RWE npower

RWE

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Metering Price Control Review

Dear Rachel,

RWE npower welcomes the opportunity to comment on the above consultation and does so on behalf of all its npower branded energy supply businesses and its metering business Meterplus.

As stated in previous responses to Ofgem's Metering Strategy consultations we support the principle that metering competition will, in due course, create commercial opportunities and benefits for suppliers, which in turn can improve the services and products we offer our customers. However, metering competition also has the potential to create extra costs and risk to our business and cannot be relied upon to deliver an accelerated implementation of new Smart Metering technology, which we are keen to see brought about.

At this time it is not possible for us to make firm decisions about how we pursue our metering strategy because of a number of uncertainties impacting the market. Any fundamental change to the regulatory framework and market dynamics whilst such uncertainty persists will, we believe, compound the costs and risks we face and create distortions in the supply market.

Competition in gas and electricity metering has clearly not developed at the pace anticipated by National Grid, DNOs and Ofgem when the respective gas and electricity metering price controls were set. Nor is it likely to develop at an accelerated rate until such time as the uncertainties overhanging the market are resolved or better understood. Therefore we do not believe it is appropriate to remove the DNO licence obligations and price caps for new and replacement electricity meters at this time despite this prospect having been signalled at the commencement of the current price control period.

In response to the specific questions raised in the consultation we would make the following comments.

Gas Metering Price Controls

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Is it necessary to review the price controls on gas meters prior to conclusion of the Competition Act investigation?

We do not believe it is appropriate to review the price controls on gas meters whilst the Competition Act investigation into the MSA contracts remains ongoing. Any action the Authority may decide to take to rectify perceived abuse of a dominance will require suppliers to review their metering strategy in light of this, and it is inappropriate to consider any adjustment to the fallback price cap arrangements until such time as this is better understood.

Is it necessary to reset the level of the cap on gas PPM meters prior to conclusion of the investigation?

Similarly we do not believe it is appropriate to reset the level of the price cap on gas PPM meters whilst the Competition Act investigation into the MSA contracts remains ongoing.

Electricity Metering Price Controls

Have we identified the key characteristics and dynamics of the electricity metering market?

Despite a gradual increase in the number of metering businesses operating in the electricity metering market the market is still characterised by the existence of regional monopolies based around the ex PES area. As far as we are aware no metering business currently offers a nationwide meter operation service and those that do offer a wider geographic coverage do so by sub-contracting fieldwork services to the incumbent.

Whilst the speed of competition could increase through the transfer of ownership of installed meters metering businesses have been reluctant to pursue this option. Suppliers have also been unwilling to fund the level of investment this would require or to take ownership of new/replacement meters. With the possible implementation of Smart metering technology on the horizon this position is unlikely to change in the near future.

We agree that competition is likely to be limited to the provision of new and replacement meters. However, the pace of competition will not be driven solely by meter inaccuracy or exchange policies going forward as other suppliers may negotiate competitive contracts with meter operators that provide for 'free' installation of a new/replacement meter, the cost being amortised and recovered with meter rental. British Gas has done this in their competitive metering contracts.

Smart metering technology will also provide suppliers with opportunities to differentiate their energy product offerings to customers, the benefits of which might, in time, warrant the cost of replacing a traditional meter before the end of its normal asset life.

Economies of scale may not be a critical obstacle to further development of the electricity metering market as far as meter procurement is concerned. However, as the installation element of meter provision is significantly affected by volumes and density of customers within a geographic area, suppliers with small portfolios in a given region may not be able to gain the same advantage from economies of scale, as regards price and quality of service, compared to suppliers with larger portfolios.

The risk of meter asset stranding is a real one in our view, and whilst not unique to the metering market it is heightened by the customers ability to switch supplier at 28 days notice. Whilst domestic suppliers are increasingly offering customers contracts with price caps or fixed price periods, customers are not locked into a minimum contract term as they are in the case of telecommunications and television. It is naive to think that suppliers may choose to bear the risk of asset stranding and rely on competitive pricing and customer service to manage this risk, and the "churn contracts" suppliers have been required to enter into where they have inherited a competitive meter installed by the dominant supplier are invariably unsatisfactory and one sided, with little scope for negotiation.

Suppliers having entered into "churn contracts" is not a good indicator of the development of metering competition as their coverage is still far from complete. When faced with the alternative of carrying out a meter exchange suppliers have little option but to accept the terms presented, despite the inadequacies of the service offered.

Have we identified the key developments in the electricity market over recent years?

British Gas, being by far the largest supplier in the energy market, is the supplier most able to benefit from the economies of scale arising from a large and concentrated customer base. It is not surprising therefore that they were the first supplier to competitively tender their metering requirements and award dual fuel meter operation and meter provision contracts. In doing so BG have been able to take advantage of lower prices and improved service levels. Competing suppliers on the other hand have experienced poor quality and timeliness of the data handled by BG's contractors where they have inherited their meter on change of supplier. They have also been forced into accepting "churn contracts" whose terms are one sided and greatly influenced by the structure of the contracts in place with BG, as their only other option would be to undertake a further costly meter exchange to the inconvenience of their newly acquired customer.

RWE npower, along with a number of other suppliers, did issue a tender for metering services early in 2004 but has not yet awarded any contracts as a result. At this time it has no definitive plans to do so until the key uncertainties overhanging the market for metering services have been resolved. However we are continually reviewing the position.

We do not believe it would be commercially beneficial for us to tender for gas and electricity metering services separately, although we may need to consider this option while the Competition Act investigation into the MSA contracts continues. The outcome of MSA investigation could materially influence our metering strategy. Whilst we do not yet know when the MSA investigation will be concluded we do not expect to be in a position to contract for competitive dual fuel metering services in the immediate future. In event the matter is referred to the Competition Act Appeals Tribunal timescales would be pushed back still further.

Any tender we may issue for gas and electricity metering services will also need to take account of expected developments in Smart metering technology. Ofgem's recent "Next Steps" document on this subject lays out the steps and programme of work necessary to facilitate delivery of Smart metering through metering competition. However, the timescales and practical difficulties that need to be overcome to achieve this are not clear at this time. Nor is yet it clear what the implications of implementing the Energy Service Directive in May 2008 will be (as Ofgem themselves point out in this consultation), and the DTI consultation on this is not expected to be issued until the end of this year at the earliest.

Have we identified the factors which determine whether suppliers use the market to meet their electricity metering needs?

The extent to which a supplier chooses to enter into metering contracts that fall outside the provision of the DNO price control and licence obligations will be driven by the commercial and service benefits they gain from doing so.

Having undergone a tender exercise ourselves, we believe there are benefits to be gained from metering competition once we are able to define our requirements with confidence and enter into discussions with metering businesses within a clearly established market framework.

Due to the economies of scale that exist in metering operation and provision some suppliers will benefit more than others. As a consequence we believe there is a need to maintain a regulated metering service underpinned by a licence obligation for new and replacement meters, at least until such time as suppliers are able to properly contract for alternative services from competitive meter providers.

Have we made a fair assessment of the prospects for further development of the electricity metering market?

Ofgem's analysis suggests that competitors in the electricity meter provision market have obtained less than 1% of the market to date. Whilst 20% of new and replacement electricity meters are being installed via competitively sourced contracts, the effect of this is likely to increase the overall level of competitive market penetration by just 1% per annum.

Until such time as other suppliers start awarding commercial metering contracts this level of penetration is unlikely to rise significantly and this will not happen until the aforementioned uncertainties overhanging the market are resolved.

Should electricity metering price caps be allowed to fall away on 31 March 2007 in respect of meter operations and provision of new and replacement meters?

We do not believe that competition has advanced sufficiently to justify withdrawal of price caps for meter operation and the withdrawal of price caps and licence obligations for new and replacement meters provision with effect from 31st March 2007.

Whilst the number of companies offering electricity meter operation and provision has increased, day to day field operation is largely provided by incumbent metering businesses. In the event DNOs choose to withdraw provision of new and replacement meters this is likely to favour the dominant supplier who already has contracts in place, and restrict the contractual options open to other suppliers.

Ofgem's Competition Act investigation into the withdrawal of meter reading services by the incumbent metering business in the London distribution area highlights the type of problems that could occur as a result of such action. Whilst the investigation is still ongoing, and no view has yet been reached on whether this constitutes the abuse of a dominant position, we would expect the difficulties experienced by suppliers arising from withdrawal of new meter provision to be similar, if not greater.

Should the price controls on legacy electricity meters be maintained at least until 2010?

We believe that considerable benefits would arise for suppliers, customers and the UK as a whole from an early, rapid and universal installation of Smart meters in domestic premises within Great Britain.

Whilst we are not wedded to a particular market structure to deliver this solution, in our view it is difficult to see how competition in metering can guarantee to implement this programme coherently and efficiently.

In the event this solution were to be delivered by way of licence obligations on network operators, or by adopting regional franchises to implement and install smart metering technology to a common standard and specification, it may well be appropriate to review or replace price controls on electricity meters prior to the expiry of the current price controls in 2010.

However, as Ofgem favour a competitive market solution for delivering Smart metering it is hard, within the remaining period of the price controls, to see suppliers moving away from the current practice of replacing legacy meters only when they become inaccurate or have reached the end of their working life. To this extent we believe legacy meter provision price controls should remain in place until 2010 at the earliest.

In the absence of a significant increase in the replacement rate of legacy meters incumbent DNOs are unlikely to withdraw meter operation services to legacy meters from April 2007. We would not be surprised however to see a number of DNOs withdraw both meter provision and meter operation services for new and replacement meters should price controls and licence obligation be withdrawn. Incumbent DNOs may however use their market power to raise their site appointment charges for legacy meters to levels significantly above those set by the current price cap.

We do not believe that metering competition is sufficiently well developed to enable suppliers to mitigate this cost exposure. Nor do we think that arrangements are sufficiently well established to enable suppliers to effectively appoint competitive meter operators to service incumbent legacy meters.

Therefore in our opinion the price caps relating to meter operation for legacy meters should be retained for at least the same length of time as the price caps on legacy meter provision.

Are the concerns over potential issues for small and/or out of area electricity suppliers valid?

We believe that small and out of area suppliers will find it harder to manage withdrawal of meter provision by the incumbent in a ex PES area compared to withdrawal of meter reading services. However, in due course it is our view that all suppliers will be able to benefit in some way from metering competition provided they are not bounced into taking action by premature withdrawal of electricity meter price controls and licence obligations.

Withdrawal of these price controls and licence obligations will leave small and out of area suppliers exposed in the event a DNO attends an emergency visit and discovers the meter is faulty. This is because despite "UMETS" being discussed during the development of REMA it was never resolved satisfactorily by way of a contractual framework. Currently as the DNO who attends in the event of a loss of supply is also effectively the meter operator they will replace the meter if necessary and the costs are wrapped up within use of system charges.

In the event the price controls and licence obligations are withdrawn suppliers will need contractual safeguards to protect themselves from DNOs removing fit for purpose meters for purely commercial reasons. Meter replacement should only take place where the meter is faulty or inaccurate, where it is ceases to be certified or where the supplier has requested a change for functionality or technology purposes. We believe these are principles a supplier could reasonably expect to be included within any contractual arrangements which replace the current licence obligation, and we would welcome Ofgem guidelines being published on this issue in the event the licence obligation is withdrawn.

Suppliers will also need full visibility of the details of the meter portfolio of their customers and of the DNO's planned policy exchange programme (neither of which they currently have), so as to allow them to make alternative contractual arrangements in the event the DNO withdraws its metering service.

If so, would a non-discrimination obligation on suppliers be an appropriate response to these concerns?

We do not believe that placing a non-discrimination obligation on suppliers is an appropriate measure to address concerns that may arise from the withdrawal of metering price controls and licence obligations that currently apply to DNOs.

The extent to which a supplier is able to extend the scope of their "in house" metering business will be determined by that businesses capability to undertake meter fieldwork in a particular geographic area, and this is unlikely to be the principle way in which competition develops.

It is hard to see how such an obligation would provide any better protection for small suppliers than retaining the current price controls and licence obligations for new and replacement meters.

If applied only to suppliers with "in house" metering businesses such an obligation would discriminate in favour of those suppliers that did not own a metering business. As the dominant supplier falls into this category they would have a significant unfair advantage, as they would not be obliged to offer equivalent terms (which may already be better than those of the incumbent due to their dominance) whereas those suppliers owning metering businesses would be for areas in which they operate.

Suppliers are unlikely to be asset owners (unlike the DNOs) and such an obligation would impose an administrative burden on suppliers with metering businesses as they would need to try and enter into "churn contracts" to protect against the risk of stranded assets.

Should you wish to discuss our response in more detail please do not hesitate to contact me.

Yours sincerely,

Sent by e-mail and so unsigned

Steve Rose
Economic Regulation