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

Dear Jenny,

RWE npower, on behalf of its npower branded gas supply businesses and its metering business MeterPlus, welcomes the opportunity of responding to the above consultation.

The consultation provides a welcome opportunity to formally voice our concerns over the strategic direction of NGT's metering businesses and the development of competition. It is disappointing that Ofgem have, in our opinion, taken somewhat of a back seat role as these issues came to the fore in the run up to, and since, the implementation of RGMA.

This has given NGT the upperhand in their relationship with their gas supplier customers, and has allowed them to present proposals as being very much faits accomplis which gas suppliers are forced to adopt a take it or leave it approach to.

The fact that NGT have made it clear that they intend to go ahead with their proposed merger, the assignment of the MSA contracts and the prepayment meter charge rebalance under the MSA contracts on the 1<sup>st</sup> May 2005 regardless of the outcome of this consultation, is one of many examples recently of this approach.

We hope and expect however, that if as a result of this consultation, Ofgem do have concerns regarding NGT's proposals and the impact they may have on future metering competition, they will be able to influence, amend or delay NGT's proposals as required. This is despite the fact that it would appear that Ofgem approval is not needed for the disposal of what are essentially regulated assets.

RWE npower has consistently supported Ofgem's metering strategy to introduce effective competition in meter provision and meter reading services. This will we believe afford us opportunities to reduce our metering costs but equally importantly to secure improved services and asset management, both of which we believe will ultimately benefit customers.

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We supported the development of the RGMA baseline as, in the words of Ofgem, we recognised that “new industry processes would be required to allow other companies to effectively compete in providing metering and meter reading services to those provided by Transco and to ensure that industry processes do not favour Transco’s own metering and meter reading services”.

Unfortunately however, the RGMA baseline and the implementation of new industry flows were compromised by Transco Metering’s (TMSL) system development and MAM manual such that suppliers have had to develop their systems to take account of this. Commercial MAMs therefore are disadvantaged if their systems and work request processes differ to those of TMSL, as suppliers systems developed for RGMA implementation have been based on this compromised position.

Despite RGMA having been implemented without any noticeable detrimental impact on the gas supply market we believe that the success, or otherwise, of RGMA is yet to be determined. The outcome of the data reconciliation exercise about to be undertaken will be the true measure as to whether the processes are robust and working as intended, and there is certainly evidence to suggest that data quality may be deteriorating, meter details are not being exchanged efficiently and that the task of fitting a meter to a new connection has become far more complicated following RGMA implementation. With this in mind we believe that it is premature of NGT to merge their regulated and competitive metering businesses, as such a merger will inevitably lead to internal re-organisation, transfer of responsibilities and system integration, all of which are likely to compound any existing problems rather than aid their resolution.

NGT's proposal to merge their regulated and non regulated metering businesses will do nothing to enhance competition in meter provision, and may in fact degrade it. NGT Metering, as a result of this merger, will become the largest commercial MAM by far and will acquire a largely captive customer base (due to restrictions/penalties under the MSA contracts) which at this point in time accounts for 95% of the domestic gas meters in situ. They will also inherit contracts from Transco/new DN owners for legacy provision which may not be subject to competitive tendering for a number of years. These contracts, combined with the lower unit cost base and nationwide field force they will gain as a result of the merger, represents an insurmountable barrier to entry for any new entrant and gives NGT Metering a significant competitive advantage over its gas market competitors. It also provides NGT Metering with significant opportunities to compete for, and expand into, other utility metering work.

Despite Ofgem’s original assumptions when setting Transco’s current price control that metering competition should develop sufficiently to allow for tariff caps to be removed in April 2004 competition is still limited, as we know from having recently tendered for competitive metering services.

As the tariff caps were introduced to “protect customers in the transition to a competitive metering market”, particularly in the case of pre-payment customers, their effective removal as a consequence of this merger and the provisions in the MSA contracts (signed by suppliers representing 95% of the domestic market, including ourselves) implies that competition must now be sufficiently developed. Transco’s price control, which has a further two years to run, contained provisions for tariff caps to be disapplied should Ofgem decide that competition was sufficiently developed to justify this or that a suppliers “cherry picking” of metering services made them non cost reflective. As far as we are aware these have never been triggered and we believe it is pertinent that Transco have chosen to achieve the same effect via a different strategy (i.e. offering MSA contracts and their merger proposals) rather through the provisions in their licence. We therefore agree with Ofgem’s comments in 4.14 and 4.15 that the provisions within Transco’s price control would be a more appropriate method for disapplication of price caps and that NGT taking forward the proposed sale of its metering assets without following the defined disapplication process may set a precedent for future structural changes.

Also the price caps were set based on certain assumptions about the regulatory asset value of the meter assets, the replacement cost of meters, the meter exchange policy and an expectation about the degree of asset stranding caused by competition taking effect. The fact that none of these factors are particularly

transparent to suppliers, but are to Ofgem, may be another reason Transco have adopted this strategy for effectively removing price caps.

As a signatory to the MSA contract we do not deny that we were aware of the fact that the contracts could be novated (although this was presented more as an issue relevant to DN sales) and that provision existed for pre-payment metering charges to be re-balanced on the basis that Transco would remain NPV neutral over the life of the contract. However, insufficient information was proffered to enable us to assess the full implications of these conditions and it was made clear throughout that no negotiation of the terms was possible and that the agreement had to be signed within a three month time window in order to obtain the up front cash benefits on offer. We were also led to believe by Transco that the agreements had been discussed with Ofgem and were felt by Transco to pose no Competition Act concerns.

This is not an excuse for us having unwittingly signed an agreement we did not fully understand the full consequences of. We stand by our decision to sign the MSA contract based on our evaluation of the benefits that would result and our knowledge of the limited nature of competition available from other commercial MAMs. However, it is a classic example of how Transco have been able to use the information asymmetry that exists between themselves and suppliers, along with their market dominance, to achieve their strategic aims.

Recent speculation in the press suggests that NGT's ultimate strategy may be to dispose of NGT Metering altogether, and the forthcoming sale of 4 DNs and Transco's steadfast refusal throughout RGMA and the DN sales process to countenance any sale of metering assets lends credibility to this speculation. With this in mind, and bearing in mind our previous comments on price control, we would expect Ofgem to take more than a cursory interest in the transfer price of the assets sold by Transco to UMS and the market value attributed to TMSL. If, as NGT claim, their proposals are prompted by their desire to "have a metering organisation capable of working effectively in the newly competitive multi-utility metering market" such that they can provide a "cost effective service for its customers", and are not driven by the desire to create value for NGT shareholders, Transco should have no objection to Ofgem undertaking financial/regulatory scrutiny of this merger as protector of the interest of end consumers.

Turning now to the issues specifically identified for comment in the consultation we would make the following comments.

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?

We were made aware of this proposed merger/sale by NGT in December 2004 and have received presentations and have met NGT representatives to discuss its implications.

We understood that the MSA contract options allowed for this to happen and for prepayment charges to be rebased, although the timing and detail of this only became clear following the announcement.

NGT have made it clear that they expect this merger to take place on the 1<sup>st</sup> May and that they expect to send out engrossed contracts for us to sign imminently. We have stated that we should not be expected to sign the agreements until Ofgem have issued their responses to this consultation, and we would expect NGT to accept this as a reasonable position.

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

Having signed the MSA agreement we now no longer expect to acquire metering services by way of Transco's, or a new DN owner's, licence provision. However, we believe that the transporter licence

conditions do provide suppliers the opportunity to ensure they can meet their supply licence obligations to provide meters regulated tariff cap prices, at least in the case of domestic suppliers.

It should be noted however, that licence conditions alone do not guarantee suppliers can effectively access price capped gas meter tariffs as effective access implies that the process for MAM appointment is undertaken efficiently. If this is not the case, or if a supplier designs its systems based on the regulated MAMs system/dataflow requirements which then change, this may present significant obstacles in the form of increased system development costs.

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

We support the move to better cost reflection of prepayment metering charges but are concerned about the significance of this change on the customer and the timing of the implementation.

Budgets, financial planning and thus our expectations about pricing policy have inevitably been determined for this year before details of the rebalancing had been provided.

Whilst accepting the necessity to address the principle of prepayment/credit meter rebalancing NGT are, in our opinion, acting with undue haste in undertaking this at the earliest possible opportunity.

We believe it may be in the interest of the prepayment customers to consider phasing the increase in prepayment meter provision charges over say a 3 year. Alternatively if there is to be a one off increase the date that prepayment costs should perhaps be rebalanced should be determined as a consequence of Transco, or a new DN owner, exercising the disapplication options under their licence.

At this stage it would seem likely based on the state of competition and the scale of the cross subsidy that has existed for many years, that increased prepayment meter provision costs will ultimately be reflected in prepayment customers bills.

As with all price reviews, RWE npower will consider current and projected costs 'in the round' and review the competitive market environment at the time before making any price changes we believe are necessary.

As mentioned earlier, the MSA agreement defined at a high level the basis on which credit and prepayment meter prices would be rebalanced. However, as we can only assess the proposal that has now been presented based on our own portfolio, we can only take NGT's word for the fact that the proposal ensures they remain NPV neutral over the life of the agreement.

Were Transco to have applied for tariff cap disapplication under their licence, Ofgem would have been required to scrutinise any such calculation before deciding whether to accept disapplication and we would expect Ofgem to have an interest in scrutinising NGT's calculation under the MSA contract therefore.

### 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?

We agree that the responsibilities associated with keeping meters in proper order should not default to the consumer as a matter of course, and will aim to ensure that suitable arrangements are in place through our MAM contracts to maintain meters and keep them in proper order for measurement. However, maintenance is not the only issue relating to Gas Act ownership, for example meter marking, and so we believe there would be benefit from further clarification of responsibilities and, if necessary licence revision, in this area.

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

Despite this being an issue about which there has apparently been considerable discussion between NGT, the DTI and Ofgem, we were not aware of it until publication of this consultation. Nor do we expect were other gas suppliers.

Bearing in mind the numbers of imperial meters still in situ it is obviously of great concern to us that if a court ruled that their use was illegal, and if we as a supplier are now deemed to be the Gas Act owner as a consequence of the merger and the MSA contracts, we may be subject to a material cost exposure.

Had we been made aware of the possible implications of this when the MSA contract terms were offered it would have afforded us the opportunity to obtain legal advice on this matter, and to consider whether the terms of the agreement adequately protected us from such an eventuality. As it is however, we are now in a position where were this to occur there is now uncertainty as to who would bear the considerable costs that would arise from such a meter replacement programme.

If 70% of the Transco meter portfolio is still imperial, it suggests to us there have been failings of their meter procurement and meter replacement policy over the last 20 years. If all the imperial meters have been in-situ since before 1/12/80 and have simply been recycled ever since, these meters will have been written off as assets from an accounting perspective and will affect the assessment of the value of the Transco meter base and the rental prices quoted by UMS for the legacy portfolio.

Ofgem refer to a 'glide path' for replacement of imperial meters but it is not clear to us what this looks like. If it has taken 25 years to replace 30% of the imperial meter stock, it could take another 50+ years to replace the rest, which suggests this potential risk is not going to go away quickly.

Whilst the likelihood of a court determining that imperial meters are illegal is perhaps small, we believe that in such an event responsibility for meter replacement should rest with the party who has legal title to the meter, regardless of the technical definition of who owns the meter for the purposes of the Gas Act. Again this is something which needs to be addressed through clarification and possible licence revision.

In summary therefore the merger of TMSL and UMS into a single unregulated metering business raises a number of issues which require regulatory consideration, and until such time as this has occurred it would not be appropriate for the merger to proceed.

Competition in gas metering provision has not developed as quickly as Ofgem had previously suggested it might and this merger is unlikely to accelerate it, and may indeed have the opposite effect.

We would expect Ofgem therefore to give careful consideration of the implications of this merger, regardless of the fact that they may not need to give it their formal approval, and to more pro actively engage in industry metering discussions going forward.

Our response is made within the context of the proposed merger and with regard to the specific issues being consulted upon. We would however welcome the opportunity to discuss it with you, and other wider issues regarding gas and electricity metering, should wish to do so.

Yours sincerely,

Steve Rose  
Economic Regulation