

Metering Price Control Review

National Grid Gas Response to the Ofgem Consultation Document

1. Introduction

We welcome this consultation on the requirements for future regulation of metering and in particular Ofgem's commitment to competition. National Grid believes that competition in a market free of regulatory uncertainty provides the best opportunity for efficient delivery of the services needed by customers, including the introduction of innovative technologies. As a gas transporter, National Grid Gas has a duty under Standard Special Conditions A10 'Provision and Return of Meters' and A43 'Provision of Metering and Meter Reading Services', to provide and install a domestic meter if requested by a supplier at a price regulated by a tariff cap. We currently provide around 19 million domestic gas meters in Great Britain.

1.1 Review of the Metering Market

We note Ofgem's assessment that the electricity metering market is developing well and welcome the conclusion that regulation should be lifted where competition is judged to be operating.

Reliable and sustainable asset provision needs to have appropriate commercial security for investors. Early displacement of assets should be based on a benefits case that includes assessment of the cost of the early removal and appropriate compensation for the asset owner. If this security is not available then it is unlikely that the market will attract investment either by existing participants or new entrants for technological innovation such as 'smart' metering.

We believe that an efficient metering market should be founded on the natural churn of assets available under new or replacement cycles. This provides confidence for asset investors and also avoids a 'gold-rush' situation leading to inefficiency, higher prices and detriment to both suppliers of the metering services and consumers. The removal of tariff controls on new and replacement electricity meters whilst retaining them for previously installed meters is an appropriate balance, recognising the extent of the competition that exists for providing new and replacement meters whilst retaining protection for customers that continue to use legacy meters. Promoting competition for new install or replacement of existing meters as they reach the end of their service life is efficient use of the assets and in the long term should represent the least cost solution for consumers.

1.2 Gas Metering Price Controls

We look forward to a timely resolution of the Competition Act Investigation (the Investigation) to deliver clarity to the metering market and remove regulatory uncertainty. However, we do not believe that the Investigation should be seen as a barrier to lifting the gas metering tariff caps as they are not the subject of the Investigation and have no direct bearing on it.

We believe that against objective measures, competition in gas metering has developed well with up to 56% of new and replacement meters being provided by competitive operators. As a matter of principle, and for the reasons discussed in the previous section, the approach to price controls should be consistent across both gas and electricity metering markets. Thus, we feel that Ofgem should remove with effect from April 2007 the tariff controls on new & replacement gas meters and the Gas Transporter's (GTs) licence obligation to provide and install a meter when requested by a supplier in recognition of the level of alternative provision available for new and replacement meters. This would enhance competition by incentivising the market to seek alternative meter asset providers and provide National Grid Gas and other Distribution Networks with some discretion in metering strategy.

The time constraints of this price control review dictate that unless Ofgem determines that the tariff cap for legacy gas credit meters is removed prior to April 2007, then as the least uncertain option it should remain in its current form and continue to be subject to RPI. This would be consistent with Ofgem's proposals for electricity legacy meters, which recognise the different market characteristics of legacy and new and replacement meters.

We note Ofgem's acknowledgement that the tariff caps for gas prepayment meters are below the commercial rate by at least 10%. National Grid Gas has expressed concern with the level of the prepayment tariff cap since its proposal in 2001 and the comments in paragraph 4.30 of the consultation document correspond with our views that if tariff caps are set too low then the attractiveness of investing in more expensive but potentially more efficient technology is weakened. Additionally, a tariff cap which is below the commercial rate must discourage potential new entrants.

We believe that the low level of the cap on charges for pre-payment gas meters is a barrier to competition as the price charged is below the cost of providing this service. This constraint should be removed at the earliest opportunity, or at the least reset to a cost reflective level as was the case in the 2005 DNO price control review.

2. Responses to Individual Questions Raised

This section details National Grid's views on the questions raised by Ofgem in the consultation document.

2.1 General Comments

We would like to correct a factual error in the document under paragraph 2.3. The Meter Service Agreements (MSAs) are primarily between National Grid Gas (formerly Transco) and gas suppliers. The tariff caps apply to these contracts because they are made with the Licensee and are thus captured by GT Licence condition E5.

2.2 Chapter Two – Gas Metering Price Controls

Q1: Is it necessary to review the price controls on gas meters prior to conclusion of the Competition Act investigation?

In addressing this question we felt it was helpful to first compare the current situation for new and replacement meters (including pre-payment) in domestic electricity and gas. The table below outlines some common features upon which to reflect.

Key Feature	Electricity	Gas
Competition in provision of new and replacement meters	20%	56%
Competitive metering businesses	7 DNO affiliated & 3 British Gas tender (Onstream, Meterfit & Capital).	3 British Gas tender (Onstream ¹ , Meterfit & Capital).
Pre-payment tariff caps	Cost reflective tariff caps to encourage competition and innovation, with protection mechanism for DNOs where accelerated replacement takes place.	Tariff caps set below cost of provision and maintenance.

National Grid believes that competition in gas metering has developed considerably since the introduction of the separate gas metering price controls in April 2002. Our analysis indicates that 56% of domestic new and replacement gas meters are provided by meter operators other than National Grid Gas. Whilst the two sectors are not entirely comparable, this evidence alone would suggest competition is effective and there is a prima facie case to consider removing the price controls for new and replacement gas meters and the obligations to provide a meter when requested.

¹ OnStream is National Grid's competitive metering business

The Investigation has caused uncertainty in the metering market and we note Ofgem's reluctance to remove gas-metering controls until it has been concluded, but do not agree that it would be inappropriate to make a decision on removal of controls at this stage, for the reasons set out earlier.

Accordingly we believe:

- Tariff caps for new and replacement gas meters should be removed from 1 April 2007 in line with those for electricity meters, reflecting the actual relative levels of competition in both sectors and the need for certainty and consistency to encourage competition.
- The associated obligation on GTs to provide and install a meter upon request is removed to further encourage competitive alternatives.
- Tariff caps for legacy credit meters could be rolled over, reflecting the anticipated level of replacement and the need to provide a degree of regulatory protection to those consumers who retain such meters until they are replaced.

Q2: Is it necessary to reset the level of the cap on gas pre-payment meters prior to conclusion of the investigation?

National Grid welcomes Ofgem's acknowledgement that the cap on gas prepayment meters are leading to an under recovery, as costs exceed the price caps set by Ofgem. This situation was discussed during the 2002 Price Control and a number of respondents including Transco raised concerns about the effect this would have on the market.

We believe that it is necessary to reset the level of the cap on pre-payment gas meters prior to the conclusion of the Investigation, as the low level of the tariff cap on these meters is undoubtedly a barrier to competition. We also believe this is an area where the benefits of gas 'smart' meters may outweigh the costs and adjusting the pre-payment price cap would encourage the introduction of these more innovative meters by suppliers. We suggest that the price cap for gas pre-payment meters be reset on a more cost reflective basis from 1 April 2007.

We acknowledge that in judging whether the pre-payment meter cap should be removed, consideration should be given to the potential impact on low-income customers. However, the analysis in Ofgem's consultation on prepayment metering (Feb 2005) showed that fewer than 15% of those in fuel poverty use a gas prepayment meter. Thus, the majority of those in fuel poverty would be largely unaffected by such change. Even if only a minority of pre-payment meter customers are fuel poor, concerns have previously been expressed about the impact on other low income customers of a change in the level of prepayment meter charges. We suggest that a pragmatic mechanism to mitigate this impact could be to phase the adjustment. For example, that charges for all new installation requests could be adjusted

with effect from April 2007 while charges for existing meters could be phased towards being fully cost reflective in two stages.

National Grid describes the methodology for deriving rental charges in the metering charges statement (the 'Blue Book') published on our internet site. The calculation made in December 2005 showed that the unconstrained charge for a prepayment meter would be £47.24 (compared to the current tariff cap of £30.53). This calculation consists of the following annualised components:

- Provision = £27.19
- Installation = £5.05
- Maintenance = £15.00

These components are recalculated each year and National Grid would be willing to provide more up-to-date analysis if Ofgem was to propose lifting the cap.

2.2 Chapter Four – Review of the Electricity Metering Market.

Q1: Have we identified the key characteristics and dynamics of the electricity metering market?

We feel that the electricity metering market characteristics identified by Ofgem justify the proposals in relation to the electricity metering price controls. In addition, we believe that many domestic consumers are opting to purchase their gas and electricity from one provider, and as a consequence suppliers are seeking dual fuel metering services. It would have been useful to explore how this change in the gas and electricity supply market might impact on the future development of competition in energy metering.

We believe that it is worth noting that some of the features of the electricity metering market identified by Ofgem also apply to the gas metering market:

- The rate of legacy meter replacement is relatively low as it is not economical to displace existing assets unless they are inaccurate or reaching the end of their certified lives.
- However, innovative metering solutions may have a significant impact on these economics and justify a faster replacement rate for legacy meters.

Q2: Have we identified the key developments in the electricity metering market over recent years?

Ofgem appears to have identified most of the key developments in the electricity market, but has failed to compare them with those in gas, in order to assess the relative successes in each market. Whilst we fully support Ofgem's proposals in relation to electricity metering we believe that the issues we raise in this response in relation to regulatory consistency are compelling.

Q3: Have we identified the factors which determine whether suppliers use the competitive market to meet their electricity needs?

We believe suppliers have demonstrated their awareness of metering competition by launching tenders for new and replacement meter services. In the case of British Gas Trading, contracts have been awarded and have resulted in the 20% competitive element of the electricity meter provision and maintenance market cited by Ofgem. In the gas market, British Gas Trading has appointed competitive meter operators OnStream, Meterfit and Capital who now fit 56% of new and replacement meters. Many other suppliers have indicated that they are poised to exercise the choice available to them to appoint alternative meter providers.

Q4: Have we made a fair assessment of the prospects of further development of the electricity metering market?

We agree that conditions are good for further development of competition in electricity meter operation and in the provision of new and replacement electricity meters. However, the Competition Act Investigation has created regulatory uncertainty and may be temporarily delaying the further development of metering competition. We envisage that smart metering, in conjunction with the Energy Services Directive, will give further impetus to the electricity metering market, particularly in new and replacement meters. The same prospects for further development of competition would also apply to the gas metering market, particularly if the price controls were applied consistently between gas and electricity.

2.3 Chapter Five – Recommendations for Electricity Metering Price Controls.

Q1: Should the electricity meter price caps be allowed to fall away on 31 March 2007 in respect of meter operation and the provision and replacement meters?

National Grid supports competition and believes that where it has developed or is developing sufficiently to provide a viable alternative for customers, then regulatory oversight should be removed or reduced. Accordingly, we support Ofgem's proposal to lift the electricity metering price controls on the provision of new and replacement meters from 1 April 2007. The associated removal of the obligation to supply meters is also a positive step towards facilitating competition.

We believe that competition in gas metering means Ofgem should also remove gas metering price caps for new and replacement meters as well as the GT licence obligation to provide and install a domestic gas meter when requested by a supplier.

Q2: Should the price controls on legacy electricity meters be maintained at least until 2010?

Whilst we believe that it would be desirable to lift the price controls for legacy meters, we understand that if displacement rates are low then customers may continue to require the regulatory protection afforded by price controls for some time. We would expect Ofgem to keep the situation under review to determine the earliest date for removal of controls.

Q3: Are the concerns over potential issues for small and/or out of area electricity suppliers valid?

Q4: If so would a non-discrimination obligation on suppliers be an appropriate response to these concerns?

Although we appreciate the possible impacts on small suppliers by the removal of the price controls, we do not feel we are in a position to respond to questions 3 & 4.