

Jenny Boothe
Markets
Ofgem
9 Millbank
London
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8th April 2005

Dear Ms Boothe,

**Ofgem consultation 78/05: The Proposed Restructuring of National Grid
Transco's metering business**

energywatch welcome the opportunity to respond to this consultation.
However, we have serious concerns that centre on:

1. The flawed consultation process that has been followed by Ofgem in this instance.
2. The likely impact of these proposals on gas PPM consumers. While this group do not necessarily constitute the fuel poor they are invariably low-income consumers, of which one in three are already struggling with debts. The consultation document seems oblivious to the detriment that these proposals could cause this cohort of consumers. We would expect the required impact assessment to expose this.
3. The dominance of the unregulated UMS in the market for metering services.
4. The possibility that this restructuring will result in an even more complex and fragmented industry than already exists.

The attached document sets out these concerns in detail.

energywatch would like to see Ofgem work with NGT to halt the restructuring until such time that the concerns outlined in the attached have been properly addressed, and that the impacts on gas PPM consumers have been fully understood, properly consulted on with stakeholders, and the relevant safeguards put in place.

If you wish to discuss any of the issues raised in this submission please do not hesitate to contact me.

Yours sincerely

Adam Scorer
Director of Campaigns

energywatch response to:

Ofgem consultation 78/05: The Proposed Restructuring of National Grid Transco's metering business

1 Consultation process

1.1 energywatch is extremely disappointed at the consultation process adopted by Ofgem for taking forward Transco's proposal. The justification for the revised timescales for the consultation period is not compelling, especially given that Ofgem has been aware of these proposals since November 2004.

1.2 The one month response time permitted for submissions appears to contravene the *Code of Practice on Consultation* issued by the Cabinet Office Regulatory Impact Unit, which clearly states at paragraph 1 that:

"Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of policy"

1.3 As a government agency Ofgem appears to be bound by this RIU code unless Ministers conclude that exceptional circumstances require a departure from it. There is no indication that a Ministerial exemption has been granted in this instance. Ofgem therefore needs to consider the validity of the present consultation exercise, especially given that it has also neglected its duty to undertake an impact assessment (see 1.5).

1.4 The fact that Transco has discussed the changes with suppliers offers little comfort as it is consumers, not suppliers who ultimately bear the costs associated with changes to metering or transportation charges. We are therefore surprised and disappointed that the views of consumers, their representatives and other stakeholders have not been sought until this late stage.

1.5 Under its guidance to Ofgem on social issues¹, the Government has indicated that regulatory decisions should be subject to a full impact assessment which should include an analysis of the social costs and benefits of these decisions. energywatch, and other stakeholders interested in protecting the interests of low income consumers and those at risk of fuel poverty, believe that such an assessment is vital in this instance and must be undertaken. In particular Ofgem needs to be aware of the actual impact on charges to low income groups, which will include many vulnerable consumers; and to the level of fuel poverty in the UK, particularly at a time of escalating prices.

¹ Social and Environmental Guidance to Ofgem (3.2).

1.6 Without this information there is uncertainty over whether price rises will be passed on to gas PPM users, when that might take place, and what powers Ofgem have to either prevent negative outcomes or to put the necessary safeguards in place. Without the clarity that an impact assessment would provide, energywatch and other stakeholders can only assume the worst. This assessment must therefore be undertaken urgently and must be followed by a consultation exercise that allows an appropriate length of time to respond to the matters raised.

1.7 Ofgem's document fails to mention the changes in metering charges until page 11 of the document, and even then elects not to provide any analysis of the potential increases in costs to consumers. We note that Transco was to provide indicative charges to "*contract signatories*" by 22 March, but energywatch has not been provided with any data and will therefore assume the worst case scenario. The fact that Transco wants to restructure in line with its DN sales process is absolutely not a reason to abandon due process and rigorous regulation of monopolies.

1.8 As a starting point Ofgem must consider:

- Why has no data been provided on the potential changes to charges? We would expect this data to be provided to enable consumers and other stakeholders to make an informed and balanced response to this consultation.
- At what point in its internal process, or its consultation, have Ofgem considered its statutory duties² to protect the interests of consumers, notably those low-income and vulnerable consumers who are most likely to have gas pre-payment meters?
- Where potential barriers to entry are created and customer protection weakened, what additional licence conditions may be necessary for Ofgem to fulfil its statutory obligations?

2. Impact on consumers using gas pre-payment meters

2.1 energywatch is extremely concerned at Transco's proposed restructuring of its metering business, not because we wish to dictate NGT's business structure, but because of the huge increase in pre-payment metering costs that we can only assume will eventually be passed on to low-income and vulnerable consumers as a result. At a time when gas prices are already

² Gas Act as Amended - 4AA - (3) In performing that duty, the Secretary of State or the Authority shall have regard to the interests of—

- (a) individuals who are disabled or chronically sick;
- (b) individuals of pensionable age;
- (c) individuals with low incomes; and
- (d) individuals residing in rural areas.

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

unjustifiably high, energywatch expect Ofgem to do everything within its power to protect consumers from any further unforeseen additional costs.

- 2.2 Given the statement at consultation paragraph 4.11 that “*NGT has indicated that the cost for a pre-payment meter will increase and the cost of a credit meter will decrease*”, our immediate concerns focus on the implications for PPM consumers because as energy Minister, Mike O’Brien, has acknowledged: *the use of prepayment meters is concentrated among lower income consumers*³.
- 2.3 While energywatch recognise that PPM use does not always signify a correlation with fuel poverty, it does provide us with one of the best indicators of the behaviour of low-income consumers who are struggling with their energy costs and how price rises impact upon them.
- 2.4 PPM use is one of the best examples of the poor being expected to pay more. Ofgem’s recent consultation on PPMs (32/05) confirmed this, stating as it does that: *on average consumers who use PPMs for both fuels pay £63 per year more than consumers who pay by the cheapest payment method of direct debit and £31 more than consumers who pay by standard credit.*
- 2.5 energywatch have established that for a medium user, the gulf between the highest PPM tariff on the market and the lowest direct debit tariff is £149 per year for gas.
- 2.6 This bad situation is already being made worse by the doubling of wholesale gas prices within a year, and will be made yet worse still if increases of the magnitude described in this document are implemented. energywatch is therefore concerned by the consultation’s implicit suggestion that the restructuring of Transco’s metering business will inevitably lead to price increases for pre-payment consumers, if not now then under the next price control. This cannot be in line with Ofgem’s statutory duties.
- 2.7 It should also be noted that one third of gas PPM consumers are paying a gas debt through their meter. The alarming increase quarter on quarter in gas PPMs installed for debt between Q 4 2003 and Q4 2004 (see appendix 1), suggests that this is a worsening problem. Additional costs will exacerbate the problems these consumers experience and could well lead to rationing or, at worst, self-disconnection.
- 2.8 Have Ofgem considered the extent to which these proposals will undermine the social initiatives being developed by suppliers for low-income consumers - the group at greatest risk of, or already experiencing, fuel poverty. Increased gas PPM costs threaten to counter any savings

³ Hansard, 16th November 2004: Column 1311w

that suppliers are working to introduce and will neutralise the efforts of those suppliers who have equalised their PPM and standard credit tariffs.

Were the existing regulations to be altered what tools do Ofgem have to fulfil its statutory obligations in relation to the protection of consumers, in this instance the gas PPM consumers who would be adversely affected? Going forward can Ofgem be confident that it can meet its duties when licensees are able to operate outside their licences?

3. Social Issues

3.1 As section 2 has highlighted the proposed restructuring will impact disproportionately and adversely on those consumers who are already struggling with energy costs.

3.2 energywatch is concerned that Ofgem does not have the power to stop this restructuring, but it does have other tools to ensure that if the restructuring goes ahead that additional protection is afforded to consumers. This may take the form of a new licence condition, for example on the contracts for meter provision.

3.3 Without a full review of the metering market there is a risk that some consumers may not now be supplied under the licence and could see increased charges. The actual impact on consumers is not assessed in Ofgem's document, but needs to be looked at as a matter of urgency. energywatch therefore reiterates the need for Ofgem to undertake a full impact assessment which analyses social costs and benefits.

4. The Gas Act

4.1 energywatch acknowledges the points made by Ofgem in relation to lack of clarity under the Gas Act 1986 with regard to the ownership of meters. However, in line with Ofgem and the industry, energywatch is of the view that the majority of consumers are not able to take responsibility for gas metering, as they do not have the expertise or qualifications.

4.2 If Ofgem believe that the Act needs to more clearly put the responsibility for meters on those best able to manage those assets, i.e. suppliers and transporters, this should be pursued as a matter of urgency.

5. Transco's Licence

5.1 The protection of consumers in relation to metering has traditionally been dealt with via the gas transporters licence. This was due to the historical position of Transco as the monopoly provider and owner of meters.

- 5.2 energywatch expressed reservations on both the RGMA process and the development of a competitive market place for provision of meters and metering services. These are outlined at section 6: industry processes.
- 5.3 We are not aware of evidence to suggest that effective competition has developed to the degree necessary to warrant the removal of direct regulation, especially of the provision of services and assets to vulnerable consumers. Indeed, we note Ofgem's comment that metering competition in gas has developed at a slower than anticipated rate⁴.
- 5.4 SC8 of Transco's GT licence requires Transco to meet all reasonable requests for both the supply and removal of meters. It is our understanding that these licence obligations are to be extended to all transporters. This may lead iDNs to create metering businesses to meet their obligations, which would potentially increase competition, but this will take time to develop.
- 5.5 Transco's licence SpC31 caps the prices that Transco can charge for a number of metering activities (covering credit meters and prepayment meters). It would appear under 5(2) of this condition that a formal application to the Authority to disapply these tariff caps would be required and would not be expected to be given less than 18 months after the application has been delivered. energywatch would like to know as a matter of urgency if such a request for disapplication has been made by Transco. Ofgem acknowledges that Transco may not have intended to remove meters from the price control, but the fact it does, must require Transco to follow the process in its licence. Without the disapplication, which energywatch does not support, Transco's licence obligations remain in force.
- 5.6 energywatch believes that the sale of the metering business, without a formal disapplication, does not in anyway alter Transco's licence obligations, which Ofgem notes were designed to protect consumers until such time as effective choice of pre-payment meters was available. We disagree that the transfer removes Transco's licence obligations and all meters provided under the licence requirements must remain subject to the price control. It may be possible for UMS to rebalance charges for selling into the competitive market, but where meters are supplied under SC8 then the maximum tariff caps must remain.
- 5.7 Transco will need to identify all the meters that are provided under SC8 and continue to apply the tariff caps, even if it obtains those meters at differing costs for its own provider (UMS or another company). Furthermore, the iDNs are due to have the same maximum tariff caps under their new GT licences⁵ in order to maintain the protection currently offered to consumers. In its consultation Ofgem states: "*it would not be*

⁴ Ofgem consultation 32/05: Prepayment Meters – Consultations on new powers under the Energy Act 2004 and update on recent developments

⁵ Ofgem consultation Formal consultation under section 23 and section 8AA of the Gas Act 1986, Feb 2005, p312

appropriate, as part of the DN sales project, to change the provisions of Amended Special Condition 31". Ofgem must be convinced that Transco's proposed actions would not have exactly this effect.

- 5.8 It would appear that in Transco's view, UMS would have to rebalance charges to comply with the Competition Act, inferring that by removing TMS Transco is knowingly going to put itself in breach of its licence or it must take some financial hit as a result of supplying meters at a cost below the price it buys them from UMS. Transco must explain how it will meet its licence obligations and assure consumers that Transco's shareholders will pay these costs not consumers, as this is a commercial not regulatory decision.
- 5.9 Furthermore Ofgem should publicly state that it will not be allowing Transco to recoup these costs at its next price control or via a "rebalancing" of regulatory charges in the meantime.
- 5.10 SpC32 further protects consumers by placing a non-discrimination provision on Transco in relation to the provision of metering activities. While in theory such a non-discrimination provision could be covered by competition law, it is energywatch's view that the competitive metering market is too under developed to rely on competition law when Transco's metering business will remain the dominant supplier, notably in the provision of meters to vulnerable consumers.

6. Industry Processes

- 6.1 In the context of the major structural changes in the gas industry, both energywatch and its predecessor, GCC, have argued that metering competition is not a priority at this time.
- 6.2 As the RGMA process developed energywatch has been keen to see a set of industry process that would avoid the problems experienced in the transfer process. There were three scenarios energywatch wanted to avoid:
- Scenario A: Where a consumer has changed supplier successfully, but is left off supply as the new supplier has not had the meter changed, either as a result of the meter service provider (MSP) or the incumbent supplier not communicating with their meter service provider.
 - Scenario B: The consumer has their meter changed as a result of an involuntary transfer and is left off supply as there will never be a replacement meter.
 - Scenario C: A consumer changing supplier on an independent gas transporters network changes but experiences problems if the MSP does not have a contract with the IGT operator.

6.3 energywatch would like assurances that the restructuring proposals will not result in a situation where these worse case scenarios become a reality.

7. Liability chain and increased transaction costs between TMS and UMS

7.1 With the outsourcing of TMS metering provision, energywatch would need assurances that the creation of a liability chain between TMS and UMS will not lead to further confusion on those occasions that mistakes are made. We feel this could disproportionately affect PPM customers given the extra processes needed to sustain a PPM.

7.2 In our view it is not at all clear that costs would necessarily be reduced for metering services as a result of increased transaction costs between TMS and UMS

8. Competition Act and the market for metering Services

8.1 energywatch would be interested to see Ofgem's view on Transco's assertion that UMS must rebalance charges to comply with the Competition Act 1998. If Transco is happy to share their legal view we would also welcome that information. It is not clear to us what Transco's exact concern is, but we assume that Ofgem must have satisfied themselves that a rebalancing of charges would be necessary. Were Transco to be incorrect, as we suspect, it may be possible for the transfer to go ahead and a contractual relationship put in place to ensure that the licence conditions remain in force in such a way as to protect consumers.

8.2 The Chapter 1 of the Competition Act 1998 prohibits conduct which amounts to an abuse of a dominant position within the UK (or any part of it) and which affects trade within the United Kingdom. In this case energywatch believe it would be easy to prove dominance within the market for meter provision. We would therefore expect Ofgem to be especially vigilant of the conduct of an unregulated business with a high degree of dominance until there is an effective countervailing power in the market.

8.3 energywatch believe that there is a separate market for the provision of PPM services. In contrast to standard credit arrangements, PPMs require an expensive support service (e.g. battery replacement). If this is the case it is likely that the entry barriers would be higher than for the credit meter market. This in the long term could allow greater scope for rent seeking behaviour than in the market for the provision of credit meters.

8.4 energywatch is also concerned that if the restructuring goes ahead, Ofgem will have a very limited role in the regulation of metering. There has been no evidence to suggest the metering market is competitive and therefore the retention of the metering activities where they can be more easily regulated seems beneficial.

8.5 In the case of contracts, a new market entrant must be given the right to have a contract, for the purpose of tariff capped metering activities, that reflects the regulated prices. energywatch expects Ofgem to get confirmation from Transco that this will be the case, both to minimise barriers to entry and to comply with their licence.

9. The price control and the interface between regulated and unregulated businesses

9.1 The separate price control for metering services sets a reference price for the rest of the industry. If on the one hand the price control was too generous in its cost estimation then there will be headroom for new entrants into this market to undercut UMS. However, this would mean consumers paying for an inefficient service. If on the other hand the price control is effective in its estimation of costs, it would be unlikely that a new entrant could effectively compete with UMS.

9.2 As UMS is unregulated in contrast to TMS, there is scope for UMS to increase its charges to Transco and thus benefit the group as a whole. We are concerned that Ofgem would be in no better position to investigate the Transco metering contract with UMS than it would any other internal procurement strategy. In effect, we would argue that the relationship relates to Transco's transfer pricing policies.

10. Metering Charges

10.1 It is difficult without a far greater degree of detail to know if Transco's existing charges, and the related tariff caps are reasonable. Ofgem may take this opportunity to examine the exact level of cross subsidy and to ensure that, where competition may have driven down prices that the caps are still at the correct level. Given the proposed price rises (prepayment meters increase from £29.98 to £46.75) the arguments about benefits arising as a result of greater cost reflectivity have to be balanced against the social costs to low income and fuel poor households.

10.2 energywatch does not want to see one group of consumers carry undue burdens as a result of cross-subsidies. However, there must be a clear benefit in restructuring these charges as there will be costs associated with asset transfers, contract novation, etc. Ofgem's document does not value these costs or benefits, nor does it comment on the sorts of benefits that may arise. Again, NGT's dominance in the gas meter market suggests that they will be able to pass on the costs associated with restructuring to suppliers and ultimately consumers.

11. Suppliers

11.1 While it is a matter for suppliers if they choose to pass through increased costs to consumers, it is our experience that they will do so at least to some extent, particularly in the medium to long term. energywatch

notes that the novation of the contract only provides the suppliers with a charging schedule while he remains the supplier. If a customer was to change supplier, a new contract may be required by the new supplier (e.g. if the company was entering domestic supply), under which UMS may choose to alter the charges to whatever level they see fit. A new supplier entering the market may see less favourable treatment than incumbent suppliers if UMS can justify increased charges, effectively creating a barrier to entry. Without effective competition in the provision of all meters and metering services, consumers deserve to be protected from at worst, potential abuse of a dominant position, or at best inefficient market operation.

11.2 The National Audit Office in its 2004 report *Ofgem: Social Action Plan and Household Energy Efficiency* recommended that Ofgem should encourage suppliers to offer prepayment meters as cost effectively as possible, these developments threaten to discourage suppliers from following this course of action.⁶

12. Conclusions

12.1 Energy markets and energy services are deliberately regulated by Government under sector specific laws to ensure that wider social and environmental considerations can be taken into account where markets fail, or no market exists. The use of licences is a key instrument in effective regulation under the Energy and Utility Acts. energywatch believes that Ofgem must urgently consider if they need increased regulation on Transco in order to ensure that the restructuring does not result in less rigorous regulation of the supply chain. In the meantime, Ofgem should be clear that the licence obligations on Transco remain and will be enforced.

12.2 Ofgem should reject NGT's proposed restructuring of Transco's metering business until such time as all of the issues outlines above have been addressed, and until the necessary impact assessment has been undertaken and commented on by all stakeholders.

Appendix 1

⁶ Social Action Plan and Household Energy Efficiency – Report by the Comptroller and Auditor General, 2004 Prepayment Meter Innovation

Gas PPM Install per Quarter to Recover Debt

