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Dear Rachel,

Metering Price Control Review

SSE are pleased to respond to the recent Ofgem consultation on the above topic. We have provided a response to each of the consultation questions in the attached Appendix, together with further commentary where we have considered it appropriate.

With regard to gas metering price controls, we accept that it is not appropriate to review the state of gas metering competition whilst there is an ongoing Competition Act investigation. We would, however, be keen to see a full consultation and review as soon as the investigation is completed.

Whilst we note that this proposal affects the regulated price for gas prepayment meters (PPMs), on balance we believe it is better to delay consideration of the current arrangements until the outcome of the investigation is known. Nevertheless, we are concerned that competition in PPMs has been slow to develop, with only one meter manufacturer and one PPM Infrastructure Provider (PPMIP) available to suppliers at present. We would wish a thorough review of gas PPM regulation as part of the wider review of gas metering competition as soon as the Competition Act investigation is complete.

With regard to electricity metering price controls, we do not believe that it is appropriate to lift the current controls on the provision of new and replacement meters or on meter operation from 1st April 2007 as proposed in the consultation document. Whilst it is clear that the structures are in place to facilitate competition in the provision of electricity metering services, we do not believe that competition has developed sufficiently to allow lifting of the current controls at this time.

Ofgem have noted that the number of meters installed and operated on a competitive basis now stands at around 20% and that there are around ten metering businesses in the GB electricity sector, with competing businesses in each of the former monopoly regions. However, many of these businesses are simply ex-DNO businesses that have been sold off which, we believe, accounts for a significant proportion of the 20% figure quoted.

Furthermore, as noted in the consultation document, only one major supplier has concluded a competitive tender for third party electricity metering services to date. Other suppliers have gone out to tender for competitive metering services but these appear to be on hold, awaiting the outcome of the current Competition Act investigation into domestic sized gas meters.

In our view, therefore, it is premature to conclude that competition is established and that price controls should be removed from 1st April 2007. We firmly believe that the DNOs should continue to be obliged to provide basic metering services under a metering price control until competition is more fully developed

Furthermore, we note that Ofgem have some anecdotal evidence that the current price caps may be set too low to adequately promote competition. It may therefore be appropriate to review the regulated tariffs to ensure they match current new entrant prices in order to help stimulate competition. A headroom analysis on new entrant prices will help Ofgem in assessing whether or not the price caps need to be changed.

We are firmly of the view that the price caps should be for residual protection only, allowing suppliers a safety net for basic metering services until competition is fully established. Ensuring price caps are set at new entrant prices will, we believe, help to promote competition whilst providing just such a safety net.

In summary, whilst we believe that competition is developing in the metering services market across GB we do not think that it has developed sufficiently to allow the lifting of the current price controls at this time. We recommend that the price controls be reviewed again in two years time, when competition may be more fully established such that the price controls could be allowed to fall away.

Notwithstanding this viewpoint, we believe that it will be important for Ofgem to notify their intentions to the market as soon as possible. If Ofgem do allow the current price controls to fall away from 1st April 2007, suppliers will need as long a lead-time as possible to re-tender for metering services if necessary.

Finally, we believe that there should always be a licence obligation (as opposed to a price control) on the network operator to provide basic metering services 'of last resort'. For gas this should fall on National Grid as the incumbent meter service provider and for electricity it should fall on the DNOs.

If you have any queries on the above, or our response to the consultation questions, please do not hesitate to call me.

Yours sincerely,

Rob McDonald
Director of Regulation

Appendix – Response to the Consultation Questions

CHAPTER: One

No questions

CHAPTER: Two

Question 1: Is it necessary to review the price controls on gas meters prior to conclusion of the Competition Act investigation?

Response: We believe that it is inappropriate to review the price controls on gas meters prior to the conclusion of the Competition Act investigation and agree with Ofgem's proposal not to review these controls until the conclusion of the investigation.

However, we consider it essential that a full consultation and review of the controls is initiated as soon as the investigation is completed.

Question 2: Is it necessary to reset the level of the cap on gas PPM meters prior to conclusion of the investigation?

Response: We note that it is the view of suppliers and competing PPM providers that commercial rates for these meters exceed the price cap. The retention of the current cap will therefore continue to restrict competition in the short term.

Furthermore, we believe that a full review of regulation (and the potential for competition) is required for the gas PPM market. Currently there is a monopoly PPMIP and a monopoly manufacturer providing PPMs. However, we understand that the market is now beginning to develop, with a further meter manufacturer developing a PPM that will fit into the current PPMIP system and another developing a key meter that should therefore open up the PPMIP arena. Any review of PPM regulation should assess the opportunity for new such entrants to break into the market.

However, we accept that it may be difficult to assess how much regulation is required over the provision of PPM's until the Competition Act investigation is complete. As such we agree that, on balance, it is better to delay consideration of the current arrangements until that time.

CHAPTER: Three

No questions

CHAPTER: Four

Question 1: Have we identified the key characteristics and dynamics of the electricity metering market?

Response: In general we believe that the key characteristics and dynamics of the market have been identified in the paper.

However, it is worth noting that the provision of metering services encompasses two totally different businesses. Firstly, meter asset provision, which is effectively a

financing instrument. Secondly, meter operation, which is characterised as a 'man-in-van' business. In some cases the two are provided as a package, but in other cases totally separate companies provide the different parts. This is true in both the price controlled and new, emerging competitive markets.

The meter provider is looking for a long-term guaranteed financial return on its investment, whilst the meter operator is looking for a short-term profit on its man-in-van business.

As such, competition could develop at different paces for the two services.

Question 2: Have we identified the key developments in the electricity metering market over recent years?

Response: The consultation paper provides an outline of the British Gas tender for competitive metering services across all ex-PES areas as one of the key developments in the metering market in recent years.

However, the British Gas tender may raise issues for customers when they subsequently switch supplier. For example, subsequent suppliers may have additional hurdles to overcome in the form of changing meters on change of supplier, and the operational costs and premiums of having to appoint agents not of their choice.

Such hurdles serve to slow the development of competition.

Furthermore, Ofgem have indicated that competitors now provide meter operation in respect of 20% of electricity meters and that around 20% of new and replacement meters are being installed via competitively sourced contracts. We believe that these figures need to be treated with some caution: a number of the competitors are simply metering businesses that have been sold off by the DNOs.

Question 3: Have we identified the factors which determine whether suppliers use the competitive market to meet their electricity metering needs?

Response: Please see our response to Question 4 below.

Question 4: Have we made a fair assessment of the prospects for further development of the electricity metering market?

Response: Whilst the assessment of the prospects for further development of the market are reasonable, we believe that it is too early to conclude that competition is fully established. Indeed, Ofgem have indicated that no supplier other than British Gas has concluded a competitive tender for third party electricity metering services.

Whilst other suppliers (including SSE Energy Supply Ltd) have gone out to tender for competitive metering services we understand that these are on hold pending the outcome of the Competition Act investigation into the gas metering contracts with National Grid. Furthermore, as noted by Ofgem, the potential impact of the Energy

Services Directive is causing further uncertainty over the development of competition in metering.

Therefore, when taken along with our response to Question 2 above, we do not believe that it is appropriate to allow the current price controls to fall away.

We note that Ofgem have some anecdotal evidence that the metering price controls may be too low to adequately promote competition. In our view, the metering price controls should be reviewed to ensure that they are at a level that will encourage meter providers to develop new products and services to meet the needs of suppliers and customers. As noted in the discussion document, if the price caps are set too low they will reduce the attractiveness of investing in innovative metering.

A headroom analysis on new entrant prices would provide Ofgem with the necessary information to decide whether or not to reset the price caps from 1st April 2007.

CHAPTER: Five

Question 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?

Response: No, for the reasons discussed above, we do not think it is appropriate to allow these price caps to fall away at this time.

However, we do believe that price caps should be for residual protection only, allowing suppliers to fall back on the incumbent metering businesses for provision of basic metering services whilst competition develops. Ensuring that the price controls are set at new entrant prices will help to stimulate competition whilst ensuring a basic safety net is available.

Whilst we do not believe that the competitive market has developed sufficiently to allow the existing price controls to fall away in April 2007, we do believe that they should be removed at some time in the near future. We would suggest that the price controls be reviewed again in two years time. If the price caps are reset to align with current new entrant prices we believe that competition may well have developed sufficiently in that time to allow the price controls to fall away.

In our view it is also still necessary to have a licence obligation on the network operator to provide a 'last resort' basic metering service. In gas this would fall upon National Grid as the dominant meter service provider and in electricity on the DNOs within their distribution service areas.

Question 2: Should the price controls on legacy electricity meters be maintained at least until 2010?

Response: We agree these price controls should be maintained. However, if a further review of meter operation and the provision of new and replacement meters is carried out in two years time we believe that it would also be appropriate to review this decision at that time.

Question 3: Are the concerns over potential issues for small and/or out of area electricity suppliers valid?

Response: Yes, we believe these are valid concerns. They are important in understanding if competition has established sufficiently to remove the current price controls.

Question 4: If so, would a non-discrimination obligation on suppliers be an appropriate response to these concerns?

Response: We do not believe a non-discrimination obligation on suppliers would be appropriate. In our view an ongoing obligation on network operators to provide a 'last resort' basic metering service will ensure an adequate safety net for small and out-of-area suppliers.