

Rates on Gas Meters

Decision Document

September 2003

Summary

On 21 May 2003 Ofgem published a consultation document in relation to prescribed rates on gas meters.

The purpose of this consultation was to seek views on the possibility of allowing Transco to recover rates on gas meters through its transportation activities rather than its metering activities which it does currently.

A number of responses were received and were supportive of Ofgem's proposal. This document addresses the issues raised by respondents to the consultation document.

The most significant issue from Ofgem's perspective was in relation to the timing of the proposed transfer.

In the light of industry responses it is Ofgem's intention to proceed with the changes to Transco's licence. However, the changes to the licence provisions will not have effect until 1 April 2005.

The amendments to Transco's licence conditions will be made as soon as possible to provide the industry with certainty as to the future treatment of rates.

Table of contents

1. Summary Impact Assessment	1
2. Timetable	3
Contact	3
3. Background	4
4. Responses	5
Distributional effects	5
Local Government Bill	6
Amendment to special licence condition 28B	6
Timing	7
Value of Changes	8
5. Decision	10
Appendix 1 List of non-confidential respondents to May document	11

1. Summary Impact Assessment

- 1.1. Currently, whilst Transco is required to pay rates on its meters, no other meter provider is required to pay rates on a meter connected to Transco's transportation network. Therefore Transco incurs an element of cost in providing meters that is not incurred by other metering companies.
- 1.2. This inconsistency means that Transco is at a competitive disadvantage in the gas metering market. 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 in the longer term and could lead to poor investment decisions by Transco and competitors.
- 1.3. 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 Office of the Deputy Prime Minister (ODPM) has proposed legislation, as part of the Local Government Bill 2003, to facilitate the removal of the inconsistency in the treatment of rates identified above.
- 1.4. 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.
- 1.5. In its May 2003 document² Ofgem proposed making a modification to Transco's metering price controls which would have the effect of transferring the element of rates associated with metering from the metering to the transportation price control, thus eliminating the incentive for inefficient entry discussed above.
- 1.6. The current document is being issued to confirm Ofgem's decision to make this modification but to change the timing as a result of information provided in responses to the initial consultation.

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 the Office of the Deputy Prime Minister.

² "Rates on Gas Meters – Initial Consultation Document", Ofgem, May 2003

- 1.7. This document also indicates Ofgem's initial views of the values for the changes in metering price caps that will be introduced as a result of this proposal. These final changes will be the subject of a separate statutory consultation under section 23 of the Gas Act 1986.

2. Timetable

- 2.1. This decision document will be followed by a Gas Act section 23 consultation. This consultation will detail the amendments to be made to Transco's licence. Ofgem intends to issue the section 23 consultation by mid-October 2003.
- 2.2. A section 23 consultation is required to be at least 28 days. As the statutory consultation will cover changes proposed already in this document Ofgem anticipates that there will be few new issues raised in the responses to the statutory consultation. If this assumption is met the licence modification would be introduced by February 2004.
- 2.3. The amendments will commence operation on 1 April 2005. This will coincide with expected changes to the process for valuation of metering assets for rates purposes.

Contact

- 2.4. If you wish to comment on this document before the issuing of the section 23 notice please contact either David Howdon (Tel: 020 7901 7420, email: david.howdon@ofgem.gov.uk) or Mark Allen (Tel: 020 7901 7005, email: mark.allen@ofgem.gov.uk).

3. Background

- 3.1. The May document outlined a proposal to transfer the revenue associated with the recovery of gas rates on meters from Transco's metering business to its transportation business. The original proposal was to make this change as soon as possible.
- 3.2. Ofgem called for responses to the issues outlined in the consultation document. A number of responses were received. The non-confidential responses can be found on the Ofgem website (www.ofgem.gov.uk).
- 3.3. This document is being published to announce the outcome of the consultation and outline Ofgem's approach to the issues raised in the consultation.

4. Responses

- 4.1. Five responses were received and raised a variety of issues in relation to the proposal. One response was wholly confidential and one contained confidential elements. All respondents supported the proposal to transfer the recovery of rates to transportation. However, respondents raised a number of issues with the proposal. The concerns raised are addressed below.

Distributional effects

Respondents' views

- 4.2. One respondent indicated that as the recovery of rates is being reallocated from a fixed activity to a variable activity some customers may see increases or decreases in their costs depending on the amount of gas consumed. They asked for further analysis to be done to establish the exact amount of this change and to quantify any significant impacts of the reallocation.

Ofgem's view

- 4.3. The proposals here include details of the proposed changes to the metering price caps. This will enable consumers and suppliers to determine the change in their costs as a result of the proposed change.
- 4.4. There will be two main ways in which this policy could have redistributive effects. Firstly the redistribution could transfer monies from customers with single meters to customers at multi-metered sites as the latter will benefit most from the reduction in metering charges. Secondly the change could transfer monies from those customers with high consumptions to those with low consumptions. However, the amount of money involved in these changes will be relatively small and therefore as noted in the consultation document Ofgem does not anticipate that any distributional effects would be significant.

Local Government Bill

Respondents' views

- 4.5. One respondent expressed the view that meters should be removed from the assessment of rates entirely. The respondent also indicated that their understanding of the provisions of the Local Government Bill was that it would operate differently from the way outlined by Ofgem in its consultation document.

Ofgem's view

- 4.6. Ofgem have sought the Office of Deputy Prime Minister's (ODPM) advice on the operation of the Local Government Bill. ODPM have indicated that the Bill and subordinate legislation will enable rates to be levied against the network provider for all meters connected to that network. Ofgem notes that the question of what items are subject to rates is not a matter over which Ofgem has any *vires*.

Amendment to special licence condition 28B

Respondents' views

- 4.7. One respondent did not agree with Ofgem's view that no amendment will be required to Transco's Special Condition 28B. They note that clause 8 and clause 3 of special condition 28B set out the maximum Local Distribution Zone ('LDZ') and National Transmission System ('NTS') allowed revenues and refer to the terms LDZFt and TOFt (defined in the licence condition) respectively. They additionally note that these paragraphs and terms allow for the recovery of 100% of prescribed rates in respect of LDZ transportation and NTS transportation activity.

Ofgem's view

- 4.8. Following the concern raised about the operation of these provisions, Ofgem looked again at the operation of special condition 28B. Ofgem remains confident that its understanding of the operation of special condition 28B is

accurate. It is Ofgem's understanding that the rates bill that Transco faces does not explicitly identify certain parts of rates as being allocated to Transco's metering business. Therefore, this is compatible with recovering rates through LDZFt and TOFt in special condition 28B. Transco have indicated their willingness to undertake this transfer so there is no requirement for Ofgem to require the transfer under special licence condition 29.

Timing

Respondents' views

- 4.9. One respondent indicated in a confidential response that they had concerns about the timeframe for the changes that Ofgem were outlining. Whilst the confidential nature of the response makes it inappropriate to go into the detail of the concerns they centred on the impact of the timing of the change and its effect of transferring money from suppliers to Transco.
- 4.10. The respondent indicated that they and others were close to finalising contracts in relation to the provision of metering services on which the transfer of rates would have a material impact.
- 4.11. The respondent also indicated that the previous discussions on this issue had created an expectation in industry that the changes would be introduced from 1 April 2005 when the statutory changes are introduced by ODPM.
- 4.12. Transco supported Ofgem's proposal to introduce the charges at an earlier date.

Ofgem's view

- 4.13. That Transco and suppliers are negotiating, or have entered into, a commercial contract is not a relevant factor for Ofgem to consider in making its decisions.
- 4.14. Ofgem accepts the view that the industry had anticipated an introduction in 1 April 2005. Making the current changes through regulatory action, on the timescales originally proposed, could be perceived as increasing regulatory uncertainty. Given that delaying the effective date will have minimal impact of the extent of inefficient entry for the reasons set out below, Ofgem has decided

that the changes should only be introduced with effect from 1 April 2005, in line with the changes to the rates regime as we currently anticipate them.

- 4.15. However in order to address the concerns about incentives for inefficient entry Ofgem will make the change to Transco's price control as soon as possible although it will only be effective from April 2005. This will reduce uncertainty and significantly reduce the incentive for inefficient entry as any entrants, and those signing contracts with them, will be aware that the "distortion" will be removed in less than two years.

Value of Changes

Respondents Views

- 4.16. One respondent had raised concerns that Ofgem was unable to provide a more accurate estimate of the reduction in the price caps.
- 4.17. Transco also raised with Ofgem its views on how the change in the metering price caps should be calculated. Ofgem and Transco have had further discussions on this matter prior to the issuing of this document.

Ofgem's Views

- 4.18. Ofgem has come to an initial conclusion as to the appropriate value for the reduction in the level of the metering price control. All prices in this paragraph are given in 2003 prices. The reduction will be £1.10 per domestic meter per annum. This figure was derived by taking the amount of metering rates in Transco's regulatory accounts and allocating it between domestic and I&C meters on the basis of Regulatory Asset Value ('RAV'). The value of rates allocated to the domestic sector was then divided by the number of domestic meters to give a per meter reduction of £1.10.
- 4.19. Using a similar basis for I&C meters but taking metering revenue rather than meter numbers to allocate the savings, Ofgem would expect to see an overall reduction of 6% in I&C meter charges. I&C meter charges are not explicitly set in Transco's licence, but are covered by the non-discrimination provisions in special licence condition 32.

4.20. In coming weeks Ofgem will be confirming and verifying the datasets used in these calculations and the figures in the Gas Act section 23 consultation may vary slightly from those proposed above.

5. Decision

- 5.1. In light of the responses to our May consultation document Ofgem is proposing to proceed with the transfer of the recovery of rates from the metering price control to the transportation price control.
- 5.2. This transfer will take place on 1 April 2005. The new price controlled charges from 1 April 2005 are illustrated in Table 1.

Table 1 - Metering price caps with effect from 1 April 2005 (2003 prices)

	Domestic Credit Meter	Domestic Prepayment Meter
Price Cap	£12.03	£28.06

- 5.3. The specific charges for provision, installation and maintenance of meters are not set by Ofgem. The charges for I&C metering are expected to come down by 6% with the reduction being in the element associated with meter provision charges.
- 5.4. The 1 April 2005 implementation date will coincide with the expected date of changes to the basis to valuation for rates purposes of gas assets. This will enable the industry to deal with the changes jointly rather than at two separate stages. It is also consistent with the generally held industry perception prior to Ofgem's May document.
- 5.5. Ofgem propose that amendments be made to the licence as soon as possible in order to provide the industry with certainty as to the outcome and the timing of the transfer. Ofgem will be issuing a Gas Act section 23 consultation on the details of the amendment. Ofgem anticipates that this notice will be issued before the end of mid-October 2003.

Appendix 1 List of non-confidential respondents to May document

1.1 This appendix lists those respondents whose responses were wholly or partially non-confidential:

- ◆ East Midlands Electricity
- ◆ Scottish and Southern Energy
- ◆ Scottish Power
- ◆ Transco