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Dear Steve,

Ofgem Consultation on Review of Metering Arrangements – Initial Findings and consultation on proposed metering Industry remedies

Wales & West Utilities Limited (WWU) is a licensed Gas Distribution Network (GDN) providing Gas Transportation services for all major shippers in the UK. We cover $\frac{1}{6}$ th of the UK land mass and deliver to over 2.4 million supply points. WWU is one of only two Licence Operators that focus solely on Gas Distribution in the UK.

Executive summary

We welcome the opportunity to respond to this important consultation. We hope our comments assist appropriate policy development and result in an improved regime for consumers.

In our view, the metering arrangements in the UK do not serve consumers well. We suggest the current market arrangements have been unsuccessful in promoting effective competition and delivering value for money for consumers. We hope our comments help influence an improved solution for the imminent roll out of Smart Meters. We still think there are clear benefits of greater network involvement in ownership and rollout compared to the current preferred Supplier led model.

In relation to Network obligations within a competitive regime, we do not agree it is appropriate for Licensed Gas Transporters to have onerous Meter Provider of Last Resort Obligations. The Department of Energy and Climate Change (DECC) decision that supported a Supplier led roll out Smart Meters further supports removal of the Obligation within the current market arrangements. Suppliers can source metering services from industry participants and we think the networks are being used not as a last resort but due to the non cost reflective price caps associated with the Obligation.

Finally, the stranded costs of meters provided under the network MPLOR obligation must be recoverable.

The remainder of this response addresses the specific questions in the consultation.

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*calls will be recorded and may be monitored
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Chapter 1 Introduction to the Metering Market

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

In summary, we suggest the current market arrangements have been unsuccessful owing to the market position of the incumbent large suppliers. To support this observation we have some general comments on state of competition in the gas metering market. Paragraphs 1.1 and 1.2 of the consultation state:

1.1. Since 2000 Ofgem has taken measures to facilitate competition in gas and electricity metering services, 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.

Ofgem reports supplier responses in paragraph 1.12:

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.

This clearly shows that there is a divergence in view as to whether the current market structure can support effective competition. We consider that metering competition in gas has not been successful largely due to the structure of the market and the actions of key players that have made decisions that have not enabled a competitive market to develop.

The consultation refers to contestable markets in paragraphs 1.7 and 1.15. A contestable market is one which, although there are only a few players, exhibits competitive behaviour because low entry and exit barriers mean that the threat of entry forces the incumbents to behave competitively to keep out the potential entrants.¹

¹ See William J Baumol, John C Panzar & Robert D. Willig (1982) "Contestable Markets and the Theory of Industry Structure" Harcourt, Brace, Jovanovitch, New York

We do not consider that metering is contestable because there are significant entry costs in setting up a Meter Asset Management (MAM) company and obtaining service providers. Domestic metering is a volume business where the costs are reduced by having high customer numbers and density. Ofgem recognises this in paragraph 1.15,² however, in the context of smart metering, we disagree that the problem is caused by significant bundling of metering assets by the incumbent provider.

It is not correct that all the big six suppliers have large market share in all areas³. The history of the gas supply industry means that only one supplier has a good customer density over all regions. This has given it an advantage in the metering market.

The development of incompatible communications systems has resulted in a domestic market where it has been very difficult for independent MAMs (Meter Asset Managers) and MAPs (Meter Asset Providers) to become established. Large suppliers have either become vertically integrated (combined MAM and MAP functions into their existing supply businesses), or are moving to that position thereby further reducing the opportunities for independent MAMs and MAPs.

Rather than looking at the dumb meter market it is more important to consider what is likely to happen in a smart world. We suggest, that in the context of smart metering, it is the move to vertical integration that is the real issue not the fact that the largest regulated MAM and MAP provides most of the dumb meters in the market. The position of National Grid Gas is irrelevant when considering the smart metering world as it currently does not intend to participate in the smart metering market. Vertical integration may provide the supplier with more control over metering and may improve customer service for existing customers and may also allow the large suppliers to control the rollout of smart meters to their existing customers. However in the long run we suggest that it will enable the incumbent suppliers to maintain their market position and make it very difficult for small or new suppliers to grow and challenge the big six in the domestic supply market.

We do not suggest that the aspiration to create a competitive metering market was wrong; however, we do suggest that it has been unsuccessful owing to the market position of the incumbent large suppliers. We further suggest that if the aspiration is to provide customer benefit by making energy supply fully competitive then there may be overall benefit from returning domestic metering to network ownership to provide a level playing field for all suppliers and relying on comparative regulation to ensure high standards of performance.

² 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.

³ Overall in WWU's network for Small Supply Points the largest of the big six suppliers has a market share six times larger than the smallest and in one of the LDZs the largest supplier has a market share nearly forty times larger than the smallest big six supplier

The alternative would be to try to create a truly competitive gas smart metering market by taking decisive action to address market failure by investigating the vertical integration of supply and metering; however this is likely to take a considerable time both to investigate and agree and implement remedies.

In paragraph 1.20 Ofgem states that the criteria for assessment of the options is to balance protecting the interests of the following groups

- Consumers
- Small suppliers
- Metering Service suppliers
- Network companies

Our suggested solution would result in a better solution, particularly for small suppliers and consumers, than the current position

Chapter 2 Consumer Protection, Commercial Interoperability and Metering Agents

Consumer Protection

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

We have no direct information on the electricity market but we are not surprised by the view that removal of the electricity Meter Provider of Last Resort (MPOLR) obligation has had no impact on consumers.

Commercial Interoperability

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

We note the difficulties caused by different commercial arrangements but comment that this results from opening the market to competition. Were meters to be owned by networks then the structure of prices could be subject to licence controls and all suppliers would face the same arrangements. The costs associated with different commercial arrangements would then be removed at a stroke. Our view is that it is the data from the meter that is important and that the ownership of the meter is of secondary importance. Smart metering may provide an opportunity for new companies to enter the market; for example retail businesses that are skilled at making use of detailed customer data; however if the barriers to entry, for example having to set up a GB wide metering business are high, then they will not enter the market and this will perpetuate the current dominance of the six large domestic suppliers. We suggest that the discussions about metering competition should be seen in the wider context of competition in supply and that while fully competitive metering and supply markets is the ideal, in practice the market shares of companies in the supply market may mean that competition in supply is better achieved by having network owned metering.

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

We do not have any evidence.

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?

We do not believe that the current arrangements for domestic gas metering are working well; therefore developing a single commercial model will at best only result in the current unsatisfactory market working better. We suggest alternative solutions in our answer to Chapter 1 question 1.

Chapter 3 Vertical Integration and Network Companies' Obligations

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

Wales & West Utilities does not agree that the MPOLR should remain with GDNs for dumb meters. Under the MPOLR current regime, Wales & West Utilities makes a loss on every prepayment meter it installs and will suffer stranded asset costs on these and credit meters when they are replaced by smart meters. The fact that some suppliers only use the MPOLR service for some activities indicates that suppliers make a commercial decision whether to use the service and it is not the case that they cannot provide these services themselves or by using commercial MAMs. In the current dumb metering market the MPOLR prices may be less than is commercially available which illustrates that the price caps are not set at the correct level.

There is at least one commercial MAM that could provide domestic metering services to suppliers however our understanding is that commercial MAMs have been significantly and adversely affected by the move to vertical integration by suppliers and therefore their long-term viability is threatened. Therefore removing the MPOLR will create a demand for services and may help provide business for these MAMs

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

Wales & West Utilities receives requests for meters provided under the MPOLR for new installations and functionality changes primarily from one of the big six suppliers that did not sign the National Grid Metering contracts. As stated in our answer to Chapter 3 question 1 above we believe that the last resort obligation should be removed immediately. If the obligation is not removed immediately then it should be removed prior to the commencement of smart meter rollout. Smart meter rollout will mean that GDN will have stranded asset costs that need to be funded.

By the start of smart meter rollout suppliers will be mobilised to rollout smart meters. This means that they will be able to meet customer requests for new meters. They will also have the capability to respond to any problems with smart meters and therefore they should have the capability to respond to requests for changes between

credit and prepayment meters. Therefore there is no need for the MPOLR obligation to exist after the commencement of smart meter rollout.

Prolonging the MPOLR obligation after the start of smart meter rollout will send the signal that suppliers are not capable of fulfilling their metering responsibilities through the metering market

Standard Special Licence Condition A10⁴ which relates to the MPOLR obligation refers to “meters being generally available” Dumb meters are unlikely to be manufactured once the smart meter rollout commences and therefore they will be difficult or impossible to obtain. If this occurs transporters will not be able to provide last resort meters. This is another reason for removing the obligation no later than the start of smart meter rollout.

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?

As stated above we believe the MPOLR obligation should be removed immediately and certainly by the start of the smart meter rollout that we anticipate will start in 2012.

Our concerns with this proposal are:

- It will need to be carefully worded to be effective
- It is likely to take a long time to implement

However, as a third best option this approach would be appropriate if the condition is strong enough. We suggest that the supplier should only be able to request MPOLR services if it can satisfy both the following two tests

- 1) That it can demonstrate that it cannot obtain gas metering services either internally or from commercial MAMs in the GDN's network
- 2) It has not previously obtained some services equivalent to MPOLR services from internal service providers or from commercial MAMs

The tests should only relate to whether services are available not whether they are more expensive than the last resort services. They are proportionate because they give the transporter relief from providing a loss making service where the supplier can obtain the services from other sources.

⁴ SSC A10 (1) Subject to paragraph 2, the licensee shall comply with any reasonable request by a relevant supplier (or a gas supplier who is about to become such a relevant supplier) to provide through a meter asset manager and install at the premises of a domestic customer a gas meter owned by the licensee and of a type specified by the supplier subject, however, to a meter of that type being reasonably available to the licensee and the supplier agreeing to pay its charges in respect of the meter.

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).

Wales & West Utilities is a gas transporter and has no view on this question.

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?

The consultation suggests that suppliers should have a non-discrimination obligation to provide smart metering services to small suppliers. Before we give our views on this, we have some more general comments.

We are concerned that this has only been raised at this late stage. The fact that none of the large suppliers, other than Centrica, entered the competitive metering market to a significant extent and the consequent dependence of the commercial MAMs on one contract should have raised concerns over how the market would support smart metering rollout.

The question implicitly assumes that the big six suppliers have reasonable customer numbers and density in all areas. This is not correct.

A robust non-discrimination clause together with a requirement for cost reflective prices may mitigate the problems faced by small suppliers to some extent. However unless the large suppliers regard this obligation as an opportunity rather than a duty we expect that there are likely to be significant issues for small suppliers in obtaining these services and the information they require to manage performance.

There could be a period where small suppliers claim that they do not receive services on the same basis as the supplier who provides the services to them. This could result in complaints to Ofgem followed in turn by investigations. The risk is that there will be significant challenges and costs in making the non-discrimination clause effective.

Although this proposed non-discrimination clause would be better than nothing and improve the position of small suppliers under the current market structure we do not believe it is the best response. We suggest in our answer to Chapter 1 question 1 that networks should provide domestic metering; this will solve the problems small suppliers have in resourcing smart meters and comparative regulation will ensure networks perform. Wales & West Utilities has consistently argued that networks should provide smart meters. The network led approach was rejected by DECC on the grounds that the existing supplier led model would deliver the rollout effectively; however it is now apparent that there are significant challenges for a supplier led rollout which would not occur with a network led rollout.

If so,

- a) **Would this obligation be better placed on the Big 6, or on all vertically integrated suppliers?**

While the big six are the major players we would expect that it would be discriminatory to apply it solely to them and it would need to apply to all vertically integrated suppliers.

- b) **Should the obligation comprise meter provision services; meter installation and maintenance services; or both?**

The services must cover the full range of MAM services; including meter installation, exchange and removal as well as meter maintenance otherwise the suppliers using it will not be able to provide a full range of metering services.

It seems sensible for meter provision to be included otherwise the supplier providing the service will have significant logistical problems in coping with meters required by small suppliers. It is unclear whether, once provided, the large supplier will own the meters or the small supplier will be required to own their own meters. If the small supplier takes ownership, it will be important to clearly identify the responsibilities of the MAP and MAM.

Ofgem should also consider whether some vertically integrated suppliers that have low customer density in some areas may also wish to use the services of other vertically integrated suppliers in these areas and if they did whether this would be allowed.

- c) **Could such an obligation be overly burdensome?**

The obligation will require the providers to make more complex arrangements that they otherwise would do. We cannot comment on whether this would be required as a burden; however, an independent commercial meter operator would regard it as a part of normal business.

- d) **Should the obligation contain a sunset or review provision once the rollout of smart meters has been completed?**

All suppliers will need to service their smart meters once installed. When smart meter rollout is complete suppliers will have an ongoing requirement for maintenance, new installations, exchanges and removals that will require a good coverage of meter workers; however the volume of work may be fairly low. We suggest that small suppliers will have more problems in obtaining service providers to support ongoing maintenance than they will obtaining service providers for rollout.

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?

We do not believe this will address the fundamental issue with the supply market where there are six large companies and a fringe of small suppliers that face significant barriers to entering the volume market. This proposal will entrench the position of the big six suppliers because were a new supplier to enter the market and grow, it would have to develop its own metering business at the point where it ceased to be "small". This is likely to be a significant barrier and makes it less likely that a supplier will emerge to challenge the current six large suppliers. This problem would not occur were networks to own meters.

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

MPOLR is not required for smart meters. The whole of smart metering rollout was based on the assumption that suppliers could deliver it in the competitive market. If an MPOLR is required then it suggests that the liberalised metering market has failed and that metering should be re-bundled into the networks.

Chapter 4 Gas Metering Price Controls

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

We are unclear what is meant by legacy meters. Wales & West Utilities only owns meters installed since 2005, therefore all of these meters are likely to be operational for less than their designed life owing to the rollout of smart meters. This will result in stranded costs that need to be funded. If legacy means all meters that may suffer impaired asset life due to the rollout of smart meters then we believe that networks should be allowed to charge a price that reflects the true costs of providing them. Ideally this would be by removing the price caps.

Defining legacy as meters installed before a certain date, which we assume, will be fairly close to the start of smart meter rollout does not address the shortened asset lives of meters operational at that date.

Question 2: What is the impact on customers if we reset price controls for:

- a) **PPM meters?**
- b) **DCM meters?**

In answering this question we are assuming that the price controls would be set to reflect actual costs for each type of meter and there would be no attempt to cross subsidise prepayment by credit meters and that suppliers would have the responsibility for protecting vulnerable customers. The caps would need to be reset having regard to the costs of each individual MPOLR, National Grid Gas has a very large volume of price capped meters and is likely to face a different cost base than the other networks that emerged from Network Sales. This is due to the decision of

National Grid not to sell the meters at network sale and not due to any actions of the sold Networks.

a) PPM meters

The price would rise owing to the losses currently made and the stranding issue. The suppliers would pay the higher price for PPM meters; however customers could be protected by suppliers agreeing or being required to charge customers who have prepayment meters no more than a certain amount more than they charge customers for credit meters

b) DCM meters

The price may rise to ensure cost reflectivity and to take account of stranding costs.

Although the issue of the impact of any changes to the price caps is important, customers are more likely to be impacted by how the procurement and installation costs of smart meters are recovered. For credit customers a smart meter will cost more than a dumb meter and how customers are charged for smart metering is likely to be more material than the effect of changes in the price caps.

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.

Stranding affects newer meters more than older meters so while a revised price cap for new and replacement dumb meters is required the stranding of existing meters also needs addressing. Therefore we believe that until the MPOLR is removed a new price cap is required for all meters installed under MPLOR likely to be affected by stranding. This applies to prepayment meters installed after 2002 and credit meters installed after 1992.

MPOLRs have had no option but to provide these meters we believe that the price caps should be reset for each individual MPOLR to reflect the impact of smart meter rollout on their meter asset base.

Addressing stranding is very important because it has been excluded from the current gas price control process.

a) We are also interested to understand whether an allowance beyond a purely cost-reflective level would encourage competition?

Setting a price cap that allows some profit for networks should encourage suppliers to look for alternative providers; however as previously stated our preference is for the obligation to be removed immediately.

b) In the transition to smart metering, what consideration should be taken into account when setting a new price control tariff for dumb meters?

The following factors should be taken into account for each MPLOR, these factors are likely to result in different price caps for each MPOLR

- their existing last resort metering asset base including age profile and proportion of credit and prepayment meters
- the cost they face in providing or procuring a MAM service

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

In our response to the ROMA open letter we stated that based on the current life of a prepayment meter of six years the shortfall between the cost of providing a prepayment meter and the revenue was £29.86 a year.

We have updated the figures based on our costs to December 2010 and the shortfall for a six year life has reduced to £16.88 a year which is still significant. The reason for the decrease is largely owing to increased use of recycled rather than new meters which has reduced the average cost of a prepayment meter. Taking into account that the smart meter rollout is expected to start in 2012 and the target is to complete it by 2016/17 the average life of a prepayment meter installed in 2011 is likely to be about three years.

Using a prepayment meter life of three years means that the shortfall increases to £43.06 a year. For credit meters the shortfall with a six year life is £6.35 and with a three year life is £21.08 a year. The spreadsheet sent with this response contains more details of our analysis.

There may be arguments for protecting some customers from the full costs of prepayment meters but suggest that it is more appropriate for suppliers rather than GDNs to be constrained on what they can pass on. The caps mean that suppliers do not see the true costs of metering and therefore may make decisions based on the prices they pay rather than the true costs. If the suppliers paid the true costs of each meter and the true costs of various options of dealing with debt they could choose the most appropriate solution.

Question 5: What are the likely tradeoffs between the implications for the price for providing PPMs, especially for vulnerable customers 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?

We have suggested a solution to the vulnerable customer question in our answer to question 3 above.

All other things being equal it seems likely that if suppliers faced the true cost for dumb prepayment meters then they would speed up the rollout of smart meters to replace dumb prepayment meters.

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?

Wales & West Utilities is not a supplier and therefore is not answering this question

Yours sincerely,



Steve Edwards
Head of Commercial and Regulation
Wales & West Utilities