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for all gas and electricity customers

Review of Metering Arrangements: Decision and consultation on transition to smart meters

Decision and further consultation

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Contact: Steve Rowe, Paul Fuller

Team: Smarter Markets

Tel: 020 7901 7468

Email: steve.rowe@ofgem.gov.uk

Overview:

This document sets out final decisions and proposals relating to the regulation of certain electricity and gas metering services. The focus is on 'traditional' meters, i.e. the meters that will be replaced over time by smart meters. It therefore complements the work of the Department of Energy and Climate Change (DECC) Smart Meter Implementation Programme (SMIP), and the work of Ofgem in developing the regulatory framework for early, voluntary rollout of smart meters by some energy suppliers.

Under our Review of Metering Arrangements (ROMA), we have reviewed various aspects of how the current regulatory framework for traditional metering operates – and whether this operates in the interests of consumers. We have concluded that many aspects of current arrangements are fit-for-purpose, and should not be changed. This document sets out our conclusions and reasoning, which in effect conclude the ROMA process.

This document also consults on elements of a strategy for managing the decline of traditional meters consequent to smart meter rollout, with particular focus on the role of regulated providers of traditional metering services. We set out and seek views on a range of options for changing the obligations on Gas Distribution Networks (GDNs) and for reviewing the associated framework of price regulation. Our objective is to ensure that the transition out of traditional metering is managed efficiently, and that consumers are protected in terms of the continuing availability of metering services.

Context

This document concludes our Review of Metering Arrangements (ROMA) and also consults on our strategy for managing the transition from traditional meters to smart meters with particular focus on the role of regulated providers of metering services.

In the government's March 2011 response to the prospectus[1], it confirmed that all energy suppliers should install smart metering equipment meeting required technical specifications by a specified target date in 2019.

These obligations will be introduced principally using powers under section 88 of the Energy Act 2008, which enable the Secretary of State to modify conditions of electricity transmission and supply licences, electricity distribution licences, gas transporter, gas shipping licences and gas supply licences for the purpose of rolling out smart meters.

The rollout of smart meters will result in the replacement of all existing traditional (non-smart) meters and therefore will change the dynamics for this market. It is important to ensure that the regulatory framework for traditional meters is fit for purpose in light of these developments.

Associated documents

- Review of Metering Arrangements - Initial Findings and consultation on proposed metering industry remedies (162/10): http://www.ofgem.gov.uk/Markets/RetMkts/Metrng/Comp/Documents1/ROMA%20Consultation%20Document.pdf
- Commercial interoperability: proposals in respect of managing domestic customer switching where meters with advanced functionality are installed (109/11): http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Markets/sm/metering/sm
- Smart Metering - Response to Prospectus Consultation (45/11): http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=e-serve/sm/Documentation
- Review of Metering Arrangements Open Letter and Scope Letter: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Markets/RetMkts/Metrng/Comp
- Ofgem's Decision on the Future of the Gas and Electricity Metering Price Controls 2006 (187/06): http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Markets/RetMkts/Metrng/Metering

[1] http://www.decc.gov.uk/assets/decc/Consultations/smart-meter-imp-prospectus/1475-smart-metering-imp-response-overview.pdf

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Executive Summary

This document sets out a number of decisions in relation to the current gas and electricity metering arrangements to conclude Ofgem's Review of Metering Arrangements (ROMA). This document also invites views from stakeholders on a proposed approach for supporting an efficient transition away from traditional meters, i.e. the meters that will be replaced over time by smart meters, in respect of the role played by regulated providers of gas metering services.

It therefore complements the work of the Department of Energy and Climate Change (DECC)'s Smart Meter Implementation Programme (SMIP), and the work of Ofgem in developing the regulatory framework for early, voluntary rollout of smart meters by some energy suppliers.

Objective

Metering is an important determinant of the service received by consumers of electricity and gas. For example, it enables accurate billing, supports the ability of customers to change supplier and is a source of information for consumers. Metering, and access to metering services, is also an important enabler for organisations wishing to compete in the gas and electricity markets.

It is in the interests of consumers for metering services to be provided to a high quality and at an efficient cost. Consistent with our statutory duties, Ofgem has advocated competition as a means of promoting the efficient delivery of metering services – augmented, where necessary, with regulation.

The objective of our work in this area is to ensure that the regulatory framework that affects how traditional metering services are provided continues to be fit-for-purpose. We considered this in the light of experience of how metering competition is working and recognising new challenges associated with smart meter rollout and the associated ramp-down of traditional metering services.

ROMA conclusions

In 2010 Ofgem initiated a Review of Metering Arrangements (or 'ROMA')[2]. The purpose of the review was to assess how the prevailing mix of competition and regulation was performing as a means of protecting the interests of consumers. The review tested the following propositions with evidence from how the market for the provision of metering services is currently operating:

- **Commercial interoperability**: Whether the current commercial framework, involving a multiplicity of contract forms, may drive an inefficient market outcome – potentially resulting in domestic meters being replaced prematurely when consumers switched suppliers.

[2] http://www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/Review%20of%20Current%20Metering%20Arrangements.pdf

- **The role of regulated, 'last resort' metering services**: Whether appropriate obligations are in place on network companies in respect of the provision and pricing of metering services – and whether these obligations should extend to providing services in respect of smart meters in due course.

- **Vertical integration of metering into suppliers businesses:** whether the trend for suppliers to vertically integrate metering into their businesses would restrict access to, and the availability of, metering services.

- **Gas metering price controls:** whether the regulated revenue price restrictions remain appropriate for the transition into smart metering.

We have analysed a range of options in respect of these issues, including continuation of the prevailing regulatory arrangements – and our analysis has taken account of responses to our December 2010 'minded-to' consultation in relation to a number of metering issues. In broad terms, we have concluded that the current arrangements are fit-for-purpose, but that the obligations on networks companies including the regulated provider of metering services may need to be reformed to recognise the rollout of smart metering. Further information can be found in Chapter 2 of this document, which sets out the conclusions of Ofgem's work under ROMA.

Transition from traditional to smart meters

The rollout of smart meters will change the nature of some of the activities undertaken under the current regulatory framework in relation to gas and electricity meters. We have therefore considered whether the current arrangements will continue to operate in the interests of consumers as the provision of traditional gas metering services becomes a smaller, more marginal activity.

Our initial view is that while the arrangements in electricity are fit-for-purpose, customers might be better protected through some changes to the regulatory framework around the provision of metering services by Gas Distribution Networks (GDNs) under the Meter Provider of Last Resort (MPOLR) obligation. These changes may be appropriate to reflect that the provision of traditional metering is a declining activity. We are therefore seeking views on our proposal that an additional, transitory obligation is placed on one GDN (the Backstop MPOLR) to offer terms to provide traditional metering services to other GDNs. This would increase efficiencies in the provision of regulated metering services as this activity declines by removing the requirement for each GDN to individually retain resources to install and service traditional meters. We are also consulting on an approach to reviewing the associated framework of price regulation. These proposals are discussed in more detail in Chapter 3 of this document.

Next steps

We are seeking views on the proposed approach to managing the transition from traditional gas metering services to smart meters, as set out in Chapter 3 of this document. Views are invited by 23rd March 2012. In light of these responses, and our own further analysis, we intend to publish draft proposals by July 2012. This will include proposals for how obligations to provide services should be amended, and proposals for how maximum allowed revenues or prices should be set.

1. Update on the metering market

Introduction

1.1. This document is the last in a series of documents that Ofgem has published as part of its Review of Metering Arrangements. It sets out Ofgem's final decisions on issues raised in our ROMA 'minded-to' consultation document published in December 2010 (the December 2010 consultation).

1.2. This document also consults on a proposed approach for supporting an efficient transition away from traditional meters, i.e. the meters that will be replaced over time by smart meters, in respect of the role played by regulated providers of gas metering services.

Background

1.3. Ofgem launched ROMA in April 2010, and set out the scope of the review in July 2010[3]. The objective of ROMA is to ensure that the regulatory framework that affects how traditional metering services are provided continues to be fit-for-purpose, including recognising new challenges associated with smart meter rollout and the associated run-down of traditional metering services.

1.4. The December 2010 document consulted on Ofgem's 'minded-to' position on metering issues faced by industry and consumers in the coming years. In particular, we set out our minded-to position on the following:

- *Commercial interoperability*: we encouraged industry to improve relevant information and data flows to enhance the change of supplier process and avoid meters being removed prematurely on change of supplier

- *Vertical integration and network company obligations:* we set out our proposals in relation to the 'meter provider of last resort' (MPOLR) obligations on gas network companies and sought views on whether we should introduce a new licence obligation on suppliers to require them to offer smart meter services on cost reflective terms.

- *Gas metering price controls:* we recommended that the level of GDN metering price controls is reset for new and replacement meters only, to set an appropriate tariff cap for an interim period, reflecting the expected shorter life of these assets in the transition to smart meters. We proposed to keep the Pre Payment Meter (PPM) price control arrangements under review. In addition, we proposed that no changes should be made to the traditional

[3] http://www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/Review%20of%20Metering%20Arrangements%20Scope%20Open%20Letter.pdf

meter price controls, noting that the National Gird Gas Metering Service Agreements (MSA) were then being reconsidered following the Competition Act Investigation; we set out our proposal to maintain price caps at current levels and to monitor the market.

1.5. Since the publication of the December 2010 document, the government has published more information on the key policy design for the implementation of smart meters and the government's programme is now established and implementing this policy design. Ofgem therefore considers that there is sufficient certainty to consider the impact of smart metering on traditional meters and to engage stakeholders on potential consequent changes to the associated regulatory framework.

1.6. Further information on the background to the metering market can be found in Appendix 2.

Structure of this document

1.7. Chapter 2 of this document sets out Ofgem's final decisions in respect of ROMA including a number of issues raised in our December 2010 document relating to the existing regulatory framework for traditional metering services.

1.8. Chapter 3 discusses our latest thinking and whether the existing regulatory framework is fit for purpose in the context of the transition to smart metering. We invite views on a number of options for change in this area.

Related work areas

Smart Metering Implementation Programme

1.9. As stated above, the arrangements for the roll out of smart metering[4] will gradually result in the replacement of traditional meters. The progress being made with respect to the smart metering rollout will therefore impact on the issues being consulted on in this document. For example, the speed at which smart meters will be rolled out may have implications for when changes to the existing regulatory framework are necessary.

Regulation of early smart

1.10. Some suppliers are installing meters with smart capability ahead of the mandated rollout of smart meters. Ofgem has taken a number of steps to ensure that the regulatory framework reflects these developments such that the interests of consumers are protected including:

[4] http://www.decc.gov.uk/en/content/cms/tackling/smart_meters/smart_meters.aspx

- Additional protections for domestic consumers via the Spring Package consultation. The resultant modifications to the standard licence conditions of all gas and electricity supply licences were implemented earlier this year[5]; and

- A consultation in August 2011 on proposed modifications to gas and electricity supply licences to facilitate the switching of customers with 'early smart' meters, including to support where practicable the retention of smart functionality when a customer changes supplier. We are expecting to issue our decision document in respect of these proposals later this month.

Independent Gas Transporters

1.11. In the ROMA scope document, we set out that independent Gas Transporters (iGTs) would be excluded from the ROMA as it was to be the subject of its own review. Unfortunately, due to our commitments in other areas of work, this consultation has been delayed. We remain committed to reviewing the regulatory framework for independent networks, to ensure that consumers on IGT networks also benefit from the rollout of smart meters.

1.12. This review has not considered iGTs explicitly, however there are clear synergies with metering on iGT networks and we would expect that the lessons learned with respect to commercial interoperability from ROMA are also applied to iGT networks. Our findings from the consultation on commercial interoperability of tradition meters are discussed in Chapter 2 of this document.

National Grid – Metering competition

1.13. In February 2008 the Authority made a Decision[6] that National Grid had breached the Chapter II prohibition of the Competition Act 1998 (the Act) and Article 82 of the EC Treaty[7]; abusing its dominant position in the market for the provision of domestic-sized gas meters in Great Britain.

1.14. Ofgem's finding was subsequently upheld in substance by both the Competition Appeal Tribunal in April 2009 and the Court of Appeal in February 2010 (with the prospect of further litigation only ending once the Supreme Court had refused permission several months later).

1.15. Consistent with the findings of the Competition Appeal Tribunal, Ofgem has been engaged in the process of National Grid developing a replacement agreement that complies with the competition rules. Ofgem's role in the process will be concluded shortly, following consultation earlier this year[8], with the publication of an open letter.

[5] http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Modification%20Direction.pdf
6http://www.ofgem.gov.uk/About%20us/enforcement/NGmeters/Documents1/National%20Grid%20Competition%20Act%20Decision%202708.pdf
7 Now Article 102 of the Treaty on the Functioning of the European Union.
[8] http://www.ofgem.gov.uk/About%20us/enforcement/NGmeters/Documents1/Ofgem%20Consultation%20%20-%20MSAs.pdf

2. ROMA Final Decisions

Chapter Summary

In the December 2010 ROMA consultation, we consulted on a range of proposals to support the existing metering arrangements during the rundown of traditional meters. Having analysed the issues in the context of the current market, and considered the responses to the December consultation, we do not consider that significant regulatory change is warranted in order to protect the interests of consumers. This chapter considers each of the areas of the December consultation in turn and sets out our decisions and reasoning.

Commercial Interoperability of traditional meters

The issue

2.1. The introduction of competition in the provision and management of meters has resulted in a number of different providers of gas and electricity meters. This has resulted in a multiplicity of commercial contract terms for the management of meters between the supplier and the relevant meter asset manager (MAMs[9]) and meter operators (MoPs[10]).

2.2. To facilitate the efficient switching of customers between suppliers there is a need to ensure that the commercial metering services contracts can be transferred between suppliers. This transfer of commercial contracts relies on 'commercial interoperability' of the commercial arrangements around meters[11]. 'Commercial interoperability' is the term used to describe the compatibility of commercial contracts between suppliers, MAMs and MoPs to avoid the unnecessary replacement of metering assets (or 'meter exchanges'), which is inefficient and causes inconvenience for customers.

Ofgem decision

2.3. We consider that there are sufficient existing commercial incentives to avoid unnecessary exchanges of tradition meters, and therefore that regulatory intervention is not appropriate at this time. We welcome industry initiatives to improve commercial interoperability further. However, we recognise that the rollout of smart metering could change the commercial incentives in this area and therefore we will keep this under review. We also recognise that the commercial terms associated with smart meters are inherently more complex than the commercial terms for traditional meters.

[9] A person approved by the Authority as possessing sufficient expertise to provide gas metering services.
[10] Meter operation comprises all work associated with the installation, commissioning, testing, repair, maintenance, removal and replacement of electricity metering equipment.
[11] For example, in relation to rental rate, termination charges, and the methodology for amortising assets.

Discussion

2.4. Our concern expressed in the December 2010 consultation document was that failure to agree commercial arrangements for meters on change of supplier could result in meters being removed from the wall prematurely. Following further analysis of this issue, consideration of the responses to the consultation and discussion at our ROMA working group we have not received specific examples or evidence to suggest that the differences in commercial contracts were resulting in the premature replacement of traditional meters.

2.5. Some suppliers did raise concerns regarding commercial terms for meter contracts (including the level of the metering charges and early termination charges). However, participants were generally unsupportive of regulatory measures, such as mandating a standard form of contract as they considered the uncertainties and costs associated with such regulation would outweigh any potential benefits. A number of suppliers pointed out that the commercial incentives on them to avoid replacement of the meter and associated benefits were likely to outweigh difficulties associated with variations in contract terms.

2.6. We have therefore concluded that it is not appropriate at this time to impose any direct regulatory requirements on suppliers with respect to commercial interoperability of contracts for traditional meters. However, we continue to support efforts by the industry to improve transparency and consistency of contract terms and would welcome initiatives to take this forward. We will keep this issue under review and will reconsider our position in the light of any new evidence that customers may be disadvantaged by these arrangements.

Ability for gas suppliers to access MPOLR

The issue

2.7. GDNs currently have an obligation to provide gas meters, when requested to do so by a gas supplier, at a tariff not exceeding a regulated rate[12]. This obligation is known as the meter provider of last resort (MPOLR). The regulated rate sets out a maximum rate for installation and maintenance of Prepayment Meters (PPM) and Domestic Credit metering (DCM) which were set as part of the 2002 price control arrangements to ensure that the cost differential between the two was set at a certain limit[13].

2.8. Given that the regulated rates for installation and maintenance of meters by GDNs was set in 2002, there is concern that they may not reflect the current costs (e.g. changes in costs of installing / maintaining meters since 2002 including any

12 Set through tariff caps originally set in 2002. See 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.
13 The limit set was £15. http://www.ofgem.gov.uk/Networks/Trans/Archive/Transco/Documents1/325-26sep01_pub1.pdf

efficiency gains made are not reflected in maximum tariff). This could mean that customers are being disadvantaged if the charges for these activities are too high or conversely GDNs could be being penalised if the charges are too low. In addition, the GDNs were concerned that the regulated differential (set at £15 in 2002 increased by RPI each year) between PPM and DCM meters does not adequately reflect the additional costs of installing and maintaining PPMs. As such, the GDNs consider that their ability to cover the cost of PPM installations therefore depends in part on the relative size of the PPM and DCM portfolio.

2.9. If the current regulated rate for PPMs is lower than the competitive rate, then suppliers are incentivised to procure PPMs via the GDNs. There is some evidence to support this view. For example, whilst the number of DCMs requested under MPOLR has remained stable, the requests for PPMs are increasing. If this behaviour continues, in tandem with the current regulated tariffs, it may affect the ability of some GDNs to recover efficiently-incurred costs in aggregate.

2.10. We were minded in our December document to introduce a new licence condition requiring suppliers to be able to demonstrate that they have exhausted commercial routes before requesting a meter from a GDN, as one potential mitigation for the issue identified above.

Ofgem's decision

2.11. While we accept that in certain situations suppliers are requesting GDNs to install PPM meters where there are other commercial routes for achieving this, we do not consider it appropriate to review this obligation at this time. The role of GDNs in respect of metering activity will be fundamentally reformed by the rollout of smart meters and as part of that the regulatory obligations on GDNs will need to be reviewed. We therefore consider that there should be no supplier restriction of access to MPOLR in the short term to protect vulnerable customers whilst also maintaining customer service in the transition to smart meters.

2.12. Ofgem considers that the MPOLR obligation is necessary to protect customers' interests in the transition to smart metering. We therefore have decided not to change this obligation at this time. The question of whether and how this obligation should endure when new and replacement meters are required to be smart meters is discussed in Chapter 3.

Discussion

2.13. Most respondents to the December consultation agreed that a licence condition that would impose restrictions on suppliers in relation to MPOLR requests, as proposed by Ofgem, may be an appropriate solution. However, there was uncertainty around how this condition would be tested and enforced[14]. Other suppliers proposed an alternative option of modifying the GDN licence such that the

[14] For example, it would be difficult for a supplier to prove it had exhausted all commercial options for procurement of a meter and there is the potential for significant regulatory intervention with respect to disputes relating to such a condition.

GDN would only have the MPOLR obligation where the GDN reasonably believed that the request was a last resort (thereby moving the burden of proof from the supplier to the GDN). Respondents also considered that the need to present evidence in either case to reduce the administrative and enforcement burdens associated with any such condition.

2.14. Having reviewed the views of respondents and analysed the issues further, we agree that there are difficulties in placing an obligation on suppliers to limit use of MPLOR. Although we consider that these difficulties are surmountable, we are keen to ensure that any regulatory requirement is proportionate and reasonable.

2.15. Since the publication of our December 2010 document, the government has announced its intention to adopt a supplier-led rollout design. Under this design, gas and electricity suppliers will have regulatory obligations to use reasonable endeavours to install smart meters for all their domestic customers by an end date (expected to be 2019), and from a significantly earlier date (expected to be in 2014) to ensure that new and replacement meters are smart meters.

2.16. The rollout of smart meters therefore envisages a move away from network-led metering towards supplier-led metering. In Chapter 3 of this document we consider in more detail the MPOLR obligation in the context of this allocation of responsibilities. In the shorter-term, however, we propose to retain the current MPOLR obligation, given that the protections it affords continue to be relevant to consumers.

Small suppliers access to smart meters

The issue

2.17. We set out in our December 2010 consultation that Ofgem was keen to ensure that there is sufficient availability of smart metering services for small and out-of-area suppliers[15]. Small suppliers had expressed concern that small and out-of-area suppliers may have difficulty in obtaining smart meters if 'in-area suppliers' continued to move towards developing their own in-house metering services.

2.18. The proposed regulatory framework is predicated on the basis that smart metering services will be delivered by a competitive market, and under the existing MPOLR obligation GDNs are not required to provide a smart meter. We were therefore concerned that under the existing framework suppliers could have difficulty in accessing smart metering services, which could have significant competition implications for the retail energy markets.

[15] The privatisation of the GB electricity market resulted in the creation of fourteen regional monopoly Pubic Electricity Suppliers (PES). The following energy suppliers have evolved from the PES companies through consolidations and acquisitions The supply of energy within their incumbent regions is referred to as 'in-area region'

2.19. We therefore consulted on a proposal to introduce a non-discrimination obligation on either vertically integrated suppliers or on the 'Big 6[16]' to offer smart metering services on cost reflective terms to non vertically integrated suppliers. We considered that this measure would support retail competition.

Ofgem's decision

2.20. Ofgem has not received evidence to suggest that suppliers are experiencing difficulties accessing smart or traditional metering services at this time and therefore consider that it is premature to place obligations on larger suppliers (or suppliers with in-house metering businesses) to provide such services. In this context, it should be noted that there is evidence of some smaller suppliers using smart metering actively as part of their commercial offering to consumers.

2.21. We consider the implementation of licence conditions without evidence of harm to be overly interventionist. In addition, there is the potential for such obligations to harm innovation in the provision of such services. We will however continue to monitor this issue and if difficulties arise will review the potential role for regulatory obligations as a means of ensuring that metering services are made available.

Discussion

2.22. Our concern expressed in the December 2010 ROMA consultation document was that smaller suppliers may be experiencing difficulties gaining access to smart meters. Having reviewed the views of respondents to the consultation and undertaken our own analysis we do not consider there to be sufficient evidence that this proposition holds.

2.23. Although, a number of smaller suppliers supported our recommendation to introduce a non-discrimination metering provision obligation on larger suppliers, they did not provide evidence that they had experienced difficulties in accessing metering services. Furthermore, we note that some smaller suppliers are being proactive in rolling out 'early smart' meters which indicates that they are able to procure both meters and metering services to support such innovation.

2.24. We also note that even if we had considered that small suppliers were experiencing difficulties in obtaining these services, there are a range of possible policy responses, including but not limited to placing additional regulatory obligations on energy suppliers. There are also a range of issues to consider in assessing such options, including incentives and the cost of implementation. For example, regulatory safeguards might be required to address the incentive for a supplier to provide a poor and/or costly service to a competing supplier. To put such obligations in place without sufficient evidence of difficulties obtaining meters would not be consistent with the principles of better regulation.

[16] British Gas, Eon, Npower, EdF, Scottish Power, and Scottish & Southern Energy

2.25. On balance, we therefore agree with the majority of respondents who suggested that it was too premature to make a decision on how the market would respond for smart metering services, including in respect of how commercial behaviour is influenced or constrained by the general requirements of competition law.

3. Regulatory arrangements to support transition out of traditional metering

Chapter Summary

This chapter sets out proposals for elements of a strategy for managing the decline of traditional meters consequent to smart meter rollout, with particular focus on the role of regulated providers of traditional metering services. We set out and seek views on a range of options for changing the obligations on Gas Distribution Networks (GDNs) to provide metering services, and for reviewing the associated framework of price regulation. Our objective is to ensure that the transition out of traditional metering is managed efficiently, and that consumers are protected in terms of the continuing availability of metering services, as the provision of traditional metering services becomes a smaller, more marginal activity over time.

Question box

Question 1: What do you consider are the pros and cons of our approach to managing traditional metering in the transition to smart metering?

Question 2: Do you consider that our assessment of the related issues within the metering market is accurate?

Question 3: How should emergency metering services be provided for in the transition to smart metering?

Question 4: How should emergency metering services be provided, for smart meters?

Question 5: Which is your preferred option for managing the transitions and why?

Question 6: Under option C, is it appropriate to carry out a price control review?

Question 7: Which of our revenue restriction options do you consider is appropriate and why?

Question 8: If you are a GDN, would you prefer to transfer MAP ownership of your traditional meters (i.e. full transfer), or to subcontract new requests and the management of historical stock (i.e. partial transfer) or continue to manage your own meters?

Question 9: If you are a commercial meter operator (CMO), do you envisage a point in the smart meter rollout where you would be interested in consolidating your traditional meters?

Issue

3.1. The electricity metering price controls were removed in 2007, as were the obligations for electricity distribution network operators (DNOs) to provide meters at a regulated tariff. Whilst competition has continued to develop in electricity metering this is not the case for gas metering. The majority of gas meters continue to remain under NGMs' control with other GDNs also providing meters under the MPOLR obligation at a regulated rate.

3.2. The current regulatory framework for the provision of gas metering services has operated since 2002, when metering activities were separated from distribution activities for the purposes of price regulation in order to support a transition to a more competitive market. The supplier-led rollout of smart meters will necessarily change the nature of some of the activities undertaken under this regulatory framework.

3.3. In this context we have considered whether the current arrangements can be expected to operate in the interests of consumers if left unmodified. Our initial view, that we wish to test through consultation, is that consumers would be better protected through regulatory reforms, to reflect that traditional metering is a declining activity but will continue to be important for the market and for many consumers until the end of the smart meter rollout.

The existing regulatory framework

3.4. The regulatory framework surrounding the provision of metering services by GDNs includes (i) obligations on GDNs to undertake certain activities and (ii) regulation of prices / revenues in respect of these services. In addition, GDNs provide post-emergency metering services (PEMS) under commercial arrangements with suppliers.

3.5. As discussed in Chapter 2, the GDNs provide and install meters at no more than the regulated tariff. Further, this route for suppliers wishing to procure metering services is widely used, covering the majority of gas meters.

The factors associated with traditional metering in the transition to smart metering

3.6. There are a number of different factors that should be considered when developing policy options to manage the efficient run down of traditional metering:

3.7. First, it is clear that the rollout of smart meters will change the nature of the role undertaken by GDNs with respect to traditional meters. The provision of

metering services for traditional meters will, for example, be decreasing as the rollout of smart meters ramps up[17].

3.8. Second, we can expect the costs of the provision of metering services relating to traditional meters to change as the numbers of these meters diminish. This will be largely a result of the loss of economies of scale, resulting in higher costs to serve per meter, and greater maintenance costs.

3.9. Third, for new installations or replacement meters, traditional meters being installed prior to the smart meter mandate will have a shorter asset life[18] as they will be replaced by a smart meter before the end of their life. Set against this, there should be a growing stock of used traditional meters to drawn on and re-use as required during this period. It is important to ensure that traditional meter rundown is undertaken as efficiently as possible to protect the interests of consumers.

3.10. Fourth, the existing regime of price regulation for GDNs' metering services has been in place since 2002, therefore the tariffs may not reflect any changes in the costs of these services. These changes may be due for example to any efficiency gains that may have occurred since they were set or changes in the costs during the transition to smart metering. Therefore, the current tariffs levied by GDNs for metering services may not be reflective of the efficient costs associated with these activities. If the efficient costs associated with the regulated activities are lower than the costs incurred this could result in customer paying too much for these services. Conversely if the costs are high GDNs would be unable to recover their efficient costs

3.11. The fifth factor that should be noted is that competition with respect to the provision of gas metering services has not operated as effectively as we had hoped. This has been demonstrated by our investigation into National Grid Metering (NGM) MSA contracts and subsequent fine, which is discussed in chapter 1.

3.12. Finally, it is worth noting that the iGTs own a number of traditional meters subject to commercial contracts between the relevant IGT and relevant parties. The recovery of any costs associated with early replacement of a meter is a commercial matter for the IGT (i.e. subject to any terms in the relevant contract).

Options for managing rundown of traditional metering stock

3.13. Having given consideration to this issue Ofgem has identified the following options for managing the efficient rundown of GDNs' traditional metering stock which have been installed under their MPOLR obligation[19]:

[17] The government is proposing to include a 'new and replacement' obligation on suppliers from the beginning of the smart meter rollout after which date it is expected that new traditional meters will no longer be installed for domestic or smaller non-domestic customers.
[18] The National Measurement Office (NMO) is currently working with the gas and electricity industries to develop an in-service testing regime for gas and electricity meters. This could avoid the need for some older traditional meters to be replaced in the short term.
[19] Standard Special Condition A43 Provision of Metering and Meter Reading Services. Special Condition

- Option A: Status quo, i.e. no changes to existing obligations;
- Option B: Sunset MPOLR: 'turn off' the obligation on GDNs to provide metering services on request with effect from when the proposed obligation on suppliers to install smart meters in respect of all new and replacement meters is introduced. Under current DECC plans, this is anticipated to be in 2014. Under this option, GDNs would be obliged to continue to maintain meters provided under the MPOLR before that date;
- Option C: Appointing a meter provider of last resort for MPOLRs with sunset: As option B above plus an obligation on one GDN to provide metering services on request of other GDNs.

3.14. Based on our preliminary analysis, we are minded to progress option C. The following three sections explain each option in more detail, and set out the reasoning for our minded-to position.

Option A: Status quo

3.15. Under option A, there would be no changes to the existing regulatory obligations on GDNs. This approach has certain benefits due to its simplicity, for example no changes to the regulatory regime would be required and as such there would not be any additional regulatory burden on industry.

3.16. However, this option may not offer protection to consumers by facilitating an efficient rundown of traditional metering. It may increase GDN costs unnecessarily, and reduce or skew the incentives on suppliers to install smart meters.

3.17. While the obligation on GDNs could be extended to include the provision of smart meters, this is is potentially inconsistent with supplier-led rollout - and absent evidence that such a regulated service provider is required for smart meters could constitute unnecessary regulation. From a practical perspective, extending the GDN obligation to include smart meters would require GDNs to implement new procedures, undertake training of staff and processes to support smart metering.

3.18. This option would also require a review of the current regulated tariff caps to ensure that these are fit for purpose in the light of changes to underlying cost.

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. Metering services include the provision, installation, commissioning, inspection, repairing, alteration, repositioning, removal, renewal and maintenance of the gas meter

Option B: Sunset MPOLR

3.19. Under this option the MPOLR obligation on GDNs would be removed with effect from a specified date. It seems appropriate to link the date on which this obligation would cease to the date at which suppliers are obliged to install smart meters for all new and replacement meters. This is currently planned to be in 2014.

3.20. This approach would have the benefit of providing protection for consumers throughout the transition to smart by ensuring that traditional metering services remain available through a backstop, regulated service provide until the point at which suppliers take on the primary obligation for ensuring that new and replacement meters are smart meter. It would also remove the need for GDNs to develop resources to support smart metering, which could be unnecessarily costly if suppliers choose not to use the regulated service offered by GDNs.

3.21. A number of suppliers are already installing early smart metering through commercial arrangement or in-house, which suggests there is competition in the services to support these meters which supports the removal of regulated provision of metering services post smart metering implementation.

3.22. There may be a need to review the price controls of GDNs under this option to ensure that they reflect a fair balance of risk and reward for consumers. This is considered further below.

3.23. However, this approach does not address the potential loss of economies of scale associated with individual GDNs supporting and maintaining an ever smaller number of traditional meters as the smart meter rollout progresses.

Option C: Backstop MPOLR

3.24. This option would address directly the potential loss of economies of scale associated with GDNs not being obliged to provide smart meters, and having a reducing number of traditional meters to support and maintain. It would involve placing an obligation in the licence of one GDN to provide metering services on request to any other GDN for a transitional period. The GDN on whom this obligation relates would be known as the 'Backstop MPOLR' – and would take on this role, subject to consultation, by the end of 2012.

3.25. The meters installed under this obligation would then be owned and maintained by the Backstop MPOLR, and subject to the prevailing regime of tariff regulation. GDNs other than the Backstop MPOLR would have the option of using the services of the Backstop MPOLR under these regulated terms with respect to any new meters. This would enable the retention of economies of scale, and provide a framework for other GDNs to develop exit strategies in respect of their own provision of metering services.

3.26. In addition, Ofgem considers it may be appropriate for the Backstop MPOLR to be obliged to offer terms to GDNs for maintenance of GDNs existing meter stock. This could further consolidate the retention of economies of scale - which in turn would be of benefit to consumers.

3.27. Ofgem has also considered whether the obligations on the Backstop MPOLR should extend to the provision of PEMS. However, we note that emergency meter services are currently provided subject to commercially agreed contracts. Our initial view is that each GDN should continue to arrange for the provision of PEMs whether that is in-house or via commercially agreed contracts either within the NMM or alternative providers. We are seeking views as to whether participants agree with our view here or whether further licence obligations would be appropriate.

3.28. Finally Ofgem has considered whether it would be appropriate to place an obligation on the NMM to offer to take on ownership (asset transfer) of GDNs existing meters where requested. Clearly, an obligation of this kind would only be appropriate where there is significant customer benefit; on balance we think this should be left to GDNs to agree on commercial terms..

3.29. We consider that this option could provide economies of scale and benefit consumers in the transition out of traditional metering by ensuring that traditional metering services are available throughout the transition at an efficient cost.

3.30. Under this option, we would also need to consider the exit strategy for the Backstop MPOLR itself, given that it is designed to support a transitional activity. This could take the form of a removal of the obligation to continue to provide services, or the removal of associated regime of price regulation. The regime also needs to support activity by the Backstop MPOLR consistent with a 'tipping point' when it is more efficient to install smart meters rather than continue to support a very small stock of dumb meters. We will develop this design further if, following consultation, we decide to progress this option.

3.31. Given the significant market share owned by National Grid Gas plc (NGG) in this area, we are minded that NGG would be best placed to undertake this role. This is an issue we would, in particular, welcome views on.

Ensuring regulated tariffs are appropriate

3.32. Ofgem has a statutory duty to regulate the industry in such a way as to enable licence holders to finance their regulated activities whilst also protecting consumers' interests. In giving due regard to our obligations, we seek to ensure that regulated metering activities under any of the above options are delivered efficiently and economically.

3.33. The cost basis for the current GDN tariff caps has, for various reasons, not been reviewed in detail since 2002. There is therefore a risk that the tariff caps are not set at the appropriate level. To illustrate, the current tariff caps do not reflect

any efficiency savings that might have been realised since 2002. Nor do they necessarily reflect the value of the underlying assets the tariffs are designed to recover, given potential differences between actual and assumed capital expenditure on meters over this period or differences in the balance between credit meters and PPMs.

3.34. The following section sets out two options for ensuring that that the framework for price regulation is fit-for-purpose, and provides appropriate protection to consumers and supports appropriate revenue recover for GDNs. We have developed the options in the context of our minded-to position. However, in principle, these options could also be applied in respect of reviews of all GDN regulated tariffs if either option A or B were implemented instead.

Option 1: Charging consultation; and

Option 2: Reset NGG's metering price control.

Option 1– Charging consultation

3.35. This option proposes that NGG continues to operate under the existing metering price control tariff, whilst also taking on the additional responsibility of providing the Backstop MPOLR service. This proposal would effectively maintain uniform national tariff caps, avoiding price shocks and providing certainty for suppliers, consumers and GDNs.

3.36. Under this option, we would require NGM to satisfy Ofgem that the existing tariff structure of charges is appropriately cost-reflective. They would do this by consulting with stakeholders on a proposed charging statement and the supporting evidence to justify the proposed charges as reflective of the efficient costs associated with the activities that NGM would be obliged to undertake. This model of establishing regulated prices or revenues through consultation with, and scrutiny by, stakeholders using a process defined by Ofgem has been used effectively in other contexts, e.g. the establishment of National Grid's system operator incentives.

3.37. This option offers benefits in terms of implementation. As it would not involve a lengthy review of current metering price controls. This approach facilitates early implementation and provides the maximum amount of time for the Backstop MPOLR to focus on the task at hand. In addition to the ease of implementation, we recognise that this option would also reduce the burden to industry and stakeholders and would also be acting in the principles of better regulation by applying proportionate regulation.

3.38. This approach may also provide transparency and certainty for suppliers in considering alternative commercial offerings, including any new commercial Meter Service Agreements (MSAs) offered by NGM.

3.39. Although this option could work if the underlying costs are less than those assumed in the current regulated tariffs as the actual tariff could be set under the maximum tariff, Ofgem is aware that it would not be a solution where the costs are higher than the maximum regulated tariff. In this situation, or in the situation where Ofgem does not consider that NGG's proposed tariffs are appropriate, Ofgem considers that we would need to consider consequent amendments to the regulated tariff caps – hopefully drawing on the evidence base presented by NGG and scrutinised by stakeholders, without significant additional analysis or process.

Option 2: Price control review of tariff cap

3.40. This option would include a full review of the metering price control. This could result in the resetting of the parameters of the price control or the inclusion of an adjustment mechanism that would change NGG's price control in certain circumstances.

3.41. The advantages of a full metering price control review are that it would enable all relevant factors to be taken into consideration. As such, it would provide an accurate and transparent mechanism by which to assess costs of managing the consolidation of gas meters. However, any such review would take at least six to nine months to complete and would be resource intensive. As any price control period will be time limited (given the implementation of smart meters) this level of scrutiny may not be in the interests of consumers.

3.42. Such an approach could also delay the point at which there certainty for suppliers seeking to compare the regulated service offering with other commercial offerings in the market.

3.43. A variant of this model would be to retain the tariff caps, but to augment them with an adjustment factor. The adjustment factor would be designed to take into account a range of assumptions around the rollout of smart metering. We anticipate that the process of developing an adjustment factor would follow a similar timetable to that of a full price control review.

3.44. Ofgem's initial views

3.45. Our initial view is that option C1 (National MPOLR with a detailed charging consultation) is the appropriate regulatory approach. We view it as a proportionate and pragmatic approach to establishing an appropriate level of regulatory safeguards for an important, but transitional, activity.

3.46. We welcome your view in respect of the questions listed at the start of this chapter, and any other issues that you consider to be relevant.

Appendices

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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

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of chapter 3 and which are replicated below.

1.3. Responses should be received by 23rd March 2012 and should be sent to:

Steve Rowe

Smarter Markets
Ofgem
9 Millbank
London
SW1P 3GE

0207 901 7468
steve.rowe@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 take forward the consultation areas to a final decision in the coming months and amending gas metering price controls and licence obligations if and when required by the outcome of the consultation.

1.7. Any questions on this document should, in the first instance, be directed to:

Paul Fuller

Smarter Markets
Ofgem
9 Millbank
London
SW1P 3GE

0207 901 7242
paul.fuller@ofgem.gov.uk

The questions from the consultation are set out below:

Question 1: What do you consider are the pros and cons of our approach to managing traditional metering in the transition to smart metering?

Question 2: Do you consider that our assessment of the related issues within the metering market is accurate?

Question 3: How should emergency metering services be provided for in the transition to smart metering?

Question 4: How should emergency metering services be provided, for smart meters?

Question 5: Which is your preferred option for managing the transitions and why?

Question 6: Under option C, is it appropriate to carry out a price control review?

Question 7: Which of our revenue restriction options do you consider is appropriate and why?

Question 8: If you are a GDN, would you prefer to transfer MAP ownership of your traditional meters (i.e. full transfer), or to subcontract new requests and the management of historical stock (i.e. partial transfer) or continue to manage your own meters?

Question 9: If you are a commercial meter operator (CMO), do you envisage a point in the smart meter rollout where you would be interested in consolidating your traditional meters?

Appendix 2 - Background to metering

Since 2000, Ofgem has taken measures to encouraged innovation and competition within metering services. In 2006 Ofgem decided to allow the obligations and price controls on electricity meters to lapse in line with the sunset provisions in the licence.

At that time, Ofgem decided to maintain the gas metering price controls as we were not content that competition had developed sufficiently. We decided to review these arrangements in 2008, however due to the ongoing competition act investigation into National Grids metering contracts we decided to defer our review.

In December 2010, Ofgem published the initial findings of the ROMA review, which had two main components; one seeking to understand the impact of lifting the price controls on DNOs in 2006, the second to understand how the market was functioning with a view to introducing remedies and lessons learnt were appropriate to support the rollout of smart meters.

In parallel with the ROMA the smart metering policy has made significant progress, with a clear timetable being set by government to support the rollout of smart meters. In this context, the role for traditional meters has been defined which has accelerated the need to consider the regulatory and policy framework for dumb meters.

It is government policy to mandate the rollout of smart meters to domestic customers and small non-domestic customers. This is a key part of its agenda to support Great Britain's transition to a low-carbon economy and is intended to help meet some of the long-term challenges of ensuring an affordable, secure and sustainable energy supply.

The government has established the Smart Metering Implementation Programme ('the Programme') and is proposing that suppliers will be obliged to install smart meters in all domestic premises by 2019. The government has published a consultation on its first set of regulatory proposals, covering obligations on suppliers in relation to the rollout and the technical specifications for smart meters.

Ofgem continues to work with government and advise them on the current regulatory framework to help deliver this agenda. Against this backdrop the ROMA has shifted focus to reflect the developments of the smart metering policy. We are developing an appropriate strategy to ensure that the traditional metering market remains fit for purpose and complements the transition to smart meters whilst identifying necessary changes within the market.

Appendix 3 - Glossary

C

Commercial Arrangements

The entry into a contract for services between parties, for example such as suppliers and metering businesses.

Commercial Interoperability

The contractual terms on which a new supplier can use the meter and related equipment when a customer changes supplier.

Consumer

A person or organisation using electricity or gas at a meter point.

Contractual Terms

The offer of commercial arrangements.

Correspondence

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

D

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.

Daily credit meter (DCM)

A standard domestic meter.

DCM price controls

DCM price controls relate to provision and maintenance of new and replacement daily credit meters, installed between the present and the mandate of smart meters.

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

Energy Suppliers (suppliers)

A company licensed by Ofgem to sell energy to and bill customers in Great Britain.

G

Gas Act Owner (GAO)

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).

Gas Distribution Network (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.

Gas Transporter (GT)

A company, licensed by Ofgem, which transports gas through its network on behalf of a gas shipper.

L

Licence

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

Metering Agent

A person or undertaking which undertakes any or all of the MAP, MAM or MOp activities (and which are defined below).

Metering Assets

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.

Meter Asset Manager (MAM)

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.

Meter Asset Provision/Meter Asset Provider (MAP)

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.

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.

Meter Provider of Last Resort (MPOLR)

The GDNs who are obliged to provide gas meters at the request of a supplier to customers.

Metering services

The provision, installation, commissioning, inspection, repairing, alteration, repositioning, removal, renewal and maintenance of the whole or part of an installed gas or electricity meter.

Metering work

The completion of some aspect of metering services on the metering assets.

P

Pre payment meter (PPM or DPM)

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.

PPM price control

PPM price controls relate to provision and maintenance of new and replacement prepayment meters, installed during the same period as DCM new and replacement.

PPM service

metering services associated with PPM meters.

S

Smart meter

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.

T

Traditional meter

A meter for registering the consumption of gas volume or electrical energy, which does not have any advance or smart metering functionality as prescribed or approved by government. This refers to both DCM and PPM meter types.

V

Vertically Integrated Company

A supply company whose business also includes at least one of: metering services and ownership of the metering assets.

Appendix 4 - 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:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk