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Dear Emma,

Review of Current Metering Arrangements

Thank you for the opportunity to comment on the issues raised in your letter and the scope of your proposed review of metering arrangements within the UK energy markets. There are currently a number of inter-related issues within the metering market and your proposed review is a timely opportunity to examine and address all outstanding issues before the commencement of the smart metering implementation programme.

Northern Gas Networks (NGN) has a direct interest in the development of the metering arrangements as a participant in three key areas of the gas metering market:

- The Gas Distribution Networks (GDNs) retain a licence obligation to provide a Meter Supplier of Last Resort (MSOLR) service for four tariff-capped metering services.
- The provision of a Post Emergency Metering Service (PEMS) under commercial arrangements with gas suppliers for the replacement of domestic meters where a gas emergency has been caused by a leak from a faulty meter.
- The provision of a range of meter installation and maintenance services to National Grid Metering (NGM) within NGN's geographic area.

Each of these areas has specific issues that need to be considered as part of your proposed review and these are set out in more detail below.

Meter Supplier of Last Resort

At the time of gas distribution network sale in June 2005, the GDNs retained the licence obligation originally imposed on Transco in 2001. The obligation requires the provision of four key metering services which are tariff capped and allowed to change in line with RPI on an annual basis.

NGN acquired no metering assets at the time of network sale and has built up a stock of approximately 22,000 meters since that time. Of which almost 20,000 are domestic, tariff capped meters and the reminder are Industrial and Commercial (I&C) sized meters.

The regulatory framework that supports the provision of domestic, tariff-capped metering services presents several key issues for both NGN and the wider metering market;

- The tariff caps were introduced in 2001 under and industry structure where Transco were the dominant meter provider in the gas market. As such the arrangements were designed to satisfy the industry structure that existed at that time i.e. a single dominant supplier with significant infrastructure and expertise to support the provision of up to 20 million meters. NGN with only 20,000 meters does not possess the relevant economies of scale or infrastructure that is required by the tariff caps to make the activity financially viable at those levels.

- The tariff caps include and inherent cross-subsidy from the provision of domestic credit meters to prepayment meters. This cross-subsidy was based on an assumed ratio of the different types of domestic meter back in 2001. NGN currently have a ratio of prepayment meters (53%) which is much higher than that assumed within the tariff caps and across the national metering stock as a whole. The result is that the level of the tariff caps are not sufficient to cover the full economic costs of the provision of domestic meters. This impact is reduced for those parties who have a larger portfolio of meters and contracts for the provision of meters.

- The tariff caps are introducing distortions to the market. Energy Suppliers who have access to a range of providers to meters will aim to optimise their portfolio by choosing the meter providers that minimise their overall costs. As highlighted above, the existence and level of the tariff caps is distorting the market for the provision of different types of meters and potentially limiting the further development of competition in certain market sectors.

Notwithstanding the issues that the current structure and levels of the metering tariff caps raise for NGN, there is strong evidence to suggest that the market for domestic metering services does not need to be underwritten by the provision of a supplier of last resort service. The level of competition in the market for the provision for gas meters is now sufficient to remove the obligation as per the electricity metering market in the UK.

The limited utilisation of the service by energy suppliers (4,000 meters per annum from a total meter stock of almost 2.5 million in NGN's area) suggests that market based arrangements are sufficient to satisfy energy suppliers requirements and the obligations ion NGN can be removed.

This position is supported by the UK Government's recent decision to implement its policy for the national roll out of smart metering technology using a market based implementation model where energy suppliers are responsible for the provision and installation of gas and electricity meters. If a market based approach is deemed appropriate for the roll-out of approximately 50 million meters over the next ten years it follows that the market is sufficiently developed not to require any direct regulatory support in the form of a supplier of last resort obligation on GDNs.

Finally, the introduction of smart metering over the next ten years will have a direct impact upon NGN and the regulated domestic metering assets it owns directly. The MSOLR tariff caps are based on an assumed asset life of 20 years for domestic credit meters and 10 years for prepayment meters. With an average residual asset life of 16 years and 7 years respectively, NGN's metering portfolio carries a significant stranding risk as they are replaced with smart meters before the end of there assumed economic lives for which we would require financial compensation.

Post Emergency Metering Services (PEMS)

The GDNs currently provide a Post Emergency Metering Service (PEMS) under commercial arrangements with gas suppliers for the replacement of domestic meters where a gas emergency has been caused by a leak from a faulty meter. This service ensures that there is a continuity of gas supply for the customer.

Ofgem has strongly supported the continued provision of this service under commercial arrangements between suppliers and network companies without making it a direct licence obligation. NGN are planning to continue with the provision of this service if required by suppliers. However, the introduction of smart metering will have an impact on the provision of PEMS in both the short and longer term.

In the short term, the roll-out of smart meters will mean that there will be a requirement for a PEMS service to cover both conventional and smart meters. This will require GDNs to carry metering stock for both technologies. The limited space on vehicles will mean that greater constraints on stock will mean that less PEMS jobs can be carried out by GDN emergency staff and that stock will be held on vehicles for longer before being used. Both of these issues will potentially have an impact on the levels of service able to be provided and the costs of providing a PEMS service.

Longer term the provision of the PEMS service on smart metering technology will depend on several factors including the ability of GDN emergency staff to install and commission smart meters alongside communications links etc, the business model for the roll-out, support and maintenance of smart metres employed by the suppliers and the PEMS workload associated with new metering technology.

The retention of metering competencies and ongoing training already represents a disproportionate cost for our Firs Call Operatives (FCOs) when compared to their normal duties. The additional complexity associated with smart meters will add further to this impact on NGN's workforce.

All these factors will impact upon the provision of the PEMS service going forward and Ofgem should be fully aware of the changes in the wider meter market will have upon GDN provided services.

<u>NGN Provision of Metering Services</u>

NGN currently provides metering services to National Grid Metering primarily on I&C meter installations. It is at present unclear how the roll-out of smart metering and in particular the preferred model adopted by the UK government will impact upon this type of work carried out by NGN and other GDNs.

The Ofgem review needs to consider fully the impact of changes within the metering markets and in particular their impact upon network businesses.

In summary, NGN feel that a wide-ranging review of the metering markets within the UK energy sector is a welcome and overdue development. There are several key issues that need to be considered and resolved in advance of the smart metering implementation programme. The review needs to address;

- The reasoning for the continued licence obligation on GDNs to provide a MSOLR service to the gas market. NGN contend that the level of competition is sufficient to remove the obligation and the distorting impact that the current tariff caps have on the domestic metering market. Whilst also addressing the financial impact of the obligation on small scale metering operations such as NGN's.

- The impact of smart metering on the stranding of regulated meter assets provided under the MSOLR obligation and how GDNs will be reimbursed for the costs of these assets that are prematurely replaced.

- The impact of the developing metering market on the services provided by and the core operations of the GDNs.

I hope you find these comments useful and look forward to working with you on the above issues as the review progresses.

Yours Sincerely,

Gareth Mills
Commercial Manager