SIEMENS

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Dear Andy

Ofgem's Five Year Strategy 2008 - 2013

With reference to the open letter of 6th August from GEMA's chairman, I am pleased to provide the attached response from Siemens Energy Services (SES).

SES is a long-standing supporter of the competitive principle in utility services and was among the first independent players to participate actively in the new markets which opened up in the late nineties. We have seen tremendous achievements throughout the industry in improved service levels and reduced costs during the earlier years, but have become concerned that the pressure towards reintegration coming from some of the dominant regional players is restricting the benefits of full competition in domestic supply which could accrue to end-consumers.

Given the recent strong position taken by the European Commission only last week, we feel that this is an excellent time to consolidate the leading position of the UK by reinforcing the principle of separation between retail and distribution interests, and in particular by ensuring that dominant local positions are not used to restrict innovation in competition-enabling downstream services like metering.

Our full comments are presented in the attached Appendix

Yours sincerely

Martin Pollock
Marketing Director
Siemens Energy Services

Appendix to letter of 24 September 2007

Declaration of interest

Siemens Energy Services (SES) is a competitive provider of a wide range of metering services to the utilities industry covering Asset Provision, Asset Maintenance (Meter Work) and Asset Management, Data Retrieval, Data Processing and Data Aggregation, Prepay, Revenue Protection and Debt Recovery. SES is wholly owned by Siemens PLC; its turnover in the UK is about £120m and its headquarters are in Nottingham.

SES is pleased to respond to Ofgem's open letter of 6th August 2007 re Ofgem's Five Year Strategy 2008 – 2013 and has ordered its comments under the three headings given in the letter.

The key challenges that the industry faces in the short to medium term

At a macro level, the two challenges that have been repeatedly presented by government are security of energy supply and carbon emissions. According to the opening strategy statement of the May 2007 White Paper, *Meeting the energy challenge,* "to deliver energy security and accelerate the transition to a low carbon economy requires urgent and ambitious action". This continues the cycle which began with the European Directive on Energy in Dec 05, The Stern Report May 06, The DTI/DEFRA *Energy Challenge* Jul 06, the "Ofgem Trials" and the DTI *Energy Billing and Metering* Report, Nov 06. The White paper has since been followed by the BERR report, *Energy Billing and Metering, Changing Consumer Behaviour,* Aug 2007. These policy developments have been underpinned by a number of proposed modifications to certain competition-inhibiting licence conditions of regulated utilities, for example the removal of the DNOs' obligation to provide metering services, and the requirement for new services to be offered on a stand-alone competitive basis.

The White Paper states "our strategy continues to be based on the principle that independently regulated, competitive energy markets, are the most cost-effective and efficient way of delivering our objectives". SES strongly supports this view and considers that mechanisms which tend to create a level playing field on which energy retailers can compete are core to the success of the competitive concept.

Key challenge one is therefore to ensure that total control over local service strategy is not monopolised by dominant vertically-integrated utilities.

A second challenge arises from Ofgem's role in overseeing the introduction of Smart Metering to the UK. The BERR report referenced above reinforces government policy on the provision of real-time information in the home early next year, and of smart metering in general "over the next decade". This unfolds against a period of years of inaction by the incumbent service providers, despite the inward investment of £100m - £200m by external technology providers. The argument that the best technology has not yet been available is spurious – it has *always* the case that new technology is just around the corner and this constant cycle will continue. The fundamental issue

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is one of long-term strategic policy and the industry should concentrate on defining its *requirements* so that the technology will follow.

Key challenge two is therefore to create reasonable conditions for investment in smart metering. It should be noted that the drive for smart metering has not come from traditional metering asset providers. It has come from consumer groups and from government. (1) consumer groups objected to unacceptable standards of billing accuracy resulting in the energywatch supercomplaint of 6th Apr 2005, which in the words of energywatch at the time would address "the myriad problems faced by millions of consumers because of company incompetence over billing which suppliers have consistently failed to address". Many of these problems were attributed to meter data. (2) the government perceives a need for reduced residential consumption based on heightenend energy awareness, which arises from *both* of the top line issues mentioned above - security of supply *and* carbon emissions. Evidence presented at earlier consultations (eg by Darby in the ECI paper *The effectiveness of feedback on energy consumption*, 2006) shows that voluntary action requires live feedback. Such feedback can easily be provided by smarter meters at very low cost. It should be noted that the requirements of accurate billing and real-time consumer feedback can be met at little or no additional cost to the industry *except* for those associated with the anticipated increase in call-centre enquiries which may arise from an informed public. Also the in-home solutions for receiving, processing and displaying local energy consumption should be allowed to develop independently of specialist metering requirements so as to avoid building obsolescence into successive generations of smart meters.

How you think the Authority should respond to these challenges

With reference to *key challenge one* identified above, and the currently untenable situation where local dominance in distribution and supply is used to influence downstream services like meter operations and data collection, an appropriate response from Ofgem would be to remove the anomaly where utility-owned metering services businesses can accept Supplier contracts without tender, based on their in-house status, while also accepting Distributor contracts without tender from the same group. Such a Metering Services Business cannot meet the in-house test for both a Supplier and a Distributor.

Ofgem had already begun to resolve this anti-competitive practice in its open letter of 23rd January 2006 where it indicates that their proposal "would mean that DNOs that wished to continue providing metering services would need to do so through a separate subsidiary". Ofgem should adhere to this course of action to ensure that metering services are available to all Suppliers on an even-handed basis, are not influenced by legacy issues, and are not used to create barriers to market entry, for example through tactical bundling by the local incumbent.

Ofgem will be aware that the water regulator, Ofwat, has recently had to grapple with similar issues and has taken enforcement action against one utility for failing to carry out market testing of key service contracts, including meter provision and maintenance, and this case provides interesting parallels with the situation in electricity metering.

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With reference to key challenge two identified above, Ofgem should do the following:

The first requirement is to define (or accept a proposed definition of) the new smart metering requirement in terms of a “standard core”. The scope of the standard core definition should be strictly limited to addressing the drivers outlined above – ie accurate billing and live data in the home. If Suppliers or meter asset providers choose to add additional features because of an assumed positive payback then they should be permitted to do so ay their sole risk. The core standard would best be managed ultimately by the BSI. The BSI would also ensure maximum coordination with similar requirements internationally, eg through CENELEC.
The second requirement is to define the rules of “churn”. On change of Supplier, the new Supplier should be obliged to adopt a meter that conforms to the standard core requirement, or to compensate the asset provider if he chooses to install something else. If the previous meter asset provider had chosen to add additional features then he should be permitted to offer the services associated with these additional features to the new Supplier but the new Supplier should be obliged to purchase *only the standard core.* These rules would best be created and managed voluntarily in an industry code of practice.
The third requirement is that new smart meter asset providers should be allowed to compete fairly. That would involve ensuring that new metering was totally de-coupled from legacy arrangements. Ofgem can achieve this by implementing its proposed policy position of December 2006 on this subject.

The order of priority we should give to our areas of work in response to those challenges

Ofgem’s overall priority should be to ensure that reasonable conditions prevail to encourage fair competition in energy retailing. It is clear that certain services, like meter operations and data collection, are perceived by vertically-integrated groups as possible differentiators. For healthy competition to survive, it is mandatory that control over local service strategy is not monopolised by dominant incumbents. Fair competition among retailers is only possible if strict separation is enforced between retailing and other downstream activities like metering.

Ofgem’s second priority should be to create a reasonable investment climate for the providers of smart metering. A well-targeted core specification accompanied by appropriate codes of practice as outlined above would provide this.

During its public strategy seminar on 21st June 07 Ofgem commented that it saw no conflict of interest, in expecting energy retailers to actively pursue *reductions* in consumption from their customers. It has to be assumed that this would be reflected in a corresponding reduction in consumers’ bills. Based on figures given in Ofgem’s *Domestic Retail Market Report,* June 2007, a 5% reduction in the average £380 bill across 26m consumers would take £500m out of the residential sector of the electricity industry alone. Ofgem expressed the view that retailers would in future use the promise of reduced consumption as well as reduced prices to gain market share. A more likely scenario might be to let retailers continue to pursue their own market strategies on energy pricing while allowing consumers to invest in energy saving if they so choose. This would place the costs and long-term benefits properly where they belong, would avoid the stranded asset

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problem on the part of the utilities, and would minimise the tendency of blanket solutions to place an unwanted stealth tax on all consumers, especially the fuel poor. It should be a matter for government to decide if they wish to propose targeted support to enable vulnerable consumers to invest in energy saving technology, but such measures should not be dependent on highly complex and inaccessible metering control systems. Rather they should make use of *meter data* and place the control functions in other unregulated household devices which can much more easily develop with future changing needs.

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