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Ms Maxine Frerk
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Our ref	Your ref	Date
D10 / 486 - 16/07/03		18 August 2003

Dear Ms Frerk

Electricity Distribution Price Control Review - Metering Issues - Initial Consultation

I am writing in response to the publication of the above consultation on behalf of Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc. Please find attached our detailed comments.

I trust our response is helpful, please do not hesitate to contact me if you would like to discuss further.

Yours sincerely

R G WESTLAKE
Regulatory & Government Affairs Manager

Electricity Distribution Price Control Review
- Metering Issues, Initial Consultation, July 2003

Response from Western Power Distribution

Separate Metering Price Control

Western Power Distribution (WPD) considers the introduction of separate price controls for metering on the basis that the controls are being introduced to facilitate the introduction of competition in metering services.
Competition for the services introduces additional risk to the ability of WPD to recover the historic and future investments it has made and costs it may incur as a result of meeting its licence obligations in a non-competitive context.

Accordingly, the premise for all decisions in respect of the form and scope of the price control should be such that it is reflective of a competitive market place so that neither existing nor new participants are unfairly advantaged or disadvantaged, and that mechanisms are introduced to ensure that investments made and costs incurred under licence obligations are fully recoverable. This is applicable not only to prices, but also to regulated contract terms and conditions.

Meter Asset Provision (MAP) – Asset Valuation

If meter assets are to be valued on a depreciated replacement cost basis, certification lives adjusted for early replacement should be used and the following would need to apply:-

- the assets to be included would be meters and timeswitches
- nominal values would be equivalent to the current replacement cost of a meter with equivalent basic functionality
- overheads directly associated with meter provision only would be included
- installation would be excluded as this is part of MOp transactional pricing
- nothing would be included that is not part of an "over the counter" service
- depreciation period would be based on certification life adjusted to allow for early replacement
- there would be defined categorisation of meter types
- valuation would be based on weighted average prices and lives

Scope of Price Control

MAP services should be price controlled separately from Meter Operator (MOp) services to facilitate the separate development of competition.
The scope of the price control should be determined by the likely progress of competition, which will vary for different customer groups and metering types. This will enable progressive deregulation and thereby a smooth transition.

Competition is established in respect of half-hourly metering and this should continue to be excluded from price control regulation. All other categories are largely or fully non-competitive at present, but could be fully competitive within the price control period.

There needs to be a balance between the benefits of multiple groups in respect of the ability to deregulate at the appropriate time, and the cost and practicability of such multiplication.

Competition is driven by customers, provided they have the will and ability to choose.
The result of this is that larger, high energy use customers, normally industrial and commercial are exploiting opportunities directly. Low energy use customers, normally domestic, have little direct interest in competitive metering and competition is being driven by Suppliers as a proxy. In the middle group, there is growing interest in both competition and technology development driven by requirements for energy management rather than metering system pricing alone.

The most logical criterion for grouping is therefore customer type. For specific reasons, e.g. protection of pre-payment customers, sub-grouping by meter type may also be appropriate.

Customer-type grouping can be achieved by a combination of Profile Class and Meter Type. This does present difficulties in application, as MAP/MOp systems do not have access to Profile Class by MPAN. Neither is there a standard industry flow by which that data could be transferred. It would be necessary to modify a flow, or introduce a new flow to facilitate this approach.

No other method of grouping adequately separates by customer type or would lend itself to rational de-regulation through the introduction of competition.

Price control as an alternative to competition should be limited to the provision of the minimum metering system required for the functionality necessary to provide data for settlement purposes or to meet other statutory requirements. Any other functionality requirements should be considered separately.

Price control should be retained for pre-payment systems also, but for different reasons as the functionality exceeds the necessary minimum for settlement purposes.

Form of Price Control

The form of the price control should vary for MAP and MOp and according to the activity, customer group and exposure to competition. Half hourly metering is already sufficiently competitive to make ex-post regulation appropriate. All other metering activities should initially be price controlled.

Whilst a revenue cap is appropriate for a stable business in which activities and volumes are predictable and sustained, that will not be the case in metering. It will not be the case that, even at the outset, all metering businesses undertake the same range of activities in respect of all customers. As competition spreads, both range and volumes will vary considerably. Some form of activity price cap based on content and volume would be more appropriate and better able to cope with change. It will be necessary to recognise volume as well as content to ensure the equitable treatment of fixed overheads (e.g. MAP/MOp IT systems) that are necessary to sustain the business even for low numbers of customers, unless the Licence obligations to provide services are removed.

For MAP, the price cap should be based on depreciation, rate of return on capital and operating costs. For MOp, the price cap should be based on operating costs and rate of return on turnover.

The key issue for WPD in respect of MAP is the recovery of the investment in the metering assets. Acceptance by OFGEM that the residual value in the RAB can continue to be recovered through DUOS under separate Distribution Price Control helps but does not resolve the issue.

There remains a risk that the full value of the metering assets will not be recovered within a separate MAP price control. This is clearly inequitable on DNOs who were obliged under their Licence to provide those assets within a regulated framework that effectively guaranteed recovery of the replacement costs and provided a return commensurate with a low risk regulated business.

This could be addressed in a number of ways. The price control could include a final purchase/termination fee payable by any customer (including Supplier) who de-appoints the MAP. The fee would be calculated in the same way as the initial asset valuation and ownership of the meter would pass to the de-appointing customer.

The price control could recognise the additional risk of not recovering the asset value over the full life of the asset by shortening the recovery period or increasing the allowed return. It is estimated that the rate of return would need to be increased by at least 50% over the rate applicable to a low risk regulated business for a 5% per annum early removal of metering assets. Adjustment of the asset life is the inverse of increased rate of return.

Meters could be sold rather than leased. Selling rather than leasing removes the risk for new assets but not for existing assets and therefore would need to be combined with one of the other mechanisms. Also, it would be less acceptable to Suppliers, who would effectively be taking on the risk.

The approach that would be most consistent with meeting OFGEM and DNO objectives would be to offer a choice of either a term contract based on the certification life with lower charges based on the lower rate of return and the final purchase fee or higher charges based on the higher rate of return, with no hire term and no final purchase fee. This would be transparent, consistent with normal commercial leasing arrangements and would offer customers a real choice to be determined by their individual commercial strategies.

For WPD in respect of MOp, the key issue relates to potential unavoidable staff costs resulting from loss of market share. WPD has continued to meet its licence obligations by employing staff who joined the Electricity Supply Pension Scheme prior to 1990. These staff have certain rights protected by law and WPD will have obligations relating to those staff going forward. In a competitive environment WPD may well not be able to fund those obligations from Metering related income and we expect to be able to recover any such costs resulting from the provision of services under licence obligations to be recoverable, if necessary through the Distribution price control.

Duration of Price Control

There is no obvious reason for setting the duration of the price control as anything other than that applied to the distribution price control. The DNOs remain responsible for both controls and separating them in time is likely to increase regulatory costs.

Competition should replace regulation for each customer group once established. Ex-post regulation should be sufficient to ensure no abuse of a market position, and residual customers, or suppliers acting on their behalf, should be encouraged into competition by its ready availability and effectiveness.

The criteria for assessment of a competitive market should be:

- that a majority of customers are receiving competitive services

- that a sufficient number of competitors of suitable size exist to sustain a market.

Once a numerical threshold based on the first of these criteria has been reached, a timescale for decision-making and implementation should be made public. For example, a review date set for 6 months ahead and a prospective date for deregulation set a further 12 months beyond that, to be firmed up on the review date. This would give all parties sufficient time to make representations to the review process and prepare for competition if de-regulation does occur.