not hesitate to contact the following; Paul Rogers for NGG or Eric Fowler for NGM.

Yours sincerely,

Paul Whittaker
UK Director of Regulation
National Grid

cc Paul Fuller
Andrew MacFaul

