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Dear Jenny Boothe

### **The proposed restructuring of National Grid Transco's metering business**

I refer to the above consultation document published by Ofgem in March 2005. It sets out proposals by National Grid Transco (NGT) to restructure its gas metering business and seeks views from interested parties on the effect that this will have. Shell Gas Direct is a licensed shipper and supplier to business (non-domestic) consumers. As a supplier, we consider that NGT's proposals are likely to have a negative effect on our business and on our customers.

We set out below our concerns and make suggestions for a way forward. Our concerns fall into four main categories:

- Factors affecting the rate of growth of the competitive metering market.
- The continuing need for regulatory involvement to allow a market to develop.
- The need for the timetable and approach to change to be driven by market requirements, not NGT's own commercial drivers
- Cross-subsidies and negative impacts on customers

We respond below the issues raised by Ofgem in its consultation document. The attached appendix provides further detail with respect to our concerns about the approach being adopted by NGT.

#### **Issue 1 – what are suppliers' views in respect of the extent to which they have been made aware of this proposed sale and the contract options they have been offered by NGT?**

Some of the statements made in the section covering this question provide a cause for concern. High level contacts were made with SGD late in 2004, and a general presentation of NGT's proposal was given. However, to describe this as "detailing its plans to dispose of these assets" is considerably overstating the case. The consultation document is the first time that SGD has had access to a greater level of detail regarding the proposal. We would further argue that information on a number of key aspects of the proposal is still not available, not least the mechanism by which "market value" will be determined for the transfer price of the assets.

In the I&C market there are no “contract options”. The only contract economically available to I&C suppliers is the PMA.

## **Issue 2 – whether suppliers consider that they can effectively access the price controlled tariffs for gas meters under NGT’s proposals**

Access to the price controlled tariffs is via contracts with NGT under their transporter licence obligations. The vast majority (95%) of domestic meters are already removed from a right to access these tariffs by being operated under the MSA terms and conditions to which NGT as a transporter (Transco) is not a signatory. They gain some comfort through an undertaking in the agreement for tariffs not to exceed the regulated tariffs. The current proposal would remove the remainder of meters from regulation and hence a right to access the price controlled tariffs.

At the next price review, Ofgem would have no ability to seek information regarding the costs associated with metering (as metering would not be being provided by the transporter) in order to determine a price controlled tariff. This would effectively end the price control of metering without the development of a competitive market. The consequence of such a situation arising can only be guessed at.

## **Issue 3 – what issues arise from the rebalancing of meter charges?**

As SGD is not a supplier to domestic consumers, we are not involved in the provision of pre-payment meters. However, the proposed rebalancing (increasing the charges for pre-payment meters and consequently reducing the charges for credit meters) holds the potential to have a disproportionately adverse effect on some of the most vulnerable consumers increasing the effect of fuel poverty. We would welcome Ofgem’s views on how this will affect its work on fuel poverty as part of its Social Action Plan.

## **Issue 4 – whether there are any issues raised by the proposal in respect to the transfer of the status of ‘Gas Act Owner’ and the associated responsibilities that are passed on with this transfer?**

SGD supports the reasoning in this section, that as drafted the Gas Act would have the effect of transferring the status of meters sold to a non GT licence holder to the consumer. However, we have many concerns regarding the consequences of such an outcome.

The most important of these is in respect to safety. Domestic consumers, the majority of parties affected, are unlikely to be in a position to fulfil the obligations of “Gas Act Owner”. It would take a considerable public education programme to make these consumers aware of their responsibilities.

The use of consumer as Gas Act Owner also has a profound effect on the MAMCoP. The MAMCoP provides best industry guidance on the life cycle management of meters. Domestic suppliers have a licence obligation to only use MAMs that are MAMCoP compliant and I&C suppliers took on a similar voluntary obligation. There is no corresponding obligation on consumers to either appoint a MAM or if appointing a MAM to appoint one that is MAMCoP compliant. Whilst there may be no direct immediate consequence of this change it would be very difficult to demonstrate that adoption of such a regime would deliver the same levels of risk management of the safety issues as the current regime. Given the memorandum of Understanding that exists between Ofgem and the HSE, SGD would be interested in whether the views of the HSE have been sought as regards this issue.

## **Issue 5 – are there issues concerning the Weights and Measures Act 1985 that should be considered as part of NGT’s proposal?**

In paragraph 4.29 Ofgem express the view that the cost of replacing meters as a consequence of deeming that meters that measure in cubic feet are no longer “legal” under the terms of the Weights and Measures Act 1985 (WMA) “would likely be extremely large.” The size of the costs could be debated and instead of deciding on the basis of the likelihood, it would appear sensible to us to do some analysis of the cost and benefits. This could take the form of a brief, preliminary impact assessment with no requirement for further detailed analysis, if it turned out that the costs were very large. What has not been covered is the benefits to the development of competition in metering if such an approach were adopted. We agree that a one-off project to replace all “not legal” meters would be costly but approaches could be considered which minimised any adverse effect on consumers, eg by phasing in the required replacement over a number of years.

There presently exists the concept of policy replacement of meters. Under this, meters that fail a particular policy test are exchanged as no longer being fit for purpose. The basis on which the fitness for purpose test is based can be varied:

- safety: in the case of the George Fisher meters;
- accuracy: in the case of the leather diaphragm meters.

This concept could well be extended to where the meters are no longer legal. By determining that meters measuring in cubic feet are not acceptable under the terms of the WMA, a timescale could be set (~5 years) for the policy replacement of these assets. The definition of the replacement of these meters as policy replacement has two effects:

1. the meters are replaced without the end consumer paying a replacement charge
2. suppliers operating under the PMA contracts have the option to elect to have these replaced by a commercial MAM of their choice.

The consequence of the above would be that a known number of meters would be come available for replacement over a known timescale. This would provide a boost to the commercial metering market analogous to the release gas programme that arguably kick started the whole competitive gas market and without which it is unlikely that consumers would have benefited from gas competition to the extent today.

## **Conclusion**

SGD notes that metering competition is developing at a slower rate than Ofgem had previously anticipated. We have not shared Ofgem’s expectations about the pace of the development of the competitive metering market. SGD considers that it is now essential to ensure that any next steps that affect the structure of the market are only implemented if they can be shown to be likely to result in the market that Ofgem has expected. If you would like to discuss any of this response, please do not hesitate to contact me as above.

Yours sincerely

Tanya Morrison  
**Regulatory Affairs Manager**

## ***Appendix – SGD concerns regarding NGT’s proposals for its metering business***

### **NGT’s approach and the development of the market**

A key tenet of the operation of the commercial metering market is the unencumbered commercial exchange of meters between MAMs. Under NGT’s regulated metering contracts, NGT has not been obliged to follow this rule, by refusing to sell their metering assets. This leaves suppliers only with the option of exchanging out NGT’s meters in order to access the commercial metering market. This situation has been exacerbated further through the use by NGT of the MSA contracts which severely limit the rate at which meters can be exchanged without financial penalties, making this approach unviable for suppliers. These two factors are key to the slower than expected development of the competitive metering market as referenced by Ofgem in paragraph 4.9.

### **NGT’s position in the market**

NGT’s share in the provision of regulated meters gives it a dominant position. The use of the MSA contracts limits the rate at which meters can be removed from these contracts economically by the supplier (ie without incurring significant penalty charges). It appears that NGT’s proposal would allow it to use its position in the regulated market to have an effect in the commercial metering market, by providing access to the benefits to economies of scale in the regulated business for their commercial business. This will lead to NGT’s proposed commercial metering business’s cost to serve and overhead rates being lower than can be achieved by any new market entrants through any other means. While Ofgem notes that the metering business is subject to competition law, we would welcome Ofgem’s views on whether the approach being adopted raised any specific issues in relation to the Chapter II prohibitions.

### **Cross subsidisation between markets**

In paragraph 3.3., Ofgem reports that “NGT has indicated to Ofgem that this proposal to restructure its metering businesses was prompted by its desire to “have a metering organisation capable of working effectively in the newly competitive multi-utility metering market”.”

This could be interpreted as suggesting that NGT’s commercial metering business requires cross subsidisation from their regulated metering business to be “capable of working effectively in the newly competitive multi-utility metering market”. This would give NGT’s commercial meter division an unfair advantage over other market entrants, allowing them to make use of an indirect cross subsidization from NGT’s regulated metering business through access to economies of scale that they could not generate on their own.

### **Removal of regulatory control**

Currently the charges associated with the provision of domestic meters are capped via NGT’s GT licence. 95% of domestic meters are covered by the MSA agreements bringing them outside any robust regulation, depending instead on a statement by NGT that they would not increase charges above those set by the regulator. Allowing the remainder of the meters to be “sold” to NGT metering would remove the remaining meters from regulatory control at a time when not only is the competitive metering market not developing at the expected rate, but additional distortions in the market are

being introduced to further limit the development of competition. This would seem to deliver a double blow to the future of the competitive meter market and the realisation of the benefits to consumers that was the key factor in Ofgem's support of the creation of the competitive metering market.

### **Distortion of the market – growth**

Ofgem's observation in paragraph 4.9 that "metering competition in gas developing at a slower rate than was anticipated" can be explained by a number of factors which inhibit the development and operation of the commercial market:

- NGT's not fulfilling Ofgem's objective of unencumbered transfer of meter assets between MAMs;
- NGT's unwillingness to sell their meter assets to interested parties;
- The operation of the MSA contracts to limit the exchange out of NGT domestic meters without punitive penalty payments.

These factors distort the development of the competitive metering market, undermining the potential for the full benefits of competition to be realised. Metering separation and the development of the RGMA baseline and associated systems and contracts were done at considerable cost to the industry and without resolving these issues it appears to us unlikely that the expected benefits will be achieved. As such, consumers have been disbenefited by the changes as it has only resulted in costs which, in a competitive supply market, are passed to them.

Allowing the proposed merger to proceed could also have a negative impact on the market as NGT's commercial metering division will not be competing on an equitable basis with other commercial MAMs. This could result in a level of cross subsidisation from NGT's regulated metering division given that there is no clear definition as to the price at which the assets will be transferred and that this level is not accessible to the remainder of the market.

The reduction in NGT Metering's cost to serve would also place them in a position to develop pricing strategies at levels that would be unachievable by other market entrants. This could lead to the few new MAMs currently active leaving the market, and limit new entry with this significant barrier to entry. With this, instead of achieving the market development Ofgem envisages, ultimately, we could have a commercial metering market that stagnates and could even ultimately collapse.