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Dear Rachel

Metering Price Control Review Consultation - Response

Central Networks welcomes the opportunity to respond to Ofgem's Metering Price Control Review consultation. This response is not confidential and may be placed on the Ofgem web site. We have advocated the removal of Metering Price Controls for some years and we support the proposals and their intentions which we believe will act as a catalyst for the further development of competition in metering activities. Having provided a clear message to the industry in 2004, to now reverse or defer that proposal would provide significantly weakened signals to suppliers as to the future competitive development of metering.

Most DNO's have either sold their metering businesses to a third party, the incumbent supplier, or divested metering expertise by creating a separate, focused, metering business. In the case of CN, Metering Services was created some ten years ago and has now developed into a multi utility metering business which has expanded outside of the existing geographic boundaries providing a full range of activities. This approach provides a more integrated and efficient metering solution than can be achieved by having separate parties, frameworks or drivers delivering Meter Provision, Meter Operations and Data Retrieval and Processing as at present.

Effectiveness of market

We support Ofgem's view that the electricity metering market is developing well and would suggest that the following, some of which are included in the consultation, also serve to confirm this view:

- One supplier has already outsourced substantial activities to a number of competitive, commercial meter operators;

- Other suppliers have issued tenders but uncertainty over the Competition Act investigations into NGT and EDF have delayed the process. The outcome of the investigations, including the decision as to whether metering markets are local or national, are important consideration for suppliers and incumbent metering providers;
- There is evidence that Ex-Supplier and DNO metering businesses have developed and will continue to develop across all metering activities, both inside and outside historic geographic boundaries, and across multi utilities;
- We are aware that some sizeable suppliers have already reviewed their current arrangements against the market and either maintained these arrangements, or developed new commercial contracts. This suggests that the competitive market is significantly higher than the 20% quoted.

We also believe that the price controls, particularly relating to MAP, are set too low and result in a constraint on the development of the market. The current price control assumes a low rate of return commensurate with a distributor's cost of capital (where there is effectively protection from stranding) – as a result, current MAP prices do not incorporate the risk of future stranding particularly from innovation where accelerated change-out is likely to occur. As such, new providers have not historically been able to compete, either in MAP or in providing a combined MAP/MOp product, particularly given the uncertainty generated by the current debates around smart metering.

The price control also, we believe, provides significant barriers to the sale of existing meters to new or established providers. It would be unrealistic to expect metering providers to pay the depreciated replacement cost implied in DR4, taking on the future risk of stranding but with the present price control not allowing this risk to be factored in.

Our view is therefore that competition is developing well, particularly in MOp, with many metering businesses expanding, both across utilities and geographic boundaries. However, the current MAP price control presents significant obstacles to the development of competition. On this basis, we believe that greater alignment is required between the MAP price control and the market for the future provision of assets. Fundamentally though, we believe there is no requirement to place obligations on distributors or suppliers for MOp and future provision of new meters. Ofgem can utilise its powers under the Competition Act if it believes that further action is

necessary, either to protect smaller suppliers in certain geographic regions or to facilitate competition, without the need for licence obligations.

Innovation

Metering activities are no longer, in general, a core focus of the distribution businesses. Also, the effect of metering price controls has been to concentrate effort on providing standardised transactional charges for meter operation services and least cost meter purchases. This may have been the right approach at the point when controls were introduced, however, the need to ensure efficient costs now has to be complemented by the need to develop innovation in metering services, and the current price controls are not able to accommodate this. This is particularly pertinent with regard to Ofgem's Domestic Metering Innovation Next Steps document and the forthcoming transposition by Defra of the EU Energy Services Directive into UK legislation. The success of these two important initiatives where innovation and competition is a necessity could only be effectively introduced and implemented if the existing metering price controls on distributors are removed.

The UK is currently a little way behind some of its European neighbours in establishing smart meters and the constraints that the metering price controls bring would further delay any introduction of smart meters, possibly to the detriment of meeting the UK's carbon emissions targets. We support Ofgem's conclusion in their Domestic Innovative Metering Next Steps document that this type of metering should be market led. To achieve an optimal solution, we need to consider MAP/MOP/DC and respective trade-offs, which is not possible with separate parties and separate frameworks as under the current price control framework.

The impact of the current and proposed price controls on MAP will, we believe, distort the early replacement programme, contrary to the aspirations for domestic metering innovation. The MAP price controls have resulted in prices being artificially lower than the true market price and this has inevitably slowed development. This partly relates to the stranding issue and who carries the risk of stranded assets. The current price cap does not explicitly allow for stranding but equally neither is the risk priced into the present control. This needs to be clarified such that the disincentive for early replacement is removed and any price control is set at a level approaching a market price, incorporating risks of stranding and early replacement through future innovation.

With regard to the details of the consultation, we have answered each specific question in the attached table.

Central Networks propose to implement Ofgem's proposals regarding the removal of licence obligations to provide future meter provision and operation services by ceasing to provide these activities as a distributor. This will be with effect from 31 March 2007, however to ensure that all suppliers can continue to receive these services with certainty, our intention is to novate all existing contracts, possibly with the exception of existing assets, to our affiliate Metering Services business. As a result, suppliers and their customers would not see any change to the services they already receive.

Reflective of these proposals, Central Networks has, since February 2001, sourced its meter operations activities from either an affiliate or a third party. All such activities are therefore provided by an affiliate and our proposals only affect the contractual link and not the services provided. Our use of our affiliate metering business in this way allows the market to operate more effectively and provides more flexibility to suppliers and their customers.

If you require any further information please do not hesitate to contact me.

Yours sincerely

Jonathan Ashcroft
Regulation and Commercial Manager
Central Networks

RESPONSES TO SPECIFIC QUESTIONS:

Chapter One. No specific questions.

Chapter Two

Number	Question	Response
1	Is it necessary to review the price controls on gas meters prior to conclusion of the Competition Act investigation?	No. We believe that the Competition Act investigation should first reach a conclusion. However, as soon as practicable after the conclusion Ofgem should consult on removing the price controls on gas meters
2	Is it necessary to reset the level of the cap on gas Prepayment Meters prior to conclusion of the investigation?	No. We believe that the Competition Act investigation should first reach a conclusion

Chapter Three No specific questions

Chapter Four

Number	Question	Response
1	Have we identified the key characteristics and dynamics of the electricity metering market?	In part. However, the analysis does not reflect fully how competition has developed or how Suppliers are moving away from the DNO to metering businesses who can and do provide more flexible services. Also see the main text of our letter. As an example Central Networks are the meter operator for only 25% of our 4.8m customer base and are therefore not the dominant meter operator, the majority of consumers being served directly by Metering Services.
2	Have we identified the key developments in the electricity metering market over recent years?	In part. The Consultation Document suggests that Ofgem are not aware of any large divestment of existing meter stocks. We also believe this to be true and would suggest that one of the reasons for this is

		the price control which, if it were amended, would remove one of the risks to potential purchasers who would be able to offer a more flexible service. If Ofgem retain the Metering Price Controls then future developments will be constrained, particularly with regard to innovative metering where the existing framework promotes a lowest cost solution on the basis of a common functionality.
3	Have we identified the factors which determine whether suppliers use the competitive market to meet their electricity metering needs?	Yes. We believe that there are many reasons why metering competition hasn't grown to the extent originally anticipated. Most of these are covered in the document and include the current price control, the forthcoming Energy Services Directive, the desire for smarter metering and the investigations Ofgem are currently undertaking. It should also be recognised, within the Central Networks areas, that in addition to the incumbent DNO a further five active meter operators appointed by three different suppliers are providing services.
4	Have we made a fair assessment of the prospects for further development of the electricity metering market?	Yes. However it is important that previous signals provided to suppliers intended to stimulate competition are not weakened at this stage

Chapter Five

Number	Question	Response
1	Should the electricity meter price caps be allowed to fall away on 31 March 2007 in respect of meter operation and the provision of new and replacement meters?	Yes. We strongly believe that this approach will enable the market to develop. An optimal metering solution cannot be established through separate frameworks and drivers across MOP, MAP, DC, DP and DA. See main text for rationale.
2	Should the price controls on legacy electricity meters be maintained at least until 2010?	No. We do not believe that retaining any metering price controls will enable the market to develop in the way that Ofgem aspire to. The current price control provides significant issues with regard to the development of metering and at the least, if the obligation remains, the price control should be equivalent to the price reflective of a competitive market. See main text for rationale.
3	Are the concerns over potential issues for small and/or out of area electricity suppliers valid?	No. We believe that competition is developing and will continue to develop with meter operators offering services to large and small players. In the Central Networks areas, five meter operators are operating with commercial contracts.
4	If so, would a non-discrimination obligation on suppliers be an appropriate response to these concerns?	No. We believe that there is sufficient competitive activity available and that additional protection is already afforded to smaller suppliers via Ofgem's Competition Act powers.