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# Review of Metering Arrangements - Initial Findings and consultation on proposed metering industry remedies

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**Target audience:** All gas and electricity metering industry participants including energy suppliers, networks, metering businesses, consumer groups, and other industry parties.

**Overview:**

Ofgem have been undertaking a Review of Metering Arrangements (ROMA). This consultation presents Ofgem's minded to position on metering issues faced by both industry and consumers in the coming years.

Our minded to view on key areas of interest are as follows. For commercial interoperability, we encourage industry to improve information and data flows to enhance the change of supplier process. On vertical integration and network companies' obligations, we consider that a package of remedies will ensure dumb meters are available, and protect small and out-of-area suppliers during the transition to smart metering and beyond. We propose to facilitate this by introducing a non-discriminatory obligation on certain suppliers to offer smart metering services on cost reflective terms to other suppliers. Finally, we propose to retain metering price controls on all (dumb) gas meters. We consider that a review of the tariff cap for new and replacement meters would be appropriate for credit meters, and may also be appropriate for pre payment meters. We welcome views on all of our proposals.

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## Context

Since 2000 Ofgem has taken measures to facilitate competition in gas and electricity metering services, to promote lower metering costs, better service and encourage innovation and the introduction of smarter forms of metering.

As part of the transition to metering competition, separate metering price controls were set for domestic gas and electricity metering services in April 2002 and April 2005 respectively. In 2006 we consulted on the future of those price controls, ultimately removing some of the metering price controls in electricity in March 2007. Given the (then) ongoing Competition Act investigations into National Grid's Metering Service agreements (MSAs), Ofgem decided to review gas metering price controls at a later point. On 27 July 2010, DECC and Ofgem jointly published a Prospectus containing proposals for the delivery of electricity and gas smart metering in Great Britain. In light of this and the conclusion of the Competition Act case, Ofgem considers that it is the appropriate time to review the current metering arrangements.

In this consultation document, we set out our findings from our information request earlier in the year. We then set out our proposals on the future of the gas metering price controls and network companies' obligations (specifically meter provider of last resort arrangements), amongst other issues. The vertical integration of energy supply and metering businesses is also addressed. We invite views on these matters. The deadline for responses is 14 February 2011.

## Associated Documents

- Review of Metering Arrangements Open Letter. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Markets/RetMkts/Metrng/Comp

- Review of Metering Arrangements Scope Letter. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Markets/RetMkts/Metrng/Comp

- Smart Metering Implementation Programme Prospectus (94/10) and associated documents. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Smart%20metering%20-%20Prospectus.pdf&refer=e-serve/sm/Documentation

- Ofgem's Decision on the Future of the Gas and Electricity Metering Price Controls (2006 review). Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Markets/RetMkts/Metrng/Metering

- Regulating Energy Networks price control document. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=116&refer=Networks/rpix20/ConsultDocs

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# Summary

## Context for consumers

An important component of Ofgem's work in establishing effective metering competition had been to set price controls on the former monopoly metering businesses, to protect consumers during the transition to a competitive market while also promoting competition.

Although metering is only a small proportion of the customer's bill and a supplier's cost base, it plays a crucial role in the provision of good customer service through, for example, accurate billing. It is also an important tool that suppliers can use to develop more innovative supply products such as time-of-day pricing, energy services and micro-generation. Suppliers have a strong incentive to make sure they have the right meters to allow them to deliver the products their customers want. This is of particular importance in relation to roll-out of smart meters.

While electricity metering price controls were removed in 2007, gas metering price controls remain. While the electricity market has developed competitively since the removal of price controls, the gas metering market has not. Since the announcement of the intention to roll out smart metering, some aspects of the metering market have changed, and so it is crucial to ensure that the existing arrangements are appropriate in the transition to smart metering. The smart metering proposals are to follow in the New Year in the spring package and the Government's Prospectus response.

## Our recommendations

From an information request we gathered evidence and found specific areas where we consider a change in policy is required in order to remedy failures in the market. The areas where we have set out our minded to view are listed below and include gas metering price controls, vertical integration and network companies' obligations.

**Consumer protection, commercial interoperability and metering agents**

We consider that it would not be appropriate to intervene in the market in the areas of consumer protection and metering agents. For commercial interoperability[1], we acknowledge that the current arrangements have led to a multiplicity of contract forms and charges, and that this can lead to administrative costs for suppliers, and some uncertainty over what charges they will face when they take on a new customer. To this extent, we consider that the metering market would benefit from decreased transactional costs and increased and more transparent information flows. However, we are not certain that the evidence is sufficient to warrant intervention in relation to dumb meters.

[1] This is a defined term, see glossary.

We recognise the benefits of commercial interoperability and also recognise that some industry players would welcome regulatory support in developing a common framework setting out basic principles to avoid premature replacement of meters.

**Vertical integration and network companies' obligations**

We consider that policy changes in the following areas would be appropriate. Firstly, network obligations for meter provider of last resort (MPOLR). Given the lower level of competition in gas metering, we recommend that the MPOLR obligation on Gas Distribution Networks (GDNs) for gas dumb meters remains, until smart metering roll out has gained a critical mass. Secondly, we propose to restrict the use of MPOLR to ensure that suppliers are not abusing the MPOLR obligation particularly for prepayment meters (PPMs). We propose to introduce a new licence condition requiring suppliers to be able to demonstrate that they have exhausted commercial routes before approaching a GDN for a meter. Finally, we consider that a non-discrimination obligation may be appropriate for smart meters. We recommend a non-discrimination obligation on suppliers (on vertically integrated suppliers for benefit of small suppliers) requiring them to offer metering services on cost reflective terms for both electricity and gas meters. This may include a requirement on the supplier to demonstrate that terms are cost reflective if investigated.

**Gas metering price controls**

We recommend that changes are made to two of the three gas metering price controls. Firstly, for new and replacement credit meters (DCMs), we recognise that there will be a need to install dumb meters during the transition to smart metering. We recommend that the level of the price controls be re-set for new and replacement meters only, to allow the market to function in the interim by setting an appropriate tariff cap reflecting the shorter asset life expected of these meters. Secondly, for new and replacement PPMs, GDNs have claimed that the price control rate for PPMs is currently below the market rate which creates a distortion with the metering market. The smart metering policy team is considering a number of issues in relation to smart PPMs and the pace of the rollout; therefore, while we recommend no changes to the PPM price control at this point, we intend to keep this decision under review, and seek further information from industry to help inform our view.

We do not propose a change to legacy meter price controls. There is currently uncertainty with regard to the National Grid Metering Service Agreement (MSA) contracts which, following the end of the Competition Act decision appeal process, are currently being re-considered. This is likely to be a key turning point in the development of the gas metering market; we recommend maintaining the price caps at current levels and monitoring the market.

## The consultation

We strongly encourage industry participants and others to respond to the questions this document raises and the options proposed by 14 February 2011. We will review our minded to position in the light of the comments and any further information we receive, and envisage reaching a decision in summer 2011, after which our final decisions will be published.

# 1. Introduction to the Metering Market

Chapter Summary

We set out the scope, objectives and timescales of the ROMA review. We also set out the background of the metering market. Gas and electricity metering markets have developed at different rates due to a range of factors. In the electricity metering market, signs of competition are evident. In gas, by comparison, the competition has not developed to the same extent.

Question Box

Question 1: Do you have any views on our assessment of the current arrangements for the gas and electricity metering markets?

## Background to the metering market

1.1. Since 2000 Ofgem has taken measures to facilitate competition in gas and electricity metering services[2], to promote lower metering costs, better service, accurate billing and encourage innovation and the introduction of smarter forms of metering. Ofgem considers that competition can deliver significant benefits whilst driving down the costs of providing and maintaining conventional and smart meters, especially in a period of rapid technological innovation.

1.2. We consider that the commercial incentives created by competition, combined with the "supplier hub" principle that puts suppliers in charge of key investment decisions in metering, provide the best means of protecting consumers over the long term and ensuring that new metering investment meets their needs.

## Electricity metering market

1.3. There are around 27 million domestic electricity meters, and a significant proportion is still under Distribution Network Operators (DNOs) ownership with Commercial Meter Operators (CMOs) owning less than a tenth of the meters.

1.4. Before the introduction of metering competition, Distribution Network Operators (DNOs) provided electricity meters as part of their regulatory function. In 2006, Ofgem decided to allow the obligations and price controls on electricity meter operation services (MOp) and the provision of new/replacement electricity meters

[2] Metering services include: installation, provision, and maintenance of both electricity and gas meters.

(MAP) to lapse in line with sunset provisions set out in the distribution licence. Since 31 March 2007 DNOs have no longer been obliged to offer these services.

1.5. Since the opening of the market to competition, suppliers have been able to use CMOs offering cheaper annual rentals, meters that are more advanced and/or better service levels than the incumbent.

**Assessment of the market to date**

1.6. Based on the data reported to us more that 12 million electricity meters remain under network ownership as regulated meter assets[3].

1.7. Confidential data gathered in the information request shows that there are multiple relationships between players in the electricity metering market (Suppliers, MOps and MAPs), which goes some way to suggest that despite the relatively high level of DNO owned metering assets under regulated price control, there is a good level of competition in the market. It is encouraging to note that certain DNOs have decided to compete for contestable metering and that CMOs are also actively competing within the DNO areas.

1.8. In Chapter Two we discuss the levels of customer service that have been available since the removal of electricity metering price controls.

## Gas metering market

1.9. There are about 22 million domestic gas meters in Great Britain. The majority of domestic gas meters are owned by National Grid Metering (NGM), with CMOs and Independent Gas Transporters (iGTs) making up most of the balance. The transition to competition included setting price controls for gas and electricity meters in 2002 to protect customers, and requiring Transco in 2004 (now National Grid Gas) to formally separate out its metering business (now NGM) from its transportation business as they provided gas meters as part of their regulatory obligations[4] and had a de facto monopoly in metering.

[3] Information was requested on a voluntary basis and is not complete.

[4] Standard Special Condition A43 Provision of Metering and Meter Reading Services. Special Condition E19 (RdNs): Restriction of prices in respect of Tariff Capped Metering Activities, Special Condition C12 (NTS): Restriction of prices in respect of tariff capped metering activities.

1.10. When full gas metering competition came into force in 2004, National Grid Gas (NGG) drew up long term MSAs[5] for both the existing meters on walls and for any meters they replaced from 2004, as an alternative to their regulated offering. Ofgem made a Competition Act infringement decision which was subsequently appealed to the Competition Appeal Tribunal and the Court of Appeal. Ofgem's decision was upheld such that the legacy MSAs are effectively void. As this stage it is unclear how the negotiations for new contracts between National Grid Gas and the Suppliers will develop.

1.11. GDNs continue to have obligations to provide metering services to domestic customers under price control. In our 2006 decision document on the future of the metering price controls, we made a decision to retain the current gas metering controls and review them after the conclusion of the Competition Act investigation into the MSAs.

**Gas market scope of competition**

1.12. In response to the ROMA information request, some suppliers considered that the current price control arrangements are ensuring that dumb meters are available in the period before smart meters are specified and become available. In general, respondents did not consider that the market was competitive, to the extent that some industry participants did not consider gas metering to be sustainable on a competitive basis.

1.13. Further, we recognise that having a price cap in a market where there are also competitive providers has the potential to create distortions, as the GDNs cannot make a commercial decision as to whether and how to stay active in the metering market (and at what price). The quickest way of introducing competition would be through transfer of installed meters from regulated to competitive ownership. However, to achieve this, GDNs and NGM would have to sell their meters and competitors must be able to offer suppliers a rental at or below the regulated price (by virtue for example of having a lower cost of capital). Depending on the level at which the price cap is set, there is also a significant risk that the continued existence of regulated services reduces the incentive for suppliers to seek alternative metering service providers.

**Assessment of the market to date**

1.14. Data gathered from the information request shows that the level of contractual relations between suppliers and meter asset managers (MAMs) in the gas metering

[5] The MSA contracts were agreed by five of the six major energy suppliers and included financial penalties if suppliers replaced more than the small number of meters allowed under the contract. These contracts have severely restricted the rate at which suppliers can replace even National Grid's older meters with smarter meters from rival competing CMOs.

market is lower than in electricity. Two metering agents provide the majority of gas metering services nationally.

1.15. While there are many entrants to the market providing metering services, they remain less contestable due to the significant bundling of meter asset provision by the incumbent provider. In order for a new entrant to achieve significant economies of scale it would be necessary to unbundle existing sites which is, by definition, only possible by physically exchanging meters or sale of the assets.

1.16. The market has shown some positive response to the introduction of competition, and has created competition for the asset management and installation functions[6]. In liberalising the metering sector, the benefits have also filtered through into retail competition improving the customer experience. However, we do not consider the market is adequately competitive to lift price controls on gas meters, as the market would not be able to sustain dumb meters for the duration of their asset life in the transition to smart metering.

## The ROMA

1.17. On 1 April 2010 we published an Open Letter[7] to launch the ROMA that set out our current thinking and sought views from suppliers, metering businesses, and other interested parties on the scope of the review.

1.18. On 6 July 2010 we published a Scope Letter[8] setting out the main areas of concern. In essence, the scope of the review is firstly to gather detailed data on how the current metering market functions, which we conducted through a series of information requests, and secondly to assess a number of specific issues.

1.19. This review has enabled Ofgem to consider the current metering landscape, in particular the developments since the review of gas metering arrangements (RGMA[9]), and the impact of lifting the obligations and price controls since March 2007 for new and replacement electricity meters. We assessed the responses to our

[6] Since the introduction of competition in gas, around 25 MAMs have registered with the Ofgem MAMCoP scheme and over 120 with the Ofgem approved meter installer (OAMI) scheme.

[7] The Open Letter can be found on the Ofgem website: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=MARKETS/RETMKTS/METRNG/COMP

[8] The Scope Letter can be found of Ofgem's website: http://www.ofgem.gov.uk/MARKETS/RETMKTS/METRNG/COMP/Documents1/Review%20of%20Metering%20Arrangements%20Scope%20Open%20Letter.pdf

[9] RGMA defines the standards for electronic file formats to be used between Market Participants for metering competition related interfaces. The objective is to provide files to facilitate competition by providing Interoperability (common language) to enable Market Participants to communicate effectively in the changed metering market place. The document can be found on the SPAA website: http://www.spaa.co.uk/documents/rgma

Open Letter, and finalised the scope of the review to cover the following topics: Consumer protection, Network companies' obligations and vertical integration, and commercial interoperability.

**Objectives**

1.20. In arriving at our minded to position, we seek to find a balance between protecting the following groups, which form our key criteria for assessment:

- Consumers (pricing/cost, choice, ease of switching)
- Small suppliers (barriers to entry, uncertainty over smart metering)
- Metering service providers (barriers to entry)
- Network companies.

1.21. In addition to the general policy objectives for the ROMA, we consider that Ofgem's overarching objective in setting metering price controls is to protect the interests of customers during the transition from monopoly provision to a fully developed competitive market. In particular we aim to:

- Promote competition in the provision of metering services
- Allow licence holders to finance their activities
- Promote efficiency and sustainability
- Facilitate the development of new technology
- Streamline the transition period to smart metering.

**Linkages with smart metering**

1.22. For each area of interest, we considered the policy options in terms of a timescale between the present and an appropriate point in the smart meter rollout. However, where decisions may have a long term impact, we consider options on their long term merits for smart metering.

1.23. In the scope letter, we set out that the review would consider whether there are any aspects of the metering market that could be useful to the smart metering implementation programme.

1.24. In the responses to the information request, market participants commented on areas that could be improved for smart metering. These types of issues included the interim interoperability arrangements for smart meters, and understanding any trends in consumer-owned metering in the domestic sector.

1.25. As a part of the ROMA any relevant information which impacts upon the smart metering rollout has been considered by the smart metering implementation programme.

1.26. Issues around commercial interoperability for smart metering will be considered in the smart metering spring package of consumer protection measures, which Ofgem will bring forward in the New Year, to ensure there are no barriers to customers switching supplier. Wider issues on interim interoperability will be considered in the Government's response to the Prospectus.

1.27. Ofgem will continue to have an important role in governing metering competition and supply competition, which will facilitate and inform policy development for smart metering. Furthermore, as noted in our initial Open Letter, we intend, as part of this review, to identify any lessons learned that can be taken into account in preparation for the deployment of smart meters.

**Timescales**

1.28. Having considered the responses to this consultation, Ofgem intends to publish final decisions in the summer of 2011.

**Document structure**

1.29. Chapter Two sets out certain findings from the information request that was conducted in July 2010 and focuses on areas of review where we do not consider immediate policy remedies should be implemented.

1.30. In Chapter Three we consider the effects of vertical integration on both suppliers and metering businesses, and whether backstop metering arrangements are best placed through a supplier or through the existing network companies' obligations (through the MPOLR). We conclude by setting out our preliminary recommendations for the future treatment of the gas metering price controls in Chapter Four.

**Terminology**

1.31. A glossary of terms is contained in Appendix 4.

# 2. Consumer Protection, Commercial Interoperability and Metering Agents

Chapter Summary

This section sets out information request areas where we do not intend to mandate regulatory reform of the current arrangements. We provide our views on how consumer protection has developed since the removal of electricity meter price controls in 2007. For commercial interoperability, we consider in general that the costs and uncertainties of mandating an approach are higher than the potential benefits for dumb meters. We consider that industry developments to improve data and information flows associated with contractual arrangements would be beneficial to the market. Finally, we consider that the implementation of UNC297[10] may have improved transparency of data for metering agents.

Question Box

Consumer Protection
Question 1: Do you have any views on our assessment of consumer protection?

Commercial Interoperability
Question 2: Do you have any views on our assessment of commercial interoperability?

Question 3: Please provide any evidence you have of meters that were removed unnecessarily due to incompatible commercial arrangements.

Question 4: What are your views on whether a single commercial model is needed? If so, is this something that industry should seek to develop?

Metering Agents
Question 5: Do you consider the implementation of UNC297 to have resolved issues relating to asset visibility in gas metering?

Question 6: Are there any specific aspects of the Review of Gas Metering Arrangements ,baseline data flows that you consider need to be reviewed?

[10] Uniform Network Code (UNC) 297: Extending Rights to Protected Information Provisions for Meter Asset Managers / Registered Metering Applicants (UNC297)
http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC297%20D1.pdf

## Consumer Protection

### Background

2.1. In the ROMA scope letter, we set out that the review would consider whether the anticipated consumer benefits (such as greater levels of customer service, affordable metering services and availability of alternative retail suppliers) associated with the current electricity metering arrangements have been realised.

### Information request

2.2. In the information request, we asked what impact (if any) the removal of the electricity metering price controls has had on the quality of meters and metering services on consumers.

### Findings

2.3. The majority of suppliers do not believe that the removal of metering price controls have been detrimental to the quality of meters and metering services provided to consumers.

2.4. The general consensus from meter providers is that there has been no adverse affect on the quality of meter and metering services resulting from the removal of the price controls. Typically it is cited that the removal has led to providers being able to deliver better quality meters as a result of increased innovation in the market. One metering business expressed concerns about companies potentially cross subsidising between legacy and new & replacement electricity metering activities which are now not subject to price control.

2.5. Consumer groups did not comment on this area.

2.6. Overall, industry considers that the consumer experience from the removal of electricity price controls has been at least neutral.

### Our views

2.7. We consider that the best way to continue facilitating value and choice to consumers is by ensuring all suppliers have effective access to metering services and competitive terms.

## Commercial Interoperability

### Background

2.8. Commercial interoperability is the colloquial term given to describe the compatibility of commercial contracts between suppliers, MAMs and MOPs to avoid unnecessary replacement of metering assets to facilitate the smooth change of supplier. In the Open Letter we stated that achieving commercial interoperability is important in terms of ensuring there are no adverse impacts on metering and supply competition.

2.9. In response to our Open Letter, there were three key areas of concern: general interoperability issues, the functioning of the supplier hub model, and arrangements for MAPs.

2.10. Respondents to the Open Letter raised concerns about the lack of common commercial interoperability arrangements between suppliers and meter providers and the resulting high transaction costs. Respondents considered that this issue will become increasingly important going forward given the additional complexity of smart meters, increased asset costs and their operation.

### Information request

2.11. In the information request we sought information on the impact of the current contractual arrangements between parties on the success of the supplier hub model, and on change of supplier events in particular. We sought to evaluate how commercial interoperability is functioning and to identify lessons learned for the smart metering programme.

### Findings

2.12. The main areas where we received comments on interoperability were with respect to the commercial interoperability arrangements, rental rates, and methodology for amortising assets and to a lesser extent termination charges. We also received many comments on data issues and communications, which are related to smart metering technical interoperability and fall outside the immediate scope of this review.

2.13. The following factors are important in the determination of the structure of metering charges.

2.13.1. MAPs predominately charge for the asset only, MAM/MOps charge for the installation and ongoing maintenance. These metering agents pass through the cost to the supplier. Suppliers pass on metering rental charges by building them into the end customers' unit price. The

level and distribution of these charges can differ by region as suppliers procure metering agents by region.

2.13.2. The amortisation of installation costs and (ongoing) meter costs should be each assessed on their merits. There are two ways in which the costs of installation can be recovered.

Option 1 - Supplier pays transaction fee for meter installation then lower rental charge for meter over lifetime, or

Option 2 - Supplier pays higher rental charge over meter lifetime where the installation cost is amortised into the rental charge.

2.14. Suppliers are likely to prefer Option 2 because Option 1 gives the supplier less scope to recover their costs from the customer if the customer decides to change supplier (churns). MAPs[11] are likely to prefer Option 1 because it allows them to recover a greater proportion of the overall cost up-front.

2.15. The amortisation models were found to be over five, 10, 15 or 20 years, in general on a monthly basis. The effective life and therefore amortisation length of a smart meter is as yet unknown but is expected to be shorter than the average for a dumb meter.

2.16. For these reasons, there are a wide range of contractual models used to recover metering charges. Some charge up-front fees, while others do not, and some amortise their charges over a much longer assumed meter asset life than others do. Some MAPs also charge a termination fee to the outgoing supplier in the event that the end customer churns away and the MAP has to enter into a contract with a different supplier.

2.17. Respondents to our open letter argued that the effect of a mix of contractual models has hindered the ease of commercial interoperability. It can also result in high charges and meter exchanges. Some small suppliers were particularly concerned about termination charges and deemed rental rates. Different types of contracts make it harder for suppliers to compare prices and know what terms they may face from a MAP before they have acquired a customer. Once faced with those terms, a supplier may decide to replace the meter if it is cheaper to do so than accept the terms offered by the MAP.

2.18. At present, it could be argued that the MAP has an incentive to set prices at a premium to a tipping point. At this point, the price of accepting the MAP's terms is

[11] The metering agent could be the MAP only, or could be a MAP in addition to a MAM/MOp.

slightly lower than the cost and negative customer experience associated with meter replacement.

2.19. It could also be argued that the administration costs to suppliers in assessing each meter and contract whenever a customer is gained are larger and more arduous than the actual costs of the meter itself. Streamlining and speeding up the change of supplier process could therefore improve commercial interoperability. These types of consequences could become more costly to the consumer for smart meters because of the smart meters are more expensive than dumb meters.

2.20. Respondents to our information request were generally supportive of developing a commercial solution through standardising the form of charges. However, there was no generally preferred breakdown of installation and asset charges, there were an array of suggestions on the appropriate timescales over which the meter charges are made, and factors such as termination charges were accounted for in numerous ways.

**Our views**

2.21. We consider that it would be inappropriate for consumers to be faced with a meter exchange each time they switched supplier, and that it is important that commercial interoperability arrangements are sufficiently effective to be able to avoid this.

2.22. We acknowledge that the current arrangements have led to a multiplicity of contract forms and charges, and that this can lead to administrative costs for suppliers, and some uncertainty over what charges they will face when they take on a new customer. To this extent, we consider that the metering market would benefit from decreased transactional costs and more transparent information flows. However, we are not certain that the evidence is sufficient to warrant intervention for dumb meters. Market participants are in general finding practical arrangements and solutions to enable commercial interoperability in an imperfect competitive market.

2.23. We are also aware that any move to standardise the form of commercial contracts may introduce unintended consequences, for example an increase in the potential to transfer risk between parties associated with the early replacement of dumb meters with smart meters. Currently, we consider that the appropriate incentives are in place to allow metering competition. However, we would like to understand further the extent to which meters are replaced solely on the grounds of incompatible commercial arrangements. The terms would need to be carefully considered to ensure the principles are appropriate, support competition, protects consumers' interests, and ensure that risks are not misallocated.

2.24. If industry is able to demonstrate to us that the issues cannot be resolved through improved transparency and information alone, then it is possible that standardising contracts may be an appropriate solution. We welcome industry developments to improve data and information flows associated with contractual arrangements.

2.25. In the enduring smart metering arrangements, we also welcome greater transparency around the data systems, which could encapsulate commercial information such as the form of contract. A central body such as the DataCommsCo (DCC)[12] could then be responsible for all aspects of the change of supplier process. On change of supplier, commercial contractual information would then be available to the new supplier in a timely manner. The incoming supplier would also have all necessary information to make an informed decision on whether to keep or exchange the meter. Commercial interoperability for smart meters will be considered further in the smart metering spring package, to be published in the New Year.

**Recommendations**

2.26. We consider that industry developments to improve data and information flows associated with contractual arrangements would be beneficial to the market, and may be enough to ensure that commercial interoperability is sufficiently effective.

2.27. Given the information received to date, we consider in general that the potential costs and uncertainties of mandating a standard form for metering contracts to help commercial interoperability are likely to be higher than the potential benefits. For this reason, we do not currently propose making changes in this area. However, if industry considers that it is necessary, it remains open to them to demonstrate this to us, and to bring forward proposals for a common framework.

2.28. Further to the above improvements, we consider that an automatic means of switching metering contracts is desirable today, but essential in the enduring smart meter world when near-instant switching may be possible. A long-term view to incorporate commercial information into key databases could be beneficial. One way this could be achieved would be to include key commercial information on a central database, possibly as part of the DCC. This would need to be explored further by industry once the DCC is established.

## Metering Agents

**Background**

2.29. In the scope letter, we set out that the review would consider the arrangements for MAPs including the Change of Supplier process as part of our investigation into commercial interoperability.

[12] New proposed entity which would be created and licensed to deliver central data and communications activities. DCC would be responsible for managing the procurement and contract management of data and communications services that will underpin the smart metering system.

**Information request**

2.30. Two specific areas were addressed in the information request regarding metering agents. The first questioned which of the metering agent models (unbundled, as in electricity, or bundled, as in gas) was preferred by industry participants. The second was aiming to understand any areas in the Change of Supplier process that were not transparent or effective.

**Findings**

2.31. The findings from this section mainly relate to issues associated with metering agents.

2.32. Despite some mixed views, in general the unbundled 'electricity-type' model is preferred to the gas model. In electricity, MAPs and MOps are defined as separate officially recognised entities. In gas there is no separately defined MAP role and the only recognised party for communication is the MAM. This is because historically the MAP and MAM roles were undertaken by the same party. Now that gas MAPs and MAMs can be separate entities, this severely restricts MAP visibility of information on who is using their assets and their ability to recover revenue.

2.33. Some respondents considered that the ideal solution would be for the MAP role to be fully recognised within gas industry codes (RGMA), providing full access to asset tracking data to assist in recovery of rental fees.

2.34. Many aspects of the lack of transparency for MAMs will be improved through the implementation of the modification proposal UNC 297: Extending Rights to Protected Information Provisions for Meter Asset Managers / Registered Metering Applicants[13]. This was implemented on 23 September 2010.

**Our views**

2.35. We consider that the implementation of UNC 297 has improved information flows and transparency. We do not consider a review of RGMA to be necessary at this time.

[13] Information on the modification proposal and Ofgem's decision letter can be found here: http://www.gasgovernance.co.uk/0297.

# 3. Vertical Integration and Network Companies' Obligations

Chapter Summary

We explain what protections we consider are needed to ensure that all suppliers are able to secure metering services, both for dumb meters, and as the market transitions to smart meters.

Some market participants have concerns that increased vertical integration of supply and metering businesses will make it harder for some suppliers to procure metering services for both dumb and smart meters. GDNs are also concerned that MPOLR arrangements are being overused by some market participants. We consider each of these concerns to be valid, and propose policy solutions.

Question Box

Question 1: Do you agree with our assessment that the MPOLR requirement remain with GDNs for dumb meters?

Question 2: At what point of the smart meter rollout would be an appropriate time to remove the MPOLR obligation on GDNs?

Question 3: We intend to place a Licence Condition on suppliers for domestic credit meters (DCM) and pre payment meters (PPM) to ensure that MPOLR is only used in cases of genuine last resort. Do you consider this to be an appropriate solution to the apparent misuse of MPOLR?

Question 4: Small and/or out of area suppliers have expressed concern regarding availability of dumb electricity meters. Are these concerns valid? If so, please explain (and quantify if possible).

Question 5: Would a non-discrimination obligation on suppliers be an appropriate response to concerns related to access to smart meters during the smart metering rollout? If so,
a) Would this obligation be better placed on the Big 6, or on all vertically integrated suppliers?
b) Should the obligation comprise meter provision services; meter installation and maintenance services; or both?
c) Could such an obligation be overly burdensome?
d) Should the obligation contain a sunset or review provision once the rollout of smart meters has been completed?

Question 6: Are there any unintended consequences of introducing a non-discrimination obligation on suppliers to offer metering services on equal terms; or consequences that we have not considered?

Question 7: Do you consider a MPOLR is required for smart meters?

## Vertical Integration

### Background

3.1. In our Open Letter we stated that we are keen to understand how vertical integration of gas and electricity metering is impacting upon competition and consumers. Concerns have periodically been raised regarding the behaviour of vertically-integrated metering businesses in the market and whether this behaviour may be acting as a deterrent to new entry and/or expansion of CMOs.

3.2. Another issue we identified from the response to the Open Letter was the availability of metering services for small and/or out-of-area suppliers following removal of the price control obligations in electricity, particularly if the trend towards incumbent suppliers taking metering services in-house continues[14].

3.3. Most respondents to our Open Letter were of the view that in a competitive market, any business should be able to organise itself in its preferred manner, whether that entails focusing on one aspect of metering, or encompasses both metering and supply. However, other respondents also expressed concerns about the effects of vertical integration on small supply businesses.

### Information request

3.4. In the information request, we asked suppliers whether they were vertically integrated with metering businesses, or intended to become so in the near future. We asked other companies whether there were any concerns over the behaviour of these vertically integrated businesses.

3.5. We also asked whether vertically integrated suppliers should be obliged to offer contractual terms for meter provision and maintenance by other metering businesses.

3.6. We questioned whether there were any barriers to entry for metering businesses.

[14] Concerns were expressed during the price control review in 2006 that once obligations to offer terms for metering services were removed from DNOs, large incumbent suppliers would bring their metering services in-house and might refuse to offer services to smaller suppliers and/or those supplying outside of their incumbent region.

**Findings**

3.7. Over the last few years some larger suppliers have become vertically integrated by bringing some metering services in-house. This may have been accelerated by the smart metering mandate.

3.8. In the information request we asked about the effects of the vertical integration of metering businesses on the ease of entry to the metering market.

3.9. Respondents considered that the Big 6 are increasingly taking their metering in-house[15] and as a result CMOs might be deterred from offering services. Small suppliers consider it essential that there remains a way for new entrants to gain access to metering services, not just in gas but also electricity, particularly in low-density regions.

3.10. While this market trend is evident in both electricity and gas, there are also more specific issues related to gas, such as the GDNs' meter provider of last resort obligation which we discuss below.

**Recommendations**

Smart meter non-discrimination obligation

3.11. In response to the information request, small suppliers considered that a non - discrimination obligation is required on the Big 6 or all vertically integrated suppliers to provide both gas and electricity[16] metering services on equitable terms to ensure access to smart meters during the rollout and beyond.

3.12. While we believe that competitive pressures will generally suffice to keep prices of smart meters at an appropriate level, we are also concerned that small suppliers (that are not affiliated to an incumbent metering business), and large suppliers that have a small customer base in a particular region, could face greater difficulties in procuring competitively priced metering services for smart meters (which are not under price control). The difficulty for small suppliers obtaining competitively priced services may be exacerbated if competition primarily develops through suppliers extending the scope of their in-house metering businesses.

3.13. We consider that a non-discrimination obligation on all vertically integrated suppliers or on the Big 6 (all of whom are currently vertically integrated) may be an

[15] All of the Big 6 are now vertically integrated, including supply and some aspect of metering services.

[16] For dumb electricity meters, we received some evidence to suggest that last resort arrangements would be appropriate, particularly for small suppliers in regional areas.

appropriate mechanism to allow small suppliers to access metering services which should also support retail competition to some extent. However, we have concerns that unless we stipulate that the terms must be cost reflective (or reasonable and not unduly onerous), vertically integrated suppliers may have an incentive to charge inflated rates.

3.14. We envisage such a licence condition to include within the drafting the ability for Ofgem to request information regarding meter asset provision costs so that we could ensure services were indeed being provided on cost reflective or reasonable terms.

3.15. We consider the introduction of a non-discrimination licence obligation on the Big 6 or vertically integrated suppliers to offer metering services on cost reflective terms would be appropriate.

## MPOLR

### Background

3.16. In the Open letter we stated that the review would consider the obligation of MPOLR[17] in gas. Our assessment would inform decisions on the ongoing need for this function, and, if appropriate, where it is best placed given that suppliers will be responsible for the rollout of smart metering. We identified that we would seek to understand the extent to which the MPOLR arrangements are being used.

### Information request

3.17. We asked market participants whether they considered the MPOLR function still required in the gas market.

3.18. We also sought information on the cost of installing pre-payment meters (PPMs) compared with the current PPM tariff cap level. Additionally, we asked suppliers what their reasons were in general for requiring PPM meters to be provided under the MPOLR obligation. GDNs were asked for the numbers of meters installed under MPOLR in 2009.

[17] Meter Provider of Last Resort arrangements encompass a range of activities. Meter Provider of Last Resort is required by GDNs under Standard Special Condition A10 (Provision and Return of Meters) to provide and install meters. These include the developments since the RGMA, and in particular may include a review of PPM arrangements.

**Findings**

3.19. GDNs currently undertake the MPOLR function in the gas market, which was set up to provide a backstop arrangement in the case where suppliers could not procure meters in the competitive market.

3.20. Many respondents considered the MPOLR arrangements are distorting the market place, particularly for PPM meters. GDNs argue that the PPM price cap is lower than the efficient cost to procure and install, which creates an incentive for suppliers to ask the GDN to install a meter instead of procuring services in the competitive market. GDNs argue that not only does this mean that they provide disproportionately more PPMs than they otherwise would, but also that they operate at a financial loss. They claim that this is distorting the market and restricting competition in gas metering as the exchanged gas meter remains under price regulation.

3.21. Additionally, some respondents argued that the current MPOLR arrangements and in particular the idea of 'last resort' is a misnomer because the supplier is not obliged to demonstrate that it has attempted to contract with any other party before approaching the GDN. There was some evidence of high levels of usage by larger suppliers of the MPOLR arrangements for installation of PPM meters, with networks claiming that approximately 65% of all MPOLR requests are for PPM meters, as opposed to the natural population where around 10% of meters are PPMs. We consider that this should be addressed.

**Our views**

3.22. We have not had any information to suggest that the MPOLR arrangements are providing significant financial difficulties for the GDNs. Maintaining the MPOLR obligation on GDNs for dumb meters provides a level of security for suppliers who may otherwise be unable to procure (dumb) meters during the transition to smart metering.

3.23. There are a number of reasons why suppliers may be uncertain about their ability to procure dumb meters on the competitive market during this transitory phase. Firstly, as the date for completion of smart meter rollout approaches, the period over which a newly installed dumb meter can remain in service becomes shorter, so the ability of a dumb meter provider to recover the costs of providing that meter becomes more uncertain. Secondly it is not clear what the outcome of the MSA re-negotiations will be, nor how the market will respond to the outcome[18].

[18] If price controls for DCM meters are revised then this could provide head room, setting a price to beat for the market. We discuss this further in Chapter Four when assessing PPM price controls. This is likely to cultivate additional competition for DCM meter works and keep the metering market functioning whilst addressing the misuse of the MPOLR arrangements.

Given the uncertainty, consumers may be disadvantaged in the event that supplier cannot secure a metering contract from a CMO.

**Recommendations**

Dumb meter MPOLR obligation

3.24. Given the current levels of competition in the electricity market and our 2007 decision to remove price controls from new and replacement electricity meters, we do not consider it appropriate to reintroduce MPOLR for electricity meters on DNOs.

Suppliers' ability to use dumb meter MPOLR

3.25. We note that the MPOLR obligation has proved onerous to GDNs over the past few years, and suggest implementation of stricter conditions of use.

3.26. To ensure that suppliers are not abusing the MPOLR obligation particularly for PPMs we propose to introduce a new licence condition requiring suppliers to be able to demonstrate (for example to the GDN or ultimately to Ofgem) that they have exhausted commercial routes before approaching a GDN for a meter.

## Timescales for implementation

**Transition to smart metering**

3.27. During the transition, where dumb and smart meters are both installed and maintained, we consider that a MPOLR on networks for gas dumb meters would be appropriate, given that competition has not developed to the same extent as electricity. We consider that there are a number of potential points in time throughout the smart meter rollout when this obligation could be lifted.

**Enduring arrangements**

3.28. When the obligation on GDNs to provide MPOLR for dumb meters falls away[19], the Licence Condition on suppliers to restrict conditions of use of MPOLR would also fall away.

[19] This obligation could logically conclude in two places: at the end of the smart meter rollout when there are no more dumb meters; or, at a defined point during the smart meter rollout, for example at the publication of the technical specification, or when the DCC starts.

3.29. Depending on the state of competition in the gas and electricity markets, the requirement to provide terms on a non-discriminatory and cost reflective basis could also be reviewed. We propose to keep this under review.

# 4. Gas Metering Price Controls

Chapter Summary

This chapter sets out our minded to proposals regarding the treatment of the gas metering price controls. Gas metering price controls relate to DCM, PPM and Legacy meters. We consider that the market is not sufficiently open to competition to support removal of metering price controls, but that the level of the price control needs to be reviewed in some cases. We provide an overview of our views on each of the meter types.

Question Box

Question 1: Do you agree that legacy meters (credit and pre-payment) should remain under price control?

Question 2: What is the impact on customers if we reset price controls for:
a) PPM meters?
b) DCM meters?

Question 3: We seek views on whether there is any advantage in setting a cost reflective price cap for new and replacement dumb meters, which also accounts for unnecessary meter replacement.
a) We are also interested to understand whether an allowance beyond a purely cost-reflective level would encourage competition?
b) In the transition to smart metering, what consideration should be taken into account when setting a new price control tariff for dumb meters?

Question 4: What is your view on the total costs for the provision of PPM and how they are passed onto customers[20]?

Question 5: What are the likely tradeoffs between the implications for the price for providing PPMs, especially for vulnerable customer's verses the incentives for PPM smart rollout and cost reflectivity? For example, if we choose not to review the PPM tariff cap, would this weaken and slow the case for investing in smart PPMs?

Question 6: We are aware that National Grid Metering is renegotiating the MSA contracts.
a) Can you please indicate what your metering arrangements are likely to be going forward?

[20] We will also be writing separately to the GDNs to understand the impact of the MPOLR obligation and PPM provision.

## Background

4.1. The gas metering price controls were set in 2002, and cap the price that gas transporters can charge in respect of both credit and prepayment meters. DCM price controls relate to provision and maintenance of new and replacement credit meters, installed between the present and the mandate of smart meters. PPM price controls relate to provision and maintenance of new and replacement prepayment meters, installed during the same period as DCM new and replacement. Finally, legacy meter price controls refer to both DCM and PPM installed meters which are already installed. The charges and methodology used to set the caps and their level is set out in Appendix 2.

4.2. In the 2006 metering review, gas metering price controls were retained, to be adjusted in line with RPI annually from 1 April 2007 as in the previous five years, with a review deferred until the conclusion of the Competition Act investigation against National Grid.

4.3. In the 2006 consultation, some evidence was presented by GDNs to suggest that the PPM tariff cap was potentially distorting competition and innovation in that segment of the market. There was also some evidence that the relatively high proportion of PPMs installed under last resort obligations did not allow for full cost recovery.

4.4. In the 2006 review Decision Document we said that we would continue to monitor the situation, and if more evidence came to light regarding adverse impacts from the current gas PPM control, we could include the issue within our proposed review of the competitive metering market.

## Legacy Meter Price Control

### Information request

4.5. We asked industry whether price controls on legacy meters should be maintained in light of smart metering.

### Findings

4.6. In response to our information request, Network Operator respondents considered that retaining protection for consumers that continue to use legacy meters is appropriate.

4.7. In general both suppliers and metering businesses consider that price controls on legacy meters should be maintained. Some respondents consider that by maintaining price controls on legacy meters, price increases will be avoided. This is because market participants will be unable to accelerate the returns on those assets in light of the smart meter rollout.

**Our views**

4.8. For two reasons we do not consider that legacy meters should be removed from price control arrangements. Firstly, we have not received any compelling evidence in response to the information request. Secondly, legacy meters will on average be much older than new and replacement meters and are likely to have fully depreciated.

**Recommendations**

4.9. Based on the evidence available, we consider that retaining price controls on legacy meters is appropriate. We will also monitor the development in negotiations between Suppliers and the MSAs.

## Domestic Credit Meter Price Control

**Information request**

4.10. We did not consult specifically on the level of DCM price controls. However, we sought views on the impact of price control arrangements on the smart meter rollout.

**Findings**

4.11. Gas credit meters installed on a new and replacement basis are currently under price control. If no policy action were taken with regard to these meters, dumb meters would continue to be installed under price control for the duration of the transition to smart meters, but would then fall away as the current arrangements do not apply to smart meters.

4.12. Some respondents suggested removing the obligation to provide new and replacement meters under price control. Respondents considered that the general approach to price controls should be consistent across both gas and electricity metering markets.

4.13. Further, one respondent considered that the smart metering rollout would inevitably lead to a large number of gas meters being replaced before reaching the end of their useful economic lives. As commercial MAPs will be able to manage their own financial implications and risks by various commercial mechanisms, including but perhaps not restricted to pricing, regulated gas meter businesses should be allowed some mechanism to recover their investment. They considered that such a mechanism should take into account any previous pricing decisions that have been made to allow them to recover their investments in the wake of increased competition and the mandated roll out of smart metering.

**Our views**

4.14. Based on the analysis in Chapter One, we consider that competition in gas metering is not sufficiently developed to justify the removal of the price caps. There are two options for new and replacement credit meter price controls, as set out below.

4.15. If we were to maintain the current price controls, suppliers would be unable to recover costs associated with the shorter life of the meter. New and replacement meters installed now have an asset life that means they will not have reached the end of their asset life before they have to be replaced with a smart meter. This means there is a shorter period over which to recover the costs of the meter itself and its installation. Given the mandated smart meter rollout, this may not be an acceptable option for new and replacement dumb meters. We consider that the price caps need to be reviewed to at least cover current market prices and the shorter period assets will remain on the wall.

4.16. Price controls could be reviewed to reflect current market prices of credit meters for installation and maintenance[21]. In the transition to smart metering, for any new gas meter, the installation and maintenance costs will remain cost reflective, but the time over which these costs can be recovered is limited by the smart meter rollout. The current price level of price control arrangements allow only for RPI, not for early replacement.

4.17. We note the statement from DECC in its December 2009 documents that "the Government remains unpersuaded that there is a case for establishing a scheme to compensate for stranding costs rather than allowing them to lie where they fall". We do, however, recognise that, in some cases, meters have been provided by a network company under a regulated price control as part of their licence obligations to provide MPOLR, rather than in the competitive market. As such, any review of new and replacement tariff caps could also take into account the need to accelerate depreciation as a result of the smart metering rollout.

4.18. The benefit of reviewing price controls for new and replacement while keeping them in place for legacy meters is that if we are not content that the gas metering market has developed sufficiently with respect to competitive arrangements, a regulated offering alongside MPOLR activities (see Chapter Three) ensures dumb meters are available in the transition to smart metering. It also acts as a price ceiling on metering services in the absence of a competitive market, which may be needed in the final smart meter transition stages. Alternatively, a price to beat approach could be taken. This would include building in some headroom to the price cap to encourage competition.

[21] We did not gather information on the current cost to serve these meters but we received no voluntary responses on this issue indicating that the tariff cap is not cost reflective.

### Recommendations

4.19. Our recommendation for new and replacement (dumb) gas meters is to allow for the cost of reduced asset life through review of the price control arrangements. The exact mechanism will be considered as a part of the ongoing ROMA project. We consider that it could be achieved by setting a cost reflective tariff through review of price controls. Alternatively it could be through a price control tariff with headroom such as a price to beat. We seek industry views on these options.

## PPM Price Control

### Information request

4.20. We did not consult specifically on the level of PPM price controls. However, after asking about the MPOLR, we received information on the level of PPM price caps. We also asked industry how price controls were impacting on the smart metering rollout.

### Findings

4.21. There is evidence, as set out in Chapter Three, to suggest that the PPM tariff cap may be distorting the MPOLR arrangements, as the reported cost for a supplier to provide a PPM meter from the competitive metering market is higher than the tariff cap. It is therefore cheaper to procure a meter under MPOLR, as the GDN bears the cost differential. This has lead to some suppliers sourcing thousands of PPM meters at regulated prices via the GDNs.

4.22. There is a widely held view within industry that PPM customers would already have received a smarter meter if the tariff cap were cost reflective. Due to the price differential between the tariff cap and the reported cost of procuring a PPM meter, suppliers find it more cost effective to provide PPM customers with a dumb meter under MPOLR rather than a smart meter.

4.23. Some respondents to our information request considered that the lifespan of PPM meters could be less than anticipated, which could impact on the pricing of new PPMs as they would be priced higher to recover costs over a shorter period. Additionally, in the medium term towards the end of the smart meter rollout, the cost to serve PPMs could increase as these meters become scarcer, but the price control would limit the cost.

### Our views

4.24. Gas metering price controls were to some extent addressed in Chapter Three with the MPOLR activity.

4.25. Given we have received further evidence to suggest that the current PPM price cap is not cost reflective, and given we have established competition is not sufficiently developed to remove the price cap; we are faced with a trade-off. This trade-off is between the following:

- The impact on GDNs if required to provide these meters at below cost price;

4.25.1. In order to make a decision on this trade-off we need to better understand the likely cost impacts, particularly for GDNs.

- Market incentives for rollout of smart PPMs; and

4.25.2. If the effect of the PPM tariff cap is such that no-one other than the incumbents provides the meters, there may be a negative impact on competitive metering. This could, in turn, send a poor signal to suppliers considering when to switch to a PPM smart meter installation.

4.25.3. An important factor is the speed of smart PPM rollout. If smart PPMs are rolled out and issues over smart PPM interoperability are resolved, or there is a mandate for their rollout in the near future, then the overall volume of dumb PPMs that will have to be put on walls is smaller, and the total cost impact on GDNs is minimised. However, this is currently uncertain.

4.25.4. The smart metering implementation programme is currently considering PPM interoperability and short term commercial interoperability issues, which will be considered in the smart meter spring package consultation. There is ongoing uncertainty over the timing of any mandated rollout. We consider that our preferred policy option depends on this.

- The impacts on prices faced by PPM customers.

4.25.5. PPM customers are a group amongst whom we know the vulnerable are disproportionately represented.

**Policy Options**

4.26. We can rule out removal of the PPM price caps at this stage given the competitive nature of the gas market as set out in Chapter One.

4.27. The options that remain are to re-set the tariff caps through a review of price controls, or to maintain tariff caps at their current levels. We present our views on each option in the following sections.

4.28. Subject to further investigation, the price controls could be reviewed to reflect current market prices of PPM installation and maintenance. If the tariff cap for PPMs was re-set this would probably result in an increase in prices to PPM customers who are more likely than average to be on low incomes. Any change to the current regime would have to be balanced against this negative impact. A positive impact of these meters being charged at the current market price would be an anticipated reduction in requests for meters under MPOLR arrangements during the transition to smart metering. It may also provide an incentive for suppliers to roll out smart metering as a priority. In the medium term, however, it is possible that the costs of providing PPM meters will increase over the tariff cap level, and so the MPOLR function could be overused by suppliers avoiding the costs of PPM customers. This potential MPOLR overuse could be addressed through an amendment to the licence condition, as set out in Chapter Three.

4.29. Alternatively, price controls could be maintained at the current levels in order to protect PPM customers from price increases. We are mindful that maintaining the tariff caps would enable PPM customers to continue to access new and replacement dumb meters at the current price. MPOLR overuse (as set out above) could be addressed through modifications to the licence condition, as set out in Chapter Three. The costs differential of procuring meters under MPOLR could also be mitigated through GDN price control.

**Recommendations**

4.30. Given upcoming publications including the smart metering prospectus decision document due in the New Year we consider that we may be able to make a more considered decision on PPM tariff caps at that point. While we recommend the price controls be retained, we are leaving open the decision on whether the level of the price cap should be increased at this stage. In the meantime, we seek more information from GDNs on their costs, and also seek evidence to examine what the implications of increasing the price cap could be for PPM customers.

# Appendices

**Index**

# Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document (in particular, we would like to hear from suppliers, metering businesses (such as MAMs, MOps, and MAPs), gas and electricity distribution network operators, and consumer groups).

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 14 February 2011 and should be sent to:

Steve Rowe
Retail and Market Processes, GB Markets
Ofgem
9 Millbank
London SW1P 3GE

0207 901 7468
roma@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to publish final decisions in the summer of 2011. Any questions on this document should, in the first instance, be directed to:

Steve Rowe
Retail and Market Processes, GB Markets
Ofgem
9 Millbank
London SW1P 3GE
0207 901 7468
Steve.Rowe@ofgem.gov.uk

Chapter: One

Question 1: Do you have any views on our assessment of the current arrangements for the gas and electricity metering markets?

Chapter: Two

Consumer Protection
Question 1: Do you have any views on our assessment of consumer protection?

Commercial Interoperability
Question 2: Do you have any views on our assessment of commercial interoperability?

Question 3: Please provide any evidence you have of meters that were removed unnecessarily due to incompatible commercial arrangements.

Question 4: What are your views on whether a single commercial model is needed? If so, is this something that industry should seek to develop?

Metering Agents
Question 5: Do you consider the implementation of UNC297 to have resolved issues relating to asset visibility in gas metering?

Question 6: Are there any specific aspects of the Review of Gas Metering Arrangements baseline data flows that you consider need to be reviewed?

Chapter: Three

Question 1: Do you agree with our assessment that the MPOLR requirement remain with GDNs for dumb meters?

Question 2: At what point of the smart meter rollout would be an appropriate time to remove the MPOLR obligation on GDNs?

Question 3: We intend to place a Licence Condition on suppliers for domestic credit meters (DCM) and pre payment meters (PPM) to ensure that MPOLR is only used in cases of genuine last resort. Do you consider this to be an appropriate solution to the apparent misuse of MPOLR?

Question 4: Small and/or out of area suppliers have expressed concern regarding availability of dumb electricity meters. Are these concerns valid? If so, please explain (and quantify if possible).

Question 5: Would a non-discrimination obligation on suppliers be an appropriate response to concerns related to access to smart meters during the smart metering rollout? If so,
a) Would this obligation be better placed on the Big 6, or on all vertically integrated suppliers?
b) Should the obligation comprise meter provision services; meter installation and maintenance services; or both?

c) Could such an obligation be overly burdensome?
d) Should the obligation contain a sunset or review provision once the rollout of smart meters has been completed?

Question 6: Are there any unintended consequences of introducing a non-discrimination obligation on suppliers to offer metering services on equal terms; or consequences that we have not considered?

Question 7: Do you consider a MPOLR is required for smart meters?

Chapter: Four

Question 1: Do you agree that legacy meters (credit and pre-payment) should remain under price control?

Question 2: What is the impact on customers if we reset price controls for:
a) PPM meters?
b) DCM meters?

Question 3: We seek views on whether there is any advantage in setting a cost reflective price cap for new and replacement dumb meters, which also accounts for unnecessary meter replacement.
a) We are also interested to understand whether an allowance beyond a purely cost-reflective level would encourage competition?
b) In the transition to smart metering, what consideration should be taken into account when setting a new price control tariff for dumb meters?

Question 4: What is your view on the total costs for the provision of PPM and how they are passed onto customers22?

Question 5: What are the likely tradeoffs between the implications for the price for providing PPMs, especially for vulnerable customer's verses the incentives for PPM smart rollout and cost reflectivity? For example, if we choose not to review the PPM tariff cap, would this weaken and slow the case for investing in smart PPMs?

Question 6: We are aware that National Grid Metering is renegotiating the MSA contracts.
a) Can you please indicate what your metering arrangements are likely to be going forward?

[22] We will also be writing separately to the GDNs to understand the impact of the MPOLR obligation and PPM provision.

# Appendix 2 – Gas Metering Price Controls

1.1. The regulation of gas metering was originally set under the National Grid Gas (then Transco) transportation price controls. Separate controls for metering were established in April 2000 as part of an industry wide consultation on the development of competition in the provision of gas metering services. These were reviewed in April 2002 as part of the general review of Transco's price control, and at that time Ofgem stated the metering controls would remain in place until metering competition was sufficiently developed.

1.2. The metering controls were set to reflect the relative costs of different services and to allow Transco/National Grid Gas to recover its allowed revenue assuming current activity levels. The final control proposals were based on a 7 per cent cost of capital for metering activities, as compared with 6.25 per cent for transportation activities. The extra allowance for metering reflects the influence of competitive pressures in the metering market[23]. The control figures were also subject to "market testing" with potential new entrants to ensure that they were not deemed unreasonable.

1.3. Initially the form of the metering control was an allowed revenue cap, but following the April 2002 review this was revised and changed to a price cap covering the installation, maintenance and provision of a domestic meter, which varies by meter type. The caps do not cover the industrial and commercial meter market, or the provision of meter reading activities for Non-Daily Metered (NDM) meters. However, non-discrimination conditions were imposed in the licence provisions to ensure that these uncapped metering services are offered on a cost reflective basis.

1.4. The gas metering tariff caps only apply to the provision of basic services as defined at the time of setting the controls. Other more advanced services in the form of new types of meter or enhanced customer service are outside the scope of the controls, in order to encourage innovation in the metering market.

1.5. The gas metering price controls were implemented via evergreen licence provisions in Transco's (now National Grid Gas) Gas Transporter licence. They apply to National Grid Gas and the four independent distribution networks (IDNs) that were created through divestment of parts of National Grid Gas's distribution business in 2005[24]. The licence provisions include an obligation to provide metering services if requested by a supplier, at the price controlled rate.

[23] See Ofgem's (2001) Review of Transco's Price Control - Final Proposals.

[24] These are owned by Scotia Gas Networks, Northern Networks and Wales and West Utilities.

1.6. For information related to the tariff capped metering activities on new and replacement meters, Table 1 sets out the National Grid Gas price caps for the year commencing 1 April 2010.

**Table 1: Price controls for gas metering services (2010)**

| Price controls for gas metering services | Price caps (2010) £ pa |
|---|---|
| Providing, installing and maintaining a credit domestic meter | 14.58 |
| Providing, installing and maintaining a pre-payment meter | 34.03 |
| Providing a daily meter reading | 440.87 |
| Replacing a domestic credit or pre-payment meter | 59.65 |

**Pre-Payment Meters**

1.7. According to Special Condition E5: Restriction of prices in respect of tariff capped metering activities, the gas metering charges are as follows:

**Table 2: Gas metering charges**

| Provision, Installation and Maintenance | Domestic credit meter, £ pa | PPM, £ pa |
|---|---|---|
| 2002 | 12.91 | 28.66 |
| 2003 | 13.13 | 29.16 |
| 2004 | 13.5 | 29.98 |
| 2005 | 12.74 | 29.74 |
| 2006 | 13.08 | 30.54 |
| 2007 | 13.55 | 31.62 |
| 2008 | 14.11 | 32.93 |
| 2009 | 14.73 | 34.38 |
| 2010 | 14.58 | 34.03 |

1.8. Meter provision and maintenance - As shown in the Table 3, meter maintenance costs are particularly high for PPM customers. This reflects the fact that there is greater physical interaction between the customer and the meter.

**Table 3: NG metering charges (2010/11)**

| NG metering charges | Credit meter, £ pa | PPM, £ pa |
|---|---|---|
| Provision | 8.64 | 7.02 |
| Installation | 5.63 | 5.63 |
| Maintenance | 0.31 | 21.37 |
| Total | 14.58 | 34.02 |

# Appendix 3 - The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.[25] Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.[26]

1.4. The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

[25] Entitled "Gas Supply" and "Electricity Supply" respectively.
[26] However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

1.7. In performing these duties, the Authority must have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them[27]; and
- the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.[28]

1.9. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed[29] under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
  protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and secure a diverse and viable long-term energy supply, and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out these functions the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.11. The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or

[27] Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.
[28] The Authority may have regard to other descriptions of consumers.
[29] Or persons authorised by exemptions to carry on any activity.

sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.12. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation[30] and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

[30] Council Regulation (EC) 1/2003.

# Appendix 4 - Glossary

1.1. When answering the questions, for the purpose of this request please note for the avoidance of doubt the use of the following abbreviations, acronyms and definitions:

**C**

1.2. 'Commercial Arrangements' means the entry into a contract for services between parties, for example such as suppliers and metering businesses.

1.3. 'Commercial Interoperability' means the contractual terms on which a new supplier can use the meter and related equipment when a customer changes supplier.

1.4. 'Consumer' means a person or organisation using electricity or gas at a meter point.

1.5. 'Contractual Terms' means the offer of commercial arrangements.

1.6. 'Correspondence' includes any draft or final version of a letter, email, facsimile, or note of a telephone conversation.

**D**

1.7. 'DataCommsCo (DCC)' New proposed entity which would be created and licensed to deliver central data and communications activities. DCC would be responsible for managing the procurement and contract management of data and communications services that will underpin the smart metering system.

1.8. 'Distribution Network Operators (DNOs)' DNOs take electricity off the high-voltage transmission system and distribute this over low-voltage networks to industrial complexes, offices and homes. DNOs must hold a licence and comply with all distribution licence conditions for networks which they own and operate within their own distribution services area. There are 14 DNOs covering discrete geographical regions of Britain.

**E**

1.9. 'Energy Suppliers (suppliers)' means a company licensed by Ofgem to sell energy to and bill customers in Great Britain.

**G**

1.10. 'Gas Act Owner (GAO)' means the organisation or person responsible for providing and installing the complete metering installation for the measurement of

gas consumption, and for maintaining the meter installation in good working order, as required by the Gas Act 1986 (as amended).

1.11. 'Gas Distribution Network (GDN)' GDN - A company, licensed by Ofgem, which transports gas through its network on behalf of a gas shipper. There are four GDNs, each covering a separate geographical area of Great Britain.

1.12. 'Gas Transporter (GT)' means a company, licensed by Ofgem, which transports gas through its network on behalf of a gas shipper.

**L**

1.13. 'Legacy meters' refers to those meters which are installed, and are on the wall. This refers to both DCM and PPM meter types.

1.14. 'Licence' means transporting, shipping and supplying gas; and generating, transmitting, distributing and supplying electricity are all licensable activities. Ofgem grants licences which permit parties to carry out these activities in the GB market. The licenses require the establishment of a number of multilateral industry codes that underpin the gas and electricity markets. Licensees need to be signed up as parties to codes in order to operate in the gas and electricity markets.

**M**

1.15. 'Metering Agent' means a person or undertaking which undertaking any or all of the MAP, MAM or Mop activities (and which are defined below).

1.16. 'Metering Assets' means the meter installation. In the case of gas this means the meter and associated components within the whole installation for the purpose of measuring volume of gas. In the case of electricity it means a measuring instrument that records the amount of energy which passes through it.

1.17. 'Meter Asset Manager (MAM)' means a person approved by the Authority as possessing sufficient expertise to provide gas metering services. A gas MAM essentially provides the services that would be provided by a MAP and MOp in electricity.

1.18. 'Meter Asset Provision/Meter Asset Provider (MAP)' means the ongoing provision of the meter installation at a meter point. In electricity the Meter Asset Provider is responsible for: supplying electricity-metering equipment for the purpose of satisfying the electricity settlements process; the requirements of the relevant Use of System Agreement; and the relevant primary and secondary legislation.

1.19. 'Meter Operation/Meter Operator (MOp)' Meter operation comprises all work associated with the installation, commissioning, testing, repair, maintenance, removal and replacement of electricity metering equipment.

1.20. 'Meter Provider of Last Resort (MPOLR)' means the GDNs who are obliged to provide gas meters at the request of a supplier to customers.

1.21. 'Metering services' means the provision, installation, commissioning, inspection, repairing, alteration, repositioning, removal, renewal and maintenance of the whole or part of an installed gas or electricity meter.

1.22. 'Metering work' means the completion of some aspect of metering services on the metering assets.

**N**

1.23. 'New and replacement meters' refers to those dumb meters which are not yet installed, but will be installed between the present and the smart meter mandate. This refers to both DCM and PPM meter types.

**P**

1.24. 'PPM service' means metering services associated with the type of meters that require payment for energy to be made in advance of use or they will prevent the supply of gas or electricity. A PPM customer pays for energy by inserting electronic tokens, keys or cards into the meter.

**S**

1.25. 'Smart meter' means a meter which, in addition to traditional metering functionality (measuring and registering the amount of energy which passes through it) is capable of providing additional functionality for example two way communication allowing it to transmit meter reads and receive data remotely.

**V**

1.26. 'Vertically Integrated Company' means a supply company whose business also includes at least one of: metering services and ownership of the metering assets.

# Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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