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10 August 2006

Dear Rachel

### **Metering Price Control Review**

I am pleased to have the opportunity to respond to your recent consultation. As you know, we have been pressing for some time for clarity on the future regulation of the metering market. In our view, the development of competition could be frustrated by uncertainty over the future market structure, and we therefore welcome the clear indication of the way forward that is set out in your paper.

### **Gas Metering Price Controls**

It is important to begin with a clear statement of principles. Where competition is established it should not be necessary to impose last resort obligations or to apply price controls. In the case of the gas DNS, it could be argued that competition existed before they were split under separate ownership and that metering obligations and price controls should never have been applied to the new companies.

Having said that we would agree with your conclusion that it is more important to the development of the competitive market that the Competition Act investigations are completed. The uncertainty created by these investigations has effectively stalled the development of the gas metering market, and this is probably having a knock on effect in the parallel market for electricity metering services. Your priority should therefore be to complete your work and publish the conclusions.

Whilst we would not support the deflection of any resources to look at price controls for gas metering services, including prepayment meter rentals, until the competition investigations were completed, we would be surprised if there was a conflict here, since the two pieces of work are likely to be handled by different teams within Ofgem.

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## **Electricity Metering Price Controls**

In electricity the priorities are different. The existing DNO licences set out a clear timetable for the termination of most of the obligations in respect of metering services. (The only exception is the continuation of meter provision until the certification life of the meter expires.) In our experience, suppliers have been responding to this timetable by seeking to put in place new arrangements that recognise that the DNO is no longer the default service provider.

Your summary of recent market characteristics and developments in section 4 of your paper provides most of the background. Whilst we accept that the risks related to both economies of scale and asset stranding are ones that can be handled through commercial arrangements in a competitive market, this does require a different approach from that used to set price controls for monopoly (or quasi monopoly) undertakings. Both of these aspects of the market imply a significant fixed cost for a market participant. Price controls that are set on a price per meter basis (as with MAP) or revenue caps with volume adjusters (as with MOp) are unlikely to be equally applicable across the range of market shares that can result from competition. However, as your paper highlights, the cost of capital used in setting metering price controls is identical to that used for the core distribution businesses.

We have already written to you to explain the effects on our distribution business of the substantial reductions in meter operator activity as suppliers make other arrangements for the future. The fact that suppliers are making these choices is evidence that there is now competition in metering services and that there is no longer a need for a last resort service provider. Furthermore, our assessment demonstrates that the price controls cease to provide adequate remuneration for small scale meter operator activities, especially where there is a need to maintain a wide geographical capability to respond to meter faults.

There is no doubt that the obligations in UUE's licence to offer meter operator services in the North West of England are no longer necessary. These obligations and the associated price controls should fall away in March 2007, if not before.

The meter operator activity is one that looks increasingly attractive as volumes grow, especially where this implies greater geographical density. We therefore find it unlikely that meter operators would be reluctant to serve a range of suppliers. However, if you had cause to doubt that a meter operator, affiliated to a major supplier, would act in this way, you might decide to add conditions to the standard supply licence to provide greater protection than would be available from normal competition law.

Your suggestion that price controls should remain on the basic meter rental services is consistent with an enduring obligation to provide pre March 2007 meters until they reach the end of their certification lives. We agree that this is something that could be reassessed during the next Distribution Price Control Review. We would expect that, by that time, competitive pressures should ensure that prices are not excessive. However there may be a legitimate trade-off between retaining old meter stock until the end of its physical life and replacing meters with newer technology offering greater functionality for customers and suppliers. It would be wrong if this trade-off were distorted by an artificial restriction arising

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from continued price controls. The current MAP price caps allow only 24p per meter for the fixed costs of the service provider. This allowance does not currently cover our fixed costs and as the volume of meters provided falls, this situation will become progressively worse for a stand-alone asset rental business. By 2010 we would hope to see the service obligations and price controls for MAP fall away, leaving competitive forces to determine the residual life of meters.

In conclusion, I would repeat our support for the position outlined in your paper. It is, in our view, imperative that there is immediate clarity over the future structure of the market for metering services. We believe that suppliers are already anticipating a fully competitive market and that it would create new confusion if there were any suggestion that the plan set out in the electricity distribution licences was not honoured. Ofgem's focus should be on resolving the uncertainties created in the gas market because of the need for Competition Act investigations. Once this is resolved, we would expect to see competition gathering pace in the provision of both gas and electricity metering services.

I hope that you will be able to announce the conclusion of this consultation process soon after the closing date for responses. If you would like to discuss any of our comments, please contact me at the address above.

Yours sincerely

Mike Boxall  
Electricity Regulation Director