

Gas Transporters, industry
participants and other interested
parties

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Dear Colleague,

Decision to modify gas transporters licence conditions following our statutory consultation on the regulation of traditional gas metering during the transition to smart meters

Today, Ofgem is issuing notices¹ to make changes to the gas transporters' licence. This follows our October statutory consultation on the regulation of traditional gas metering during the transition to smart meters², which closed on 30 November 2013.

The statutory consultation set out our proposed decision for managing the transition from traditional meters to smart meters, and followed the Review of Metering Arrangements (RoMA) which Ofgem concluded 25 July 2012.

The government has decided to roll-out smart meters by end 2020, therefore the traditional gas metering market is in decline. It is therefore plausible that a recently installed traditional gas meter may be exposed to asset stranding. The Gas Distribution Network Operators (GDNs) are therefore exposed to this risk if they provide a traditional gas meter at the regulated tariff cap, when requested to do so by a supplier.

The policy set out in this decision letter, and the modifications we have made to the gas transporter licence, as set out in a Notice dated 6 December 2013, represent a package of measures to address this issue. The measures seek to effectively manage the decline of the traditional metering market while ensuring that consumers are protected during the transition to smart metering. In coming to this decision, Ofgem has taken into account all representations made to it, as well as its relevant statutory duties. Our proposed decision set out in the statutory consultation:

- Revises the regulated traditional gas metering tariff;
- Places an obligation on National Grid (NG) to provide a Backstop Meter Provider of Last Resort (B-MPoLR) service;
- Introduces reforms to GDNs obligations to provide meters when requested to do so by a supplier (known as meter provider of last resort (MPoLR)); and

¹ The notices making changes to gas transporters licences can be found on our website:

<https://www.ofgem.gov.uk/gas/retail-market/metering/transition-smart-meters>

² The October statutory consultation appears on the Ofgem website here: <https://www.ofgem.gov.uk/ofgem-publications/84201/proposeddecisionontherequallitionoftraditionalgasmeteringandstatutoryconsultation.pdf>

- Provides a mechanism for non National Grid GDNs to recover efficiently incurred metering costs.

We consulted on these measures in November and we received four non confidential and one confidential response. The non confidential responses are available to read on our website³. Stakeholders were broadly content with our proposed decision. Stakeholders' responses to the statutory consultation are set out below and grouped into two main themes, 1) the MPoLR obligation and 2) revised gas metering tariff.

Meter provider of last resort obligation

The MPoLR obligation is a requirement of the GDN's licence, which requires it to provide a traditional domestic sized meter at a regulated tariff, when requested to do so by a gas supplier. In our July 2012 policy decision document⁴, we set out our policy decision that GDNs would continue to be obliged to provide meters at the regulated tariff cap, when requested to do so by a gas supplier. We decided that the obligation would be lifted when suppliers are required to install smart meters for all new and replacement meters⁵.

Respondents' views

One of the GDNs commented that it would have preferred the MPoLR obligation to be removed completely as metering is a competitive activity. It did however welcome that Ofgem had recognised the issue in its statutory consultation. Another GDN commented that they were generally comfortable with Ofgem's proposed decision and considered that all material considerations had been appropriately addressed in the statutory consultation. A large supplier confirmed that they were content with our proposed decision in respect of the MPoLR obligation. A consumer body expressed concern that in the event the MPoLR or B-MPoLR obligation is lifted, customers may suffer a decline in traditional gas metering services.

Ofgem's decision

We consider that it is not appropriate to lift the MPoLR obligation on GDNs at this stage, but instead synchronise its removal with the roll-out of smart meters.

We have decided to place an obligation in NG's licence to provide a B-MPoLR service. This will, firstly protect consumers by ensuring that traditional meters remain available in the run up to smart meters, and secondly it will allow GDNs to discharge their MPoLR obligation through NG.

We would like to highlight that the removal of the MPoLR mechanism does not remove a licensee's obligations under Schedule 2B of the Gas Act in relation to the maintenance of meters owned by them.

In addition to NG's new responsibilities under the B-MPoLR mechanism, NG has agreed to provide a commercial asset transfer mechanism, which will allow GDNs / meter asset managers to transfer their existing assets to NG on a commercial basis. We expect the terms to be fair, equitable and non-discriminatory.

Revised gas metering tariffs

³ The response to the statutory consultation can be found on our website: <https://www.ofgem.gov.uk/gas/retail-market/metering/transition-smart-meters>

⁴ The July policy decision document can be found on our website: <https://www.ofgem.gov.uk/ofgem-publications/41961/final-policy-decision-document-25-07-12.pdf>

⁵ Gas Suppliers standard conditions, condition 33.

Gas Distribution Networks are obliged under licence to provide domestic sized meters to suppliers when requested to do so, subject to a tariff cap, last set by Ofgem in 2001. The tariff cap specifies maximum levels for charges for domestic credit meters, and the payment differential between credit and prepayment meters. In July 2012, we published our decision to review the existing metering tariff caps and set out the key areas for consideration. We asked NG to develop and consult on proposals for revising the tariff caps. On receipt of NG's proposals, we conducted further analysis. Our proposed decision reduced the credit domestic metering tariff cap by £1.81 from the current level, and maintained the price differential between the credit and prepayment tariffs. Overall, the decision reduces regulated gas metering charges by £69m in the transition to smart metering.

Respondents' views

A large supplier welcomed Ofgem's recognition that NG's proposal was overstated in terms of the regulatory asset value, risk premium and rental rates. It also highlighted that in the event the roll-out profile of smart metering changed again, the current tariff cap may be beneficial to NG. Furthermore, it considered that the reduction to the regulated tariff could have been greater. The same supplier considered that the industry would have been better served had the RoMA consultation been concluded prior to or at least at the same time as Ofgem's consultation on NG's revised Meter Service Agreements (MSAs)⁶.

One GDN conveyed its disappointment that Ofgem proposed to apply the tariff caps to the non National Grid networks because the tariff reduction would make it even more difficult for it to recover its full costs. It did however welcome the acknowledgement from Ofgem of the requirement to address the shortfall in revenue in comparison to costs. One other GDN welcomed the policy to allow their efficiently incurred regulated metering costs to be recovered – subject to satisfying certain criteria. A GDN suggested that it would be useful if Ofgem made it clear in its final notice how it intended to give effect to the cost recovery mechanism.

A consumer body suggested that the Competition Commission's provisional determinations in respect of Northern Ireland Electricity of 12 November 2013 might have some bearing on the RIIO-ED1 equity calculations, which may also be relevant to the gas metering price control.

Ofgem's decision

We consider overall that the proposed tariff represents a fair allocation of risk and reward between NG and consumers. In the event the roll-out of smart meters departs materially from the suppliers' current roll-out profile, it may be necessary to review the level of regulated tariff cap in the future. We have decided to reduce the tariff for domestic credit gas meters charges by £1.81 and maintain the differential cap between domestic and prepayment meters. Our decision ensures that all customers of regulated gas meters benefit from lower charges.

In December 2011, Ofgem published its Review of Metering Arrangements (Decision and consultation on transition to smart meters)⁷, which set out our preferred option for reviewing the regulated gas metering tariff. Following the Competition Appeal Tribunal in *National Grid v GEMA*⁸, Ofgem engaged with parties concerned in order to bring any future

⁶ Open Letter March 2012 – proposed terms of alternative contract between National Grid and Suppliers in respect of certain domestic gas meters can be found at the link below:

<https://www.ofgem.gov.uk/ofgem-publications/37858/proposed-terms-alternative-contract-between-national-grid-and-suppliers.pdf>

⁷ <https://www.ofgem.gov.uk/ofgem-publications/41962/roma-final-decision.pdf>

⁸ Ofgem's governing body is the Gas and Electricity Markets Authority and is referred to variously as GEMA or the Authority.

contracts in line with the competition rules and published its decision letter in March 2012. Given the sequence of events, we consider industry had sufficient visibility of our plans, to make informed decisions in respect of procuring metering services. In any event, the two projects were initiated by different drivers and had very distinct timelines, therefore we do not consider it was appropriate to bring forward the outcome of the gas metering price control review, or defer our consultation on the MSAs.

We considered that it was not appropriate or proportional to set individual metering tariff caps for each of the GDNs given the relatively small market share and overall materiality. In the event that non National Grid GDNs have been unable to recover future meter revenues because of premature replacement, they can make an application to Ofgem. We have decided to allow the non National Grid GDNs to recover efficiently incurred costs under the existing RIIO-GD1 price control, subject to meeting certain conditions as specified in the statutory consultation.

We consider that the cost of equity for RIIO-ED1 is not relevant for the purpose of the gas metering price control. We have set a rate of return for regulated gas metering consistent with that set in the RIIO-GD1 final decision.

Next Steps

The changes set out in this decision letter and attached notice will come into effect 1 April 2014.

Yours faithfully

Maxine Frerk

Partner Retail Markets & Research