

Rates on Gas Meters

Initial Consultation Document

May 2003 31/03

Summary

Rates are a tax on an asset. An inconsistency has been brought to Ofgem's attention in regard to the treatment of rates on gas meters. The inconsistency means that Transco is the only gas meter operator to pay rates on meters connected to its network.

This discrepancy was brought to the attention of the Office of the Deputy Prime Minister (ODPM). After consultation, ODPM decided that an amendment would need to be made to the Local Government Finance Act 1988 to rectify this situation. This amendment has been introduced as part of the Local Government Bill 2003 and means that all rates on meters will be an obligation on Transco's network business rather than on metering businesses. The amendment will not automatically lead to changes in the price of Transco's meters which are covered by a price control.

Ofgem's current view is that the most appropriate mechanism for ensuring that the amendment has its desired effect is to have Transco pay the rates on its entire network, including meters, and recover this through its transportation price control.

To facilitate this Ofgem is considering changing the Transco licence to reflect this transfer of rates. Ofgem is currently proposing to allow Transco to recover the rates under Special Condition 28B of its licence and to reduce the metering price caps under Special Condition 31. It is not expected that this will have any significant impact on customers.

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1. Rationale

Issue

- 1.1. It has become clear to Ofgem and the Office of Deputy Prime Minister (ODPM) that there is an inconsistency in the application of rates on meters.
- 1.2. Currently, whilst Transco is required to pay rates on its meters, another meter provider would not be required to pay rates on a meter connected to Transco's transportation network. Therefore Transco faces an element of cost in providing meters that is not faced by other metering companies.
- 1.3. This inconsistency means that Transco is at a competitive disadvantage in the gas metering markets. This can be expected to encourage inefficient entry into the metering market, if companies that have higher costs than Transco can undercut Transco due to the discriminatory effect of rates. This will lead to an increase in the costs of gas metering to the detriment of customers and could lead to poor investment decisions made by Transco and competitors.
- 1.4. Following a meeting with the Department of Transport, Local Government and the Regions (DTLR)¹ and interested industry parties on 7 August 2002 to discuss the options for the treatment of rates on meters the ODPM has introduced legislation, as part of the Local Government Bill 2003, to facilitate the transfer of rates.
- 1.5. Under the proposed approach network monopoly companies (i.e. Transco and the distribution network operators) will pay rates on all meters connected to their network regardless of who owns them.

Objective

- 1.6. Since Transco's activities are subject to a price control the changes in the rating regime will not automatically be passed through and result in lower metering

¹ At that time the DTLR was the government department with responsibility for local government issues in England. Since then responsibility has been transferred to ODPM.

charges. This document therefore considers options for ensuring that the change in rates will lead to the correct changes in customer charges.

- 1.7. The document also discusses whether this change should be brought in before the formal change in the rating regime. An early change would not increase the amount of money Transco receives but would remove the distortion caused by differential charging regimes.

Policy

- 1.8. Transco have suggested that the solution could be implemented through metering contracts with shippers. However Ofgem currently considers that an approach based on modifying the metering price control would lead to greater certainty and ensure that the change in the rating regime is passed through accurately.

2. Timetable and Responses

2.1. Ofgem would welcome views on the issues raised in this document. All responses will normally be published on the Ofgem website and held electronically in the Ofgem Research and Information Centre unless there are reasons why they must remain confidential. Where possible any confidential material should be placed in appendices in responses. Ofgem prefers to receive responses in an electronic form so they can easily be placed on the Ofgem website.

2.2. Ofgem would like to receive comments by **11 July 2003**. Please send any comments to:

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2.3. If there are any questions regarding this document please contact Mark Allen (mark.allen@ofgem.gov.uk) on 020 7901 7005.

3. Background

- 3.1. Prescribed rates are a tax on assets. Currently, rates are charged on the transporter's network, including meter assets. When metering services were separated from Transco's transportation business for price control purposes, the rates paid on the network were allocated between National Transportation System Transportation Owner (NTS TO), Local Distribution Zone transportation (LDZ) and metering activities. The Transco metering price control was determined taking into account rates that had been allocated to the metering part of the business.
- 3.2. However, as the rates are currently charged on the transporter's network as a whole, the meter asset is not recognised as a separate rateable object from the rest of the network. Therefore prescribed rates are charged only on those meter assets belonging to the transporter. New entrant meter operators do not have to pay rates on the meters they own. This means that Transco is at a competitive disadvantage being the only significant meter asset provider on Transco's network which is required to pay rates on its meters, with these costs being reflected in the charges they levy for metering services.
- 3.3. The Local Government Bill 2003 has been introduced into Parliament. This Bill introduces subsection 2A into section 64 of the Local Government Finance Act 1988. Broadly, this subsection identifies a meter as a rateable asset where the meter is owned by a person other than the consumer of the service. The Secretary of State, in relation to England, and the National Assembly for Wales, in regards to Wales, may by way of regulations under clause 127(6) make provision regarding the commencement of subsection 2A of s64 of the Local Government Finance Act.
- 3.4. If Ofgem considers that a modification to Transco's licence is necessary section 23 of the Gas Act 1986 requires a consultation be conducted. The consultation must be of at least 28 days and include any person likely to be affected by the making of the modification. For the avoidance of doubt this document is a consultation on the general issue and does not constitute a formal consultation for a licence change as required by the Gas Act.

4. Analysis

Why the need to change?

- 4.1. Rates are charged on the transportation network as a whole. If a person other than Transco owns a meter connected to Transco's network then that meter is not subject to rates. This creates an incentive for players to enter the gas metering market inefficiently.
- 4.2. Ofgem therefore considered it desirable that a fair and non-discriminatory mechanism be developed for the collection of rates so that certain meter operators are not disadvantaged.
- 4.3. ODPM consulted on a proposal to levy the rates on all meter asset providers in order to remove the bias in the metering market. This was considered by industry to be inefficient and complex to administer. Following industry consultation it was therefore decided by the ODPM that rates would be levied on all meters (regardless of ownership) and charged to the transporter who could pass on the cost.
- 4.4. As noted in the background, legislation has been introduced which facilitates the charging of rates on meters to Transco, even where Transco is not the owner. The change will come into effect on a date to be specified by the Secretary of State. Due to the nature of the Parliamentary process it is difficult to ascertain a date for this with any certainty.

Proposal

- 4.5. In the light of this legislative change, Ofgem is proposing to amend Transco's price control. This amendment will have the effect of transferring the revenues allowed to cover the costs of rates on meters from the metering price control to the transportation revenue controls.
- 4.6. In particular, the proposal is to reduce the metering price control under Transco's special licence condition 31. Transco would then be permitted to recover the revenue forgone from lowering metering prices through the transportation side of its business.

- 4.7. Ofgem anticipates that the fall in the cost of those meters that currently attract rates will be reflected in the charges for all those meters. The fall in meter charges should not be used to benefit customers with some types of meter to the detriment of customers using other meter types. In particular we would regard Special Condition 32 of Transco's licence as requiring that charges for those metering services not covered by explicit price controls would fall to a similar degree.
- 4.8. In the short term the aggregate costs to end customers would not be changed by this proposal, it would simply be a re-apportionment of revenues. In the longer term this should prevent inefficient entry and reduce, or avoid increases in, costs to consumers.
- 4.9. However, since the costs associated with rates are being reallocated from a fixed asset (i.e. a meter) to a variable activity (i.e. transportation) there may be some minor redistributive effect whereby customers with relatively low meter costs that consume higher quantities of gas face an increasing proportion of the costs. Whereas customers in the opposite set of circumstances, relatively low quantities of gas and higher metering costs, may benefit slightly.
- 4.10. The benefit of this proposal is that it removes a distortion from the gas metering market. Further, the proposal does so through a mechanism that is administratively simple for industry.

Licence Implications

- 4.11. Special condition 28B of Transco's licence regulates Transco's transportation charges. Clause 8 sets the maximum LDZ transportation activity revenue. Part of this clause allows the recovery of 83% of prescribed rates in respect of LDZ transportation activity and NTS transportation activity. An equivalent provision in clause 3 paragraph 1 allows the recovery of the remaining 17% in respect of NTS transportation owner activity.
- 4.12. No amendment is required to these provisions to allow Transco to transfer the recovery of amounts, currently allocated to metering, to transportation.
- 4.13. On the metering price control, Ofgem is proposing an amendment be made to special condition 31 to reduce the price control by an amount to reflect the

transfer of rates. This amendment would reduce the charges associated with the price controlled metering activities. The provisions of the non-discrimination provision (Special Condition 32) would mean that Ofgem would also expect the charges for non-price controlled metering activities to fall.

- 4.14. Further analysis needs to be conducted by Ofgem, in conjunction with Transco, to determine the exact amount of a reduction in the metering price cap. Ofgem anticipates that the price reduction on a domestic credit meter will be somewhere in the £1 to £1.60 range per year. This estimate could change as additional information becomes available to Ofgem. Ofgem also expect a fall in the charge for the provision of I&C meters reflecting the transfer of recovering rates to transportation.
- 4.15. Following consideration of the responses to this consultation a further formal consultation, as required by section 23 of the Gas Act, would be issued outlining the exact changes to the licence. This will include the exact amount of the reduction in the price caps.
- 4.16. Transco has suggested that a licence amendment would not be necessary as the desired result could be effected through an undertaking. This could have the benefit of being quicker and less resource intensive. However, Ofgem is not persuaded that reducing the one off administrative burden offsets the benefits that adjusting the tariff caps provide. It is Ofgem's view that the changes should be reflected in the licence, to give clarity and certainty to the industry and customers. A licence amendment would also ensure that credit meter customers do not benefit to the detriment of prepayment meter customers. Such a detriment could arise were there to be no fall in the cost of prepayment meters to offset the rise in transportation charges.

Timing

- 4.17. Given the legislative amendment and the outcome of the consultations conducted by ODPM, Ofgem considers that it is necessary to make these licence changes as without them the treatment of rates under legislation would not correlate with the treatment of rates under Transco's licence. The changes as outlined in this document will remove any uncertainty as to the treatment of rates under the new legislative approach. The proposed changes also ensure

that the increase in transportation revenue for Transco is offset by a reduction in metering revenue.

- 4.18. Before the formal legislative change occurs time would be needed for ODPM to introduce a statutory instrument to commence the legislative amendment. It is therefore difficult to be sure how long it will be before any formal regulations could come into force.
- 4.19. It is proposed to make the licence amendment in advance of the introduction of statutory changes and associated statutory instruments. Should the legislation come into operation before the necessary changes are made to the price controls it would cause significant confusion as to the appropriate recovery mechanism for rates.
- 4.20. The transfer of cost recovery for rates from the metering business to the transportation business is not reliant on the legislation being passed or the regulations coming into force. This is because Transco currently own the majority of gas meters and could be expected to pay rates on them as the legislation currently stands. To reiterate, the amendment is to facilitate the payment of rates by Transco where Transco do not own the meter, as would be expected to be the case for an increasing number of gas meters in a competitive gas meter market.
- 4.21. There are strong arguments for making the change as soon as possible in order to provide certainty to the industry and to discourage inefficient entry on the back of the current asymmetry in the arrangements for rates.
- 4.22. Given that Ofgem does not envisage licence changes on the transportation price control and given that the metering control is a price cap not a revenue control Ofgem considers that it would be possible to introduce the change part way through the financial year.
- 4.23. Ofgem does not consider that there is a case for making the change retrospective and therefore Ofgem anticipates introducing any changes to the price control regime with effect from the date on which the licence is modified.

Other issues

- 4.24. As indicated above further work is required on the detailed calculations of the reduction in metering charges.
- 4.25. Currently, the legislative amendments are only in relation to England and Wales and do not cover Scotland. The Scottish Executive participated in the consultation on the issue and is seeking to introduce legislation to enact changes to the treatment of rates on meters when parliamentary time allows. However, it will be important that any developments in Scotland are monitored to ensure that the licence changes are consistent with any changes in the region.
- 4.26. Since Ofgem's proposed changes are intended to precede the legislative changes Ofgem does not anticipate a need to wait for a specific Scottish proposals before proceeding, nor does it see a need for a separate treatment of rates on meters in relation to Transco's activities in Scotland.

Next Steps

- 4.27. Currently Ofgem is proposing to issue a Gas Act section 23 consultation document on 1 August 2003. This document will identify the specific changes that are being proposed to Transco's licence.
- 4.28. There is a requirement that the section 23 consultation run for at least 28 days. Given that the proposed modification will be determined with reference to the responses to this consultation document Ofgem is not currently minded to extend the section 23 consultation beyond 28 days.