Electricity distribution price control review – metering issues
Initial consultation

A Response by British Gas Trading

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Summary

British Gas Trading (British Gas) welcomes Ofgem's continuing commitment to the development of the metering market and maintaining its strategic focus on the structural framework to encourage and facilitate competition.

Distribution Network Operators' (DNOs) price controls for distribution activities must be separate from price controls for meter asset provision and maintenance services in order to facilitate metering competition in electricity by limiting the scope for cross subsidy.

The most appropriate method to value metering assets is the market price. While we realise there may be a disparity between this price and the incumbent RAVs, we do not believe this will have a significant impact on competition.

The stranding of assets is a normal consequence of competition and we do not support the principle that the incumbents should be unfairly shielded from such competitive pressures in the metering market.

Introduction

British Gas welcomes the opportunity to comment on the initial consultation document on the options for the price control treatment of the metering activities of the DNOs. We acknowledge Ofgem's intention to implement the final proposals as part of a new distribution price control with effect from 1 April 2005.

We are a strong advocate of the development of metering competition and, having committed significant resources in moving the metering agenda forward, we are generally supportive of these proposals. We see this as an important first step in delivering Ofgem's metering strategy for DNOs.

We support Ofgem's aspiration to develop an effective competitive market which encourages higher service levels and innovative products. We believe the separation of the DNO price control to be essential to create the right regulatory environment to enable metering competition to become a reality and realise its potential to improve services to the customer and drive down costs.

We see that the key risks now facing Ofgem include the approach to the:

- valuation of existing meters;
- correct allocation of costs and the removal of cross subsidies; and
- removal of incumbent advantages

We discuss these issues in the following sections.

Policy considerations for evaluating metering price controls

Whilst we agree that, initially, Ofgem will need to balance a number of potentially conflicting issues relating to its statutory duties when designing metering price controls, we believe that as competition becomes established Ofgem will be able to withdraw from direct regulation of this market.

We therefore believe that Ofgem's primary focus should be on removing the barriers to entry and creating the environment where effective competition in the provision and maintenance of electricity meters can flourish from the onset.

We accept that, before this happens, Ofgem must have regard to the ability of licence holders to finance their licensed activities but would not wish to see this duty restrict the timing or extent of the development of this market.

Similarly, we would not wish to see metering price controls create undue barriers to the development of beneficial innovations. New technology brings many benefits to customers and suppliers in the form of more accurate billing, lower costs and payment flexibility. A key parameter controlling the introduction of new technology will be dictated by the replacement rate of existing meters and the extent to which these assets are stranded could inhibit progress.

We also acknowledge that in the intervening time before competition becomes fully developed it will be necessary for Ofgem to ensure that the price control provides the incentives to DNOs for increased efficiency and stable market pricing for new entrants.

With regard to prepayment meter infrastructure provision, we see this as an opportune time to reallocate the responsibility for this from the incumbent supplier to the DNO.

Metering Controls

We concur with Ofgem that a separate price control is preferable to integrating existing metering assets into DNOs RAVs and post 2005 having no controls on subsequent metering activities. We support this view as we believe that separate price controls will reduce the scope for DNOs to cross-subsidise their competitive metering businesses from their monopoly distribution businesses.

However, even under separate price controls we believe that, dependant on the degree of separation, DNOs will still have the opportunity to allocate costs to their advantage and we would wish to see safeguards that would remove the opportunity for DNOs to attribute costs to the less contestable services i.e. meter provision, from those services which are more contestable i.e. meter maintenance.

We also have concerns that DNOs will have a competitive advantage due to their inherited internal processes and IT interfaces which would not be available to new entrants.

We understand in gas that to facilitate competition, Transco have had to achieve full, physical and system separation as part of divesting their metering business and establishing the required price control.

We therefore believe that this should be employed in electricity and that robust ring-fencing arrangements should be in place to ensure that the incumbent meter operator does not gain an unfair advantage due to its affiliation with DNOs.

Valuation of meter assets

We support Ofgem's proposal to value DNO meter assets on a depreciated replacement cost basis. We have previously stated that, once the market for metering services becomes fully competitive, price will naturally converge to reflect the current replacement cost of the meter asset. We therefore accept that Ofgem's proposal will provide a level playing field for both new entrants and incumbents and remove the perverse incentive to replace meters prematurely.

We also agree that the difference between historic and replacement value should be recovered in network charges as, in total, this provides DNOs with the agreed remuneration on historical investments and also limits the exposure to the stranding of meter assets. We believe that this provision should be sufficient to provide the appropriate level of DNO protection.

However, we believe that the disparity between the RAV (based on historical cost and adjusted to take into account regulatory depreciation) and the market value will be marginal. We accept that in gas, where the cost of meters has fallen significantly, the difference may be more pronounced, but in electricity we suspect that, given the relative stability of meter prices, the RAV will tend to reflect the market value more closely and thus the valuation issue becomes less important. If, however, the DNOs have adopted different depreciation profiles that do not reflect market value then this issue will need further thought. We would also welcome Ofgem's thoughts on how re-certification of existing meters will be accommodated without leading to an unlevel playing field tilted in favour of DNOs.

We believe that Ofgem's proposals provide adequate protection for DNOs against the effects of stranding of meter assets and that further provisions to protect DNOs from future stranding will not be in the best interests of competition. The stranding of assets is a normal consequence of competition and we do not support the principle that the incumbents should be unfairly shielded from such competitive pressures.

Structure of Price Control

With regard to scope we agree with Ofgem's proposal that all meters excluding half hourly meters should be included in the competitive market.

The barriers to entry for meter asset provision (MAP), where incumbents hold a dominant position and have equipment already in place, will be considerably greater than those for meter operation (MOp). We therefore suggest that Ofgem will need to consider the level of separation required to ensure that there is no opportunity for the cross subsidy of the more competitive MOp element from the less competitive MAP element. Whilst we accept that this may be achieved under a single price control with ring fencing provisions governing separate tariff baskets, we would like to see details of the services contained within each basket. We also accept that discrete price controls for MAP and MOp activities may be preferred by DNOs as this provides the opportunity to divest either service.

As Ofgem is aware, we have pressed for separation of MOp charges for some time. Recent Appeals to secure costs reductions have not fully reflected the actual costs associated.

With regard to the form of price control, we agree with Ofgem that an average price cap (as used in gas metering) should be employed in electricity. Our concerns with a revenue cap is that we see little benefit in protecting the incumbents from loss of market share, moreover, this could result in those customers remaining with DNOs facing significantly higher bills as DNOs lose significant market share. We also have concerns that a revenue cap will provide the opportunity to profile prices in such a way to protect the more competitive elements at the expense of the less competitive elements. If Ofgem decides to adopt a revenue cap we would expect to see why this is justified in electricity and not in gas.

With regard to duration we agree that initially a five year price control with a view to remove elements if competition becomes sufficiently established is a sensible approach. However, for business planning purposes, we see merit in allowing the initial price control to run for the full five year period before any review.

Other issues

We understand that non-standard services, including special meters and adhoc transactions, are currently outside the tariff basket although are considered as part of the price control review process. Post separate price controls these will become unregulated and may be open to abuse. We would therefore expect further safeguards to be introduced to remove this opportunity e.g. close scrutiny of prices to ensure cost reflectivity. We also believe that Ofgem should take this opportunity to transfer the revenues allowed to cover the costs of rates on meters from the metering price control to the transportation revenue controls.