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Dear Duncan,

Early Replacement of Electricity Prepayment Meters

SSE welcomes the opportunity to respond to Ofgem's recent consultation on the treatment of the early replacement of prepayment meters in the electricity price controls.

Our responses to the specific questions raised in the consultation are attached at Appendix A to this letter. We have provided specific information on the number of installed token meters in our Scottish Hydro-Electric Power Distribution area. We do wish this information to be treated as confidential and have therefore provided it separately, please see Appendix B. We have no token meters in our Southern Electric Power Distribution area.

In summary, whilst we are aware that the current life adjustment mechanism has the potential to significantly increase the short term cost of prepayment meters we are not convinced that the mechanism proposed by Ofgem is the most appropriate solution to resolve this problem.

In our view, the simplest and most transparent mechanism to allow DNOs to recover the costs of early replacement of prepayment meters is to log up those costs until 2010 at which time they can be added to the RAV.

An alternative mechanism would be via termination charges. We believe that the main arguments against their application have been superseded by the decision to remove the obligation on DNOs to offer terms for MAP and MOp.

In addition, we do not believe that the proposed 30/70 split of the costs of stranded assets between DNO was agreed at the price control review. It would appear to us to be an arbitrary split that significantly disadvantages the DNO. Given that these meters have been provided as a result of regulatory obligation, we believe a 50/50 split would be much more appropriate and in keeping with the spirit of sharing the costs of early replacement of these meters.

Finally, we are very concerned over the proposal to remove the stranding protection from key and smartcard prepayment meters. New, smarter metering technology could potentially replace these prepayment meters before the end of their asset lives and we would wish to be able to recover any stranding costs dues to their early replacement, as agreed at DPCR4. We could not therefore agree to any proposal to remove stranding protection from these assets.

If you have any comments on the above, or on our detailed responses to the questions raised on the consultation paper, please do not hesitate to contact me.

Yours sincerely,

Rob McDonald
Director of Regulation

Appendix A: SSE response to Ofgem questions on the early replacement of prepayment meters in the electricity metering price controls

CHAPTER: One
No questions.

CHAPTER: Two
Question 1: Have we made an accurate assessment of the problems with the current electricity PPM asset life adjustment mechanism?

SSE Response: We agree that the current price control is complex and could disadvantage remaining prepayment meter customers as replacement is accelerated. In our view, a simpler recovery mechanism would provide greater transparency and certainty for both then DNO and the customer. We are concerned how best to achieve this however, and this is discussed further in our response to the questions from Chapter Three (see below).

Question 2: Please see our CONFIDENTIAL response at Appendix B.

CHAPTER: Three
Question 1: Do the problems with the current electricity PPM asset life adjustment mechanism justify replacing it with an alternative mechanism?

SSE Response: As noted above, we agree that the current mechanism is complex and not very transparent. It also may not allow recovery of even the 30% of cost allowed since against the background of metering competition it is not clear that the DNO will be able to price up to the re-set metering charge caps. We would therefore prefer to see an alternative, simpler mechanism whereby a DNO could recover a reasonable portion of the stranding costs with some certainty.

In our view, the simplest, most transparent mechanism to enable a DNO to recover the efficient costs of such stranded assets would be to add them to the RAV at the end of the current price control. Each DNO could therefore log up the annual stranding costs due to the accelerated replacement of prepayment token meters and, subject to audit by Ofgem, these could then be added on to the closing RAV at 31st March 2010. We believe that this would be the fairest means of ensuring DNOs are remunerated for the early removal of metering assets.

However, there is an alternative mechanism that Ofgem may wish to consider. This is to allow recovery of stranding costs via a termination charge. We are aware that during DPCR4 Ofgem indicated that it did not support regulated termination charges. However, Ofgem have recently announced the intention to lift the requirement on DNOs to offer terms at a price controlled rate for the provision of new / replacement meters and for meter operation because, in their view, metering competition is now sufficiently well developed. Given this, we believe that the main arguments against termination charges are no longer relevant and it could be considered as an alternative to logging up the costs until the end of the current price control.

Question 2: If so, do you agree with the alternative we have proposed? In particular, we welcome comment on the following points:

- the proposal to compensate DNOs for token PPM premature replacement costs via a tariff increase across all price-controlled meters
- the proposal to remove further stranding protection from key and smartcard meters
- the proposal to bring two-rate/multi-rate PPMs within the current tariff cap for single-rate PPMs (and also whether it would make sense to carry out a similar procedure with respect to multi-rate credit meters)
- the appropriate "split" that should be applied in allocating PPM premature replacement costs between DNOs and suppliers/consumers.

SEE Response: As noted above, we do not believe that Ofgem's alternative mechanism is the most appropriate. As it stands, it removes protection agreed at the price control review and proposes an arbitrary allocation of the costs between the DNO and the consumer.

We are firmly opposed to the proposal to remove stranding protection from key and smartcard meters. Prepayment meters are likely to be the first niche markets to be replaced by smart meters, given their high cost to serve. We would find it unacceptable that DNOs would have to pay for the early replacement of these meters due to new technology. The price control arrangements were designed to insure against just this occurrence.

In addition, we do not agree that two-rate/multi-rate prepayment meters should be brought within the current tariff cap for single-rate meters. Two-rate meters require a separate timeswitch at additional cost to the basic single-rate meter and therefore should continue to have a separate tariff cap. Furthermore, we see no reason why any changes are required to the current credit meter price controls.

Finally, with regard to the appropriate 'split' to be applied in allocating premature replacement costs between DNOs and suppliers/consumers, we are strongly opposed to the proposed 30/70 split. Whilst the DPCR4 decision document did make it clear that customers should not bear the full cost of premature removal of prepayment meters, it also noted that DNOs had a licence obligation to provide such meters and should therefore not be expected to bear the full cost of action taken by suppliers as a result of changes in the metering market.

In our view, therefore, a 50/50 split would be much more appropriate and in keeping with the spirit of sharing the costs of such change. This split could as easily be applied to what we believe is a simpler and more transparent mechanism for recovering the costs of stranded assets, namely, adding these to the RAV in 2010.

Question 3: Have we made an accurate assessment of the changes that would be needed to the distribution licence in order to give effect to our proposals?

SSE Response: Whilst Ofgem's assessment of the changes required to give effect to the proposals is accurate, given our comments above, we do not agree that they should be implemented in the proposed form.

Our preference would be for the stranding costs due to the early replacement of prepayment token meters to be logged up until 2010 at which time 50% of these costs should be added to the RAV.

Question 4: [DNO licensees only] Would you be willing to agree to modifications to the distribution licence along the lines of those set out in this chapter? If not, in what ways do our proposals fall short of your addressing your concerns?

SSE Response: For the reasons noted above, we do not believe that modifications along the lines proposed are the best way forward. Our strong preference would be to allow the DNO to log up these costs until 2010 and then add them to the RAV. As noted earlier, an alternative could be for Ofgem to allow DNOs to set termination charges for these assets.

Nevertheless, if a price cap is the preferred industry approach, then recovering the costs through an increase on all price controlled meters would clearly be better than the existing arrangements. However, as noted above, we believe that two-rate/multi-rate meters should continue to have their own price caps and we strongly believe that similar caps are still necessary for key and smartcard prepayment meters.

We see no reason to make any changes to the current credit meter price caps.

In all cases, whether the recovery of DNOs stranding costs is via the RAV, termination charges or price caps, we believe that the split of costs between DNOs and customers should be 50:50.