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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1099/1/2/08

Victoria House,
Bloomsbury Place,
London WC1A 2EB

20th January 2009

Before:

VIVIEN ROSE
(Chairman)
PROFESSOR PAUL STONEMAN
DAVID SUMMERS

Sitting as a Tribunal in England and Wales

BETWEEN:

NATIONAL GRID PLC

Appellant

- v -

THE GAS AND ELECTRICITY MARKETS AUTHORITY

Respondent

supported by

SIEMENS PLC
CAPITAL METERS LIMITED
METER FIT (NORTH WEST) LIMITED
METER FIT (NORTH EAST) LIMITED

Interveners

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HEARING (DAY 4)

APPEARANCES

Mr Jon Turner QC, Mr Josh Holmes, Mr Meredith Pickford and Miss Laura Elizabeth John (instructed by Pinsent Masons LLP) appeared for the Appellant.

Ms Monica Carss-Frisk QC, Mr Brian Kennelly and Mr Tristan Jones (instructed by Ofgem) appeared for the Respondent.

Mr Christopher Vajda QC and Miss Kassie Smith (instructed by Hill Hofstetter LLP) appeared on behalf of Siemens Plc.

Mr Christopher Vajda QC and Mr Ben Rayment (instructed by Slaughter and May) appeared on behalf of Capital Meters Limited.

Mr Fergus Randolph and Ms Sarah Abram (instructed by United Utilities Group plc) appeared on behalf of Meter Fit.

1 THE CHAIRMAN: Good morning. Mr. Randolph?

2 MR. RANDOLPH: There are two discrete areas in addition to those I was dealing with yesterday
3 that I was going to touch on this morning briefly - meter replacement through maintenance
4 and volumes. Just on the first point - maintenance - just one document I would like to take
5 you to, if I may. In witness statement Bundle 1, Tab 2, p.763. As you can see at p.757 this
6 is part of a response from Centrica to the s.26 request, and it is dated 3rd February 2006.
7 763, the question is:

8 “Evidence provided to Ofgem suggests that following visits to maintain meters,
9 NGG replaced a number of BGT meters. How did this affect the annual maximum
10 number of meters that BGT is permitted to replace? Did NGG offer any resolution
11 to this, such as selling the NGG asset to BGT’s preferred MAM?
12 BGT can confirm that there has been, and continues to be a substantial volume of
13 meters exchanged resulting from NG maintenance visits. For example, we are
14 aware of exchange volumes in the region of 50-60,000 per year for Prepayment
15 Meters. BGT suspects that instead of carrying out routine maintenance such as
16 battery replacement, meters are being unnecessarily exchanged. In reality, each
17 meter exchanged as a result of an NG maintenance visit, notwithstanding the
18 number of meters available for exchange in the ‘policy replacement pot’ is one less
19 meter in the overall figure available for exchange by BGT’s CMOs.”

20 That, madam, is, I think, the point that you were referring to on day 2, p.37 of the transcript,
21 lines 24 to 26, when you were debating the matter with Mr. Turner – one for them is one
22 less for us.

23 THE CHAIRMAN: Yes.

24 MR. RANDOLPH: So that is the only point on meter maintenance that I would wish to take the
25 Tribunal to.

26 The remaining issue relates to volume. The Tribunal will recall that yesterday at the end of
27 the day, Mr. Turner said – this is for the note – transcript day 3, p.71, line 27:

28 “Our position is that only in so far as these matters are relevant the following are
29 our propositions: that Meter Fit’s volumes were not significantly reduced ...”

30 Then he goes on. That is fine, so they were reduced, but not significantly, according to
31 Mr. Turner. We do not agree with the “significant”, but we agree with the reduction.
32 By an email sent to me later that afternoon, Mr. Turner said that he wanted to emphasise
33 what his position was to avoid any misunderstandings, and he said that in respect of
34 reductions in volumes for Meter Fit there were none. We simply do not understand that

1 *volte face*, not least because in his note or in National Grid's note on the effects on CMOs –
2 do you have a copy of that? This is the note handed up on the second day of the hearing, it
3 is undated?

4 THE CHAIRMAN: What is it called?

5 MR. RANDOLPH: It is called "National Grid note on effects on CMOs". At p.5 of that note we
6 have a table, and I will go to this in a moment in slightly more detail, one can see "Original
7 volumes" along the top and then "Revised volumes" in the second section. If one simply
8 adds up both the original volumes and the revised volumes, the original volumes total some
9 692,743 and the revised volumes come to, depending on the analysis on Grid's approach,
10 either 648,619 or 652,781. In any event, there is a reduction over the period.

11 Madam, to make sure that I comply with my self-styled ordinance of stopping in time, we
12 have prepared a note which is in response to Mr. Turner's note on effects of CMOs. I
13 wonder if I could hand that up. (Same handed) I can take this very briefly because I do not
14 wish to take up the time of the Tribunal. The first point in response to the effects on CMOs,
15 and it may be helpful and sensible to have Mr. Turner's note on the effects on CMOs open
16 at p.4 which deals with Meter Fit, and then our responsive note open at p.2. The first point
17 that Mr. Turner makes is that they do not consider Meter Fit's submissions on volumes to
18 be admissible. We set out why we do not believe that is correct. It is without prejudice to
19 the point on admissibility that National Grid goes on to set out what it says are the volumes
20 over the original period and over the revised period. As I have taken you to in the National
21 Grid table, one can see that there is a clear reduction. If, in fact, you turn to p.5 of our note,
22 madam, you can see that based on the figures as we say they should be, they are not very
23 different, as you can see from the figures set out in National Grid's note. The original
24 contract volumes are the same. The renegotiated volumes are very similar. The figure we
25 get to in the Total Years 1 to 5 column is some 647,529. That makes a difference, a
26 reduction from the original contract volumes of some 45,000-odd meters. Also, it has been
27 calculated that the average years between 1 and 5 have been reduced as well. As one can
28 see from para. 6, the total and average volumes decreased by around 7 percent. We say this
29 is all-important. One of the points Mr. Turner makes is, "Oh, this is all inadmissible
30 because it is far too late". Actually, if one looks back, this whole issue was raised first by
31 Grid in its Notice of Appeal. It is all set out in the note to which Mr. Paul King, on behalf of
32 Meter Fit responded specifically, saying, "No. Volume is reduced". National Grid say
33 volumes were not reduced. Meter Fit say, yes, they were reduced further to the
34 renegotiation of the contract terms. That is important because we then link what we say is a

1 very clear factual position. We link that to the MSAs. We say that the volumes were
2 reduced because of the effect of the MSAs. We say that for the reasons set out in Mr. King's
3 evidence as is synthesised in his note from paras. 7 through to 9. That sets out in summary
4 form what Mr. King's evidence is on that.

5 We say that that supports the finding at 4.103 in the Decision. It may be helpful just to turn
6 that up at CB1, p.90. This is the section in the Decision dealing with actual as opposed to
7 likely foreclosure. The finding of the Authority, which we strongly endorse at 4.103 is:

8 "When BGT (which, at the time, represented approximately 60 % of the domestic
9 sized meter demand in Great Britain) became aware of the terms that NG was
10 proposing to it in the MSAs, BGT reduced the quantities of meters which it was
11 willing to procure from CMOs, having previously been in negotiations with a
12 number of CMOs to diversify its supplies of gas meters."

13 We say that that general statement is borne out in particular insofar as concerns Meter Fit by
14 the tables that we have just been looking at which show that between the original contract
15 agreed in 2002, and the renegotiated contract which came into effect as of June 2004
16 volumes were reduced and we say, and again I think we would follow Mr. Vajda here ----

17 THE CHAIRMAN: Well in para. 4.106 the point that is made there as regards Meter Fit is not to
18 do with the reduction in volumes it is to do with the imposition ----

19 MR. RANDOLPH: Volume cap.

20 THE CHAIRMAN: -- of the maximum cap.

21 MR. RANDOLPH: We say that is an example given by the Authority, they are just saying this is
22 because of a specific point that has been raised by Meter Fit during the course of I think the
23 Administrative proceedings. But we say the general principle, as found by Ofgem that
24 volumes reduced because of the impact of the MSAs is borne out in the evidence by the
25 reduction in volumes of meters available to Meter Fit under the renegotiated British Gas
26 contract.

27 THE CHAIRMAN: That depends really on whether under the pre-negotiation you would have
28 been able to carry forward the shortfall that occurred in year one into the subsequent years
29 because it looks on the face of the table that a lot of the disparity between the total years 1
30 to 5 under the original contract and volumes in the total years one to five under the
31 renegotiated contract volumes arises because of the difference in year one, which had
32 already gone past by the time the contract was renegotiated.

33 MR. RANDOLPH: The problem with year one was obviously a key year and the evidence is
34 there were major teething problems and that therefore volumes were not met, and the

1 evidence is that there were problems both ends with BG and Meter Fit, and it was because
2 of that the Meter Fit contract came into operation in November 2002. So November 2002 –
3 November 2003 is the first year, difficulties, not surprising we were the first player of
4 competitive market, there were teething problems and practical problems, it had to be
5 renegotiated both ways. We say one of the concerns that BG had in the renegotiation was
6 the fact that obviously it was in Meter Fit’s interest to seek to have more volumes. One of
7 the problems in that negotiation for BG was if they allowed for any increase that could
8 impact going forward on the MSAs for obvious reasons. So what National Grid did – I can
9 understand why they did it, but we say it is wrong – is they took a snapshot between years
10 three and five and said: “Okay, in that particular period ...” and it is admitted in Paul King’s
11 statement “... for a snapshot, yes, there was an increase”, but overall, which is what the
12 Tribunal we submit should be looking at – overall – over the term of the primary period
13 within which Meter fit were allowed to install, overall the volume is reduced. We say a
14 major reason for that was the fear by BGT of the impact of the MSAs, and that is simply our
15 case.

16 From our point of view we accept and endorse Mr. Turner’s approach to the position
17 yesterday insofar as reduction is concerned, not insofar as how substantial it was; we say it
18 was substantial, 7 per cent, 45,000 meters is substantial, and again it is with regret that we
19 cannot agree with Miss Carss-Frisk – what is modest to her may well be substantial to
20 Meter Fit. But put that to one side, we endorse that, we do not accept the volte face put
21 forward in an email last night, it does not make sense on the basis of this data. We go on to
22 say – and this is where we would part company with Grid – that that reduction, substantial
23 or otherwise, was due to, in part, the effect of the MSAs, and that is our case, and that is
24 why we support Ofgem’s finding with regard to actual foreclosure at para. 4.103.

25 PROFESSOR STONEMAN: Can I ask you about this first year, the number of meters replaced
26 in the first year of contract was below the original contract volumes?

27 MR. RANDOLPH: Yes.

28 PROFESSOR STONEMAN: Does that mean that the work was not done, or does it mean that
29 somebody else did the work?

30 MR. RANDOLPH: No.

31 PROFESSOR STONEMAN: Because if the work was not done then the glidepath allowance
32 goes forward. If the work was done by National Grid then it is lost to you for 18 years. Do
33 you know whether the work was not done?

1 MR. RANDOLPH: It was not done. I will take further instructions but I have to admit I had a
2 recollection at one point National Grid was forced to come in to deal with certainly policy
3 meters, because ----

4 THE CHAIRMAN: That was much later.

5 MR. RANDOLPH: It was much later, but in terms of 2002 to 2003 my understanding at present
6 is that the work simply was not done because of the teething problems.

7 PROFESSOR STONEMAN: So the glidepath allowance was moved forward.

8 MR. TURNER: Sir, this is pre the MSA coming into force.

9 MR. RANDOLPH: Oh absolutely, yes, thank you. Madam, gentlemen, unless I can be of any
10 further assistance, those are my opening submissions.

11 THE CHAIRMAN: No, well done, Mr. Randolph, thank you. Yes, Mr. Turner.

12 MR. TURNER: Madam, we will introduce our first witness, Mr. Holmes is going to take this
13 witness on behalf of National Grid.

14 MR. VAJDA: (no microphone): I am very happy ... or at any other time, but let us get on.

15 THE CHAIRMAN: Let us get on, yes, thank you, Mr. Vajda. Mr. Holmes.

16 MR. HOLMES: Before I call Mr. Avery our first witness, there is one small matter in relation to
17 confidentiality to which I should draw the Tribunal's attention. Madam, as you are aware
18 there are two categories of material claimed as confidential in the bundles. There are
19 redactions from case file documents during the Administrative procedure under part 9 of the
20 Enterprise Act 2002, and those are shown in the Tribunal's bundles by red-lining the
21 relevant material, and then there are subsequent redactions which have been made during
22 the appeal as a result of claims that the material was confidential to third parties or the
23 interveners, and that material is flagged in yellow where confidential text is included. The
24 Tribunal's bundles are, of course, fully confidential. We have prepared for National Grid's
25 witnesses a hybrid bundle for the purposes of oral examination in which the exhibits
26 contain redacted versions of the documents from the Administrative file, but in which no
27 redactions have been made in relation to the subsequent claims of confidentiality, so the
28 statements are in other words as they were originally made by the witnesses. I trust that
29 meets with the Tribunal's approval.

30 One further point, I should say that National Grid does not accept that all of the redacted
31 material in the bundles is in fact confidential, nor does it accept that its witnesses should not
32 be able to see unredacted versions of many of the documents in the case file as necessary
33 when giving their evidence, in particular documents which they themselves have prepared
34 or received, but we hope that the broad assertions to confidentiality in this case will not

1 obstruct the oral examination of our witnesses and we can perhaps deal with any problems
2 as and when they arise.

3 THE CHAIRMAN: Yes.

4 MR. HOLMES: Having said that, madam, may I call National Grid's first witness, Mr. Avery,
5 please.

6
7 Mr. NEIL CHARLES AVERY, Affirmed

8 Examined by Mr. HOLMES

9 Q Is your full name Neil Charles Avery? A. It is.

10 Q You should have in front of you a red bundle. Would you open the bundle please? Is that a
11 copy of the witness statement which you have provided in these proceedings? A. It is.

12 Q Could you turn, please to p.623 of the statement, using the pagination in the right-hand
13 corner? Can you confirm that that is your signature at the foot of that page? A. I can.

14 Q The statement is dated 17th April, 2008. A. That's correct.

15 Q I have a few short questions for you, Mr. Avery. First, in para. 1 of your statement you
16 record that when you gave the statement you were employed at Energy Watch as Director
17 of Consumer Services. Where are you now employed? A. I am now employed at
18 Consumer Focus, which was the successor body to Energy Watch. Energy Watch was
19 abolished at the end of September 2008 and its responsibilities transferred to Consumer
20 Focus.

21 Q What is your current position at Consumer Focus? A. I'm still Director of Consumer
22 Services.

23 Q Thank you. Would you turn now to para. 56 of your statement? The paragraph is flagged as
24 confidential. The first sentence of the paragraph, however, concerns the Go Live date for
25 the Meter Fit contract which is not a confidential matter. I understand that you have a
26 minor correction that you wish to make in relation to your evidence at this point? A. Yes.
27 When I prepared the statement I was under the belief that the Meter Fit contract went live
28 early in 2003. Subsequently, from documents I have seen, it was the second area of the
29 Meter Fit contract that went live early in 2003. The first area did actually go live at the end
30 of 2002 - I think November 2002. If I could apologise for that and correct that point.

31 Q Is there anything further you would like to correct in your statement? A. No.

32 Q Thank you very much, Mr. Avery. I have no further questions for now. Counsel for the
33 other parties will now ask you some questions.

1 MISS CARSS-FRISK: Madam, may I just raise two issues before I start? One is that insofar as
2 anyone on behalf of the interveners asks questions, but we do not ask, I hope it can be taken
3 that we may then rely on any such challenges and answers to those questions even if we
4 have not, in order to avoid duplication, actually put those questions ourselves.

5 THE CHAIRMAN: I have no problem with that. Yes, that is fine.

6 MISS CARSS-FRISK: The second point, madam, is that I am fairly certain I will be touching on
7 some of the yellow chunks in Mr. Avery's statement. So, it may actually make more sense
8 for those who are not part of the confidentiality ring not to be here in the course of these
9 questions.

10 THE CHAIRMAN: We will go into Camera now then. If everyone who is not in the
11 confidentiality ring could leave the room?

12 MR. HOLMES: Madam, we do wonder whether it is necessary to go into Camera for the entirety
13 of Miss Carss-Frisk's evidence(sic). If it were possible to do so only insofar as
14 confidentiality concerns arose, we would prefer that course.

15 THE CHAIRMAN: I thought there was also an issue more generally about Mr. Avery's evidence
16 which was what prompted us to issue the witness summons that indicated that he ought to
17 give his evidence In Camera in any event?

18 MR. HOLMES: Indeed, madam. It is possible that Mr. Avery may, during the course of giving
19 his evidence, consider that some of the material on which he wishes to speak is confidential
20 to his former employer. If that were to happen he would no doubt indicate as much when
21 he was giving his evidence. But, as I understand the position, no indication was given in
22 correspondence that Mr. Avery's examination would be In Camera.

23 THE CHAIRMAN: I am a bit reluctant to have the evidence chopped about by people coming in
24 and out the whole time. It might be better if he does give his evidence In Camera.

25 MISS CARSS-FRISK: Madam chairman, I think it may be rather inconvenient to do it that way.

26 THE CHAIRMAN: If it is then possible, having looked at the transcript, for sections to be
27 determined that are available to be read by people not in the confidentiality ring, perhaps
28 that is a way we can make the evidence available more generally if it is not confidential.

29 MR. VAJDA: I support wholly what National Grid say on that. We do object to all this evidence
30 being In Camera for a very good reason. I have Mr. Lewis here, who was in fact a colleague
31 of Mr. Avery. It is important for my purposes that Mr. Lewis hears the non-confidential
32 evidence of Mr. Avery. In my submission, it would be wrong for the whole of Mr. Avery's
33 evidence to be held In Camera because that will affect our ability to ask questions.

1 MR. RANDOLPH: May I simply support that because Paul King is outside of the confidentiality
2 ring and for the reasons that Mr. Vajda has given, and indeed Mr. Holmes has given, we
3 would submit that the proper approach would be, as usual, to have evidence heard open
4 except where there are good circumstances where it should be held In Camera.

5 (The Tribunal confer)

6 THE CHAIRMAN: Miss Carss-Frisk, is it possible for us to start in Open Court and see how we
7 get along, and then see when we need to go into Camera?

8 MISS CARSS-FRISK: Of course. Let us proceed then on that basis. As I said, I do not want the
9 process to be disrupted by constantly chopping and changing.

10
11 Cross-examined by Miss CARSS-FRISK

12 Q Mr. Avery, I would like to begin by exploring a little bit with you what you say in Section C
13 about Ofgem's position on accelerated replacement. You deal with that, first of all, in para.
14 13 on p.594. You say in the second sentence,

15 "I recall that after we had started negotiating the CMO contracts Ofgem indicated
16 to us nervousness about an accelerated replacement programme. British Gas did
17 not normally make notes of its meetings with Ofgem, but the concern is recorded
18 in a couple of internal documents".

19 Then you refer to an e-mail from you to the PA to British Gas' managing director, Mr.
20 Clare. If we could just go to that e-mail at p.669 of the paginated bundle. You refer in para.
21 13 to this e-mail and to British Gas' Head of Regulation, Iain Taylor. You say he would not
22 have written in those terms if he was not sure of Ofgem's concerns. Now, I just wanted to
23 look for a moment at what you said in that e-mail at p.669. You see in the second
24 paragraph from the top:

25 "Iain Taylor has written to you, warning you that we are likely to receive
26 considerable opposition from Ofgem if we implement an accelerated exchange
27 programme and that this could have adverse consequences in other areas."

28 It looks as though at that stage all Mr. Taylor was doing was predicting what might be the
29 attitude of Ofgem as opposed to being sure of what that attitude was – would that be right?

30 A. I can't say for certain what was in Iain Taylor's mind when he wrote to Mark Clare. I
31 think what I was trying to bring out in the witness statement was that, as the head of
32 regulation for British Gas, Iain Taylor would not have written to his managing director
33 alerting him to a concern had he not genuinely believed it to be a real issue. As I have
34 recorded elsewhere in the witness statement, that was taken sufficiently seriously by Mark

1 Clare for it to be recorded in the various papers to the British Gas executive and the
2 Centrica board. My belief is that at that point – this was November 2002 – British Gas
3 would have already been aware of Ofgem’s general concerns around accelerated meter
4 exchange. For example, it was set out in their metering strategy document that that was an
5 issue, but that was six months earlier. So my belief is that something further must have
6 prompted Iain Taylor to write to Mark Clare at that point. Clearly I was not party to what
7 the event was that triggered that email, but I can only presume that it must have been some
8 dialogue or contact with Ofgem on that point.

9 Q Mr. Avery, it may not be the biggest point in this case, but looking at how you put it at
10 p.669, referring to what you obviously knew about what Mr. Taylor had written, it does
11 look as though you are saying there that Mr. Taylor at that stage had been warning about
12 what was likely to be considerable opposition from Ofgem, but not that Mr. Taylor at that
13 point had actually been made specifically aware that there was opposition. You see the
14 distinction? A. I understand the distinction, but as I said, I believe that British Gas had
15 been aware of likely concerns from Ofgem throughout 2002. My belief is that there must
16 have been something that happened later in 2002 that would have prompted Iain to write to
17 Mark Clare at that point. Otherwise nothing had changed from the earlier status of that
18 issue.

19 Q Certainly, as I understand your statement, you are not saying that you were personally at
20 any stage informed by anyone on behalf of Ofgem of their attitude to accelerated
21 replacement? A. That’s correct, Ofgem’s dealings with British Gas were primarily
22 through its regulatory team. I did attend a couple of meetings with Ofgem which are
23 referenced – several meetings with Ofgem, which are referenced in the witness statement
24 that the point of dialogue between British Gas and Ofgem was through its regulatory team,
25 of which Iain Taylor was the head.

26 Q Just to be clear, the meeting you refer to specifically in para.16 in January 2003, at that
27 meeting you are not saying that this concern was raised in your presence by Ofgem then?
28 A. I think the meeting in January 2003, there are probably a couple of points that are worth
29 making on that. Firstly, by the time that meeting took place – there were earlier meetings
30 which it might be helpful to refer to separately – by the time that meeting took place the
31 Legacy MSAs’ letter of intent, the heads of terms had already been agreed. So by that point
32 we knew that we were not intending to embark on an accelerated meter exchange
33 programme and that was reflected in the dialogue that we had with Ofgem at that meeting.
34 So I think the discussions with Ofgem in that meeting would not have gone in that direction,

1 because we were able to assure them that at that point it wasn't our intention to embark on
2 an accelerated meter exchange programme.

3 Q I think the answer to my question then, Mr. Avery, would be that it is right that at that
4 meeting that you mention in para.16, Ofgem did not put to you that they had a particular
5 concern about accelerated replacement? A. It's correct that they didn't put that to us,
6 because there would have been no need for them to do so, as we had already indicated to
7 them that we had been in discussions with National Grid which would avoid the need for an
8 accelerated meter replacement programme.

9 Q It is right, is it not, that you are not able to point to any notes of any contacts between
10 Ofgem and British Gas where this concern that you refer to about accelerated replacement is
11 mentioned? A. As I said, the contact from Ofgem into British Gas was through its
12 regulatory team, so I wouldn't have received notes directly from Ofgem. Clearly the
13 consequence of the information that the regulatory team received is reflected in other
14 documents which I have referenced in the witness statement.

15 Q I think again, Mr. Avery, the answer to my question then is simply "No", is it not? A. It's
16 "No", because I wouldn't have been in receipt of those documents, not "No", because they
17 didn't necessarily exist.

18 Q Turning to para.19 of your statement, please, you refer there to para.4.176 of the Decision
19 and you say:

20 "... '[British Gas] does not believe that any discussion with Ofgem affected or
21 influenced its meter replacement policy based on age'. I believe that British Gas'
22 meter replacement policy based on age was associated with Ofgem's opposition to
23 an accelerated replacement programme. Ofgem's nervousness about an
24 accelerated replacement programme supported the overall need for British Gas to
25 reach a commercial arrangement with Grid to cover its legacy meter stock."

26 To be clear again, you are not saying, are you, that there was any specific guidance from
27 Ofgem about an age based replacement strategy, or at what ages meters should be replaced?

28 A. I can't be certain that any guidance was received. It certainly wasn't received by me.

29 Q You are saying then that you are not aware that there was any such guidance? A. I'm not
30 certain that there was any guidance, because I've not seen any documentary evidence to
31 support it, but I refer to the comments that I made earlier that, given the comments made by
32 Iain Taylor, other discussions with members of the regulatory team before the meetings that
33 we held with Ofgem, all of those indicated a concern from Ofgem about embarking on an
34 accelerated meter exchange, which we therefore took into account in the development of

1 our policy and our approach. So my belief is that there was dialogue with Ofgem on that
2 point, but I don't have any documentary evidence from Ofgem which confirms that, so I can
3 only presume the dialogue was verbal.

4 Q There is a difference, is there not, between dialogue that might include a general indication
5 about a concern about unduly accelerated replacement on the one hand and a dialogue that
6 involves guidance about the ages at which meters should be replaced? There is a difference,
7 is there not? A. Yes, you used the word "unduly" in that statement, and I'm not sure I
8 was referring to "unduly" accelerated meter exchange. Our concern at the time was that the
9 rate of meter exchanges which we built into the commercial meter operator contracts were
10 somewhat faster than the historical rates at which National Grid had been exchanging
11 meters. We were keen to ensure in the way that we presented that to Ofgem and in the
12 actions that we took that operating at a rate which was faster than the historical rate did not
13 trigger difficulties for us with Ofgem which may fetter our ability to operate the contracts
14 effectively.

15 Q Mr. Avery, I am afraid I do not think you have answered my question, which was that there
16 is a distinction, is there not, between a dialogue about the concern about an accelerated
17 replacement programme on the one hand, which you have said that there was with Ofgem,
18 and on the other hand Ofgem providing specific guidance as to the ages at which meters
19 should be replaced. There is a distinction, is there not? A. I think there's a distinction
20 but there's also a linkage. The linkage is that if one is operating on historical volumes
21 where broadly one-twentieth of the meter stock was removed each year then you would
22 assume, policy meters aside, those that were failing, that the majority of meters that would
23 be removed would be older meters, those that were approaching the end of their useful life.

24 Q That then, Mr. Avery, would be an assumption, would it not, rather than based upon any
25 specific guidance from Ofgem, which is what I am really getting at? A. Yes, perhaps I
26 could just finish the previous answer and then I will return to the question. The assumption
27 was that if you were replacing meters that were reaching the end of their useful life, that the
28 majority of the meters that would be removed would be older meters. Our concern was that
29 if we by operating at a faster rate than that, in line with commercial meter operator contracts
30 that if we were seen to be removing a significant number of younger meters then that would
31 send a clear signal to Ofgem and indeed to National Grid that we were taking meters out not
32 only that were younger but they were operating at a much faster rate and that could have
33 triggered some action or concerns by Ofgem. So our approach, based on what we
34 understood, what the business was informed by the regulatory team, was Ofgem's position

1 our approach was to focus on older meters. I cannot say that we were give a specific age by
2 Ofgem around what we were allowed to remove, or not allowed to remove. It may be that
3 the determination of the age was determined from the general policy that I have described.

4 Q Mr. Avery, I was going to invite you to look at a response given by British Gas in the
5 course of the Administrative procedure in this case that specifically says that there was no
6 guidance from Ofgem about the ages at which Meters should be replaced, but I think in the
7 light of what you have just said it will not be necessary to go to that because you have
8 confirmed now, to be clear, that you are not aware that your policy was based on specific
9 guidance from Ofgem about the ages? A. My belief is it was based on an understanding
10 of what Ofgem's position was. I am not aware that there was a specific age guidance given
11 from Ofgem.

12 Q Thank you. Turning then to your section D in your statement where you deal with the
13 negotiations of the MSAs, and I should perhaps issue a warning that I think it is likely that
14 we are going to go into the yellow areas fairly soon. In para.22 you describe how you first
15 met with Grid in April 2002 to "explore possible options" as you put it at the end of para.22.
16 Did those possible options at that stage include the possibility of exit charges in contracts?

17 A. I can't say for certain whether it did in the April 2002 meeting. There were a series of
18 meetings through to about July 2002 where the details of the proposed MSA deal were
19 discussed and the main focus, as I think I reflected in the witness statement was on price
20 and term, but in discussing that we did need to understand – apologies for the lengthy
21 answer, I am just trying to think of the sequence of issues through in my own mind in
22 determining and understanding what the impact of various contract terms would be for
23 British Gas. We did need to understand what the exit costs would be and so I think the
24 answer to your question is yes, there was discussion around the cost of exiting contracts at
25 that time.

26 THE CHAIRMAN: What do you understand by the phrase "exit charges" then? Would that
27 include the PRCs that were finally agreed? A. It would. I don't think at that time we
28 were specifically discussing PRCs, but I do recall in those discussions when we were
29 looking at what the benefits to British Gas would be in the early years from a reduced price
30 of a longer term contract, understanding what the consequences would be if we needed to
31 exit the contract, either exit it altogether or to replace more meters than would have been
32 allowed under the proposed terms of the contract. So those issues were discussed and were
33 factored into the financial evaluation which were undertaken by our finance colleagues on
34 the team.

1 MISS CARSS-FRISK: Looking then at your thoughts about the rate at which meters might be
2 replaced away from Grid, can you turn please to p.663 of your exhibit? What we have there
3 is a paper dated June 2003, can you confirm for us the precise nature of the paper?

4 A. Yes, there were a series of papers that were presented to the Centrica executive, and the
5 Centrica Board. I have been slightly puzzled by that document because the preceding page,
6 the email from me to Paul Bysouth and Colin McCann, which attaches the paper is dated
7 15th November 2002, and it appears to have an attachment which is dated in 2003, which
8 clearly does not make sense. The paper itself does look as though it was a paper that would
9 have gone to the Centrica Executive meeting in June 2003, and although the
10 recommendation is redacted I do believe it was seeking approval for Mark Clare to sign the
11 contracts. I am puzzled as to what has happened to the dates on the document, because they
12 clearly do not make good sense.

13 Q All right, well take it is June 2003 then. The passage I want to refer you to is just below the
14 middle of p.663, where it says:

15 “The attached chart shows the benefit of the proposed legacy deal compared to a)
16 a normal replacement programme, and b) an accelerated programme replacing
17 Transco’s meter stock over an 8 year period (which we believe is the most
18 aggressive exchange programme that could be delivered).”

19 Q So eight years was the fastest that you believed that British Gas could achieve, is that right?

20 A. That was the fastest we could be confident we could achieve. Again I think I have
21 reflected this in the witness statement. No one had tried to embark on a rapidly accelerated
22 meter replacement programme before so no one could be certain how fast it could be done,
23 how quickly we could encourage the CMOs to ramp up to the necessary size of their
24 operational teams to conduct a more rapid exchange. We were confident that eight years
25 was achievable, so that was the basis on which we went forward to the Centrica Board and
26 Executive. We believed it was possible to do it earlier, and we had a range of options I
27 think reflected elsewhere between five and seven years which clearly were used in
28 negotiations with National Grid.

29 Q Well, when you say you believed it was possible to do it earlier, if we look at the way it is
30 phrased at p.663 of course it says:

31 “an accelerated programme replacing Transco’s meter stock over an 8 year period (which
32 we believe is the most aggressive exchange programme that could be delivered)”

33 Now that does suggest precisely what it says, that you believed that was the fastest it could
34 be done? A. We believed it was the fastest we could be confident that it could be done,

1 and therefore that was the right benchmark in assessing the value of the MSAs against the
2 alternative. It would have been wrong to assess the value of the MSAs against the target
3 which we were not confident could be achieved. Had we not entered the MSAs, and if a
4 decision had been taken to try and maximise the benefits from rapid installation of meters
5 through the CMO contracts, we would have negotiated with the CMOs to undertake as rapid
6 an exchange as possible, that may have been faster than eight years but I cannot be
7 confident that it would have been.

8 MISS CARSS-FRISK: Madam Chairman, I am afraid I was now going to ask Mr. Avery to look
9 to his para.29 which is all in yellow.

10 THE CHAIRMAN: Could those people in court who are not in the confidentiality ring then
11 please leave the room.

12
13 (Proceedings continued In Camera)

14
15 (Following a short break)

16
17 THE CHAIRMAN: We are moving to smart metering, I think.

18 MISS CARSS-FRISK: Yes. Smart metering. In para. 95 of your statement you say,

19 "I have seen a copy of document 861A which is relied on in para. 4.124 of the
20 Decision which is to show that British Gas was concerned that the Legacy MSAs
21 would stifle innovation. The Robin referred to is Robin Beasley, who was
22 responsible to me for the AMR project in British Gas and the view he expresses
23 does not match my recollection".

24 Can we look, please, at that e-mail at p.697? To be clear, this is a National Grid e-mail,
25 recording, evidently, what they perceived in a meeting with Robin Beasley. A. Yes.

26 Q Were you at that meeting? A. I wasn't, no.

27 Q In what sense then do you say that the view recorded to have been expressed by Robin
28 Beasley does not match your recollection? A. It doesn't match my recollection of British
29 Gas' position on AMR at the time of this e-mail. I wasn't referring to recollection of the
30 meeting because obviously I wasn't at it. But, as I had responsibility for the AMR project
31 through to the creation of its business case and evaluation, I am able to comment on how the
32 comments in this e-mail stack up against what the British Gas position on AMR was at that
33 time.

1 Q But you are not suggesting, are you, that there was not a concern at around that time about
2 the possible impact of the MSAs on innovation? A. By January 2003 British Gas had
3 considered what the impact of the MSAs would be on a possible future deployment of smart
4 metering and the outcome of that is recorded in a document you took me to previously - I
5 think a few pages before this one - where I set out on p.684 to Mark Clare in November
6 2002 the way in which British Gas envisaged it would deploy new technology if there was a
7 viable business case for AMR. So, the point I am making is that the view expressed - or
8 allegedly expressed - by Robin Beasley (it wasn't his words - it was someone, Steve
9 Adams, who recorded it) -- The view that is recorded doesn't align with the British Gas
10 position which we had set out two months earlier.

11 Q Can we at least agree that although -- I understand you are saying from p.684 that there
12 were ways of dealing with changes in metering technology consistent with the MSAs. Can
13 we agree at least that certainly you had a concern within British Gas at about that time about
14 the possible impact on new technology? A. Not in January 2003, no. We'd addressed
15 that prior to signing the MSAs.

16 Q Looking at the Autumn of 2002 you have pointed to this paper at p.684, attached to an e-
17 mail of November 2002. So, let us just home in on that - October/November 2002. A.
18 Yes.

19 Q Was there a concern at that time within British Gas about this issue? A. Yes, because
20 we'd raised during the MSA negotiations the need for some flexibility to allow future AMR
21 deployment and that had resulted in National Grid coming forward with a proposal at the
22 October 2002 meeting which would've allowed a more rapid exit of the contract to deploy
23 AMR. Following that meeting and subsequent discussions we looked at - I think at Mark
24 Clare's request - what the options were for deploying AMR and whether we would need
25 that flexibility, and concluded, as set out in this note, that we didn't need contractual
26 flexibility to deploy AMR because there was a perfectly legitimate and effective way of
27 deploying it as set out in this paper through some combination of exchanging meters when
28 they became due for replacement and replacing them with smart meters, or for very young
29 meters retro-fitting an AMR device on to meters which were already capable of being
30 converted into smart meters. That policy that we set out there needed to apply I think not
31 only for the MSAs, but also for the contracts that we had entered into with our commercial
32 meter operators who would also have been installing dumb meters prior to a decision on
33 AMR. So, we did look at it, and the paper in November 2002 sets out what the conclusion

1 of that review is. As I've reflected, it's out of line with a statement that's recorded in the e-
2 mail from Steve Adams that you've drawn my attention to.

3 Q Did you discuss this matter then with Mr. Beasley, who was, as you say, responsible to you
4 for the AMR project in British Gas? It seems odd, on the face of it, that there is you saying,
5 "Well, we'd had these concerns but they had been largely dealt with at this point" and then
6 one has Mr. Beasley expressing a rather strong view, it would appear, that actually the
7 business case for AMR had been severely damaged. A. The first I was aware that that
8 conversation had happened between Robin Beasley and Steve Adams was when I was
9 shown the e-mail in the preparation of the witness statement. I knew that the meetings were
10 going on. We'd agreed to set up the meetings. I'm happy to expand, if that's helpful, on
11 what the purpose of the meetings were. But, I wasn't aware that Robin had expressed that
12 opinion. I am surprised he expressed the opinion and I fundamentally disagree with several
13 of the comments in his e-mail about the impact it would've had on either the cost or benefit
14 case. Again, I'd be happy to expand on why it wouldn't affect the costs or benefits in the
15 way that it's alleged that it would at the meeting. So, no, I didn't discuss the e-mail with
16 Robin because I didn't know that it had been written. We did discuss the deployment
17 options with Robin which would've been reflected in the paper that I did in November
18 2002, and ultimately, of course, in the business case. Clearly I couldn't have discussed
19 something with him when I hadn't seen it.

20 Q Indeed. Moving on to Section H of your statement - 'Onstream Contract' -- I just wanted
21 to pick up a point you make at para. 97. You say,

22 "I did, however, believe that there was some uneasiness within National Grid
23 about a contract under which Onstream would be incentivised to remove working
24 meters belonging to another part of the group. The message I got from Colin
25 Shoemith was not that National Grid would not sign the on-stream contract if the
26 Legacy MSA was not signed, but that the Grid board would want to understand
27 what they were letting themselves in for in one area before committing themselves
28 to a contract in another area".

29 I just want to explore that statement with you in conjunction with p.667, please. This again
30 is your email of November 2002, where at the bottom of p.667 it says:

31 "If we are unable to agree a legacy deal I believe Transco will not sign the UMS
32 contracts."

33 Can we take it that what you say at the bottom there really accurately reflects how you
34 perceived things when you wrote that?

1 THE CHAIRMAN: Was this actually written by ---- A. The email on 667 that I've been
2 referred to is written by me, yes. It's an email from me to Karen Keenan, who's the
3 managing director's PA, in preparation for a meeting that he had with Edward Astle. I was
4 referred to 667, I think.

5 MISS CARSS-FRISK: Yes, the bottom of 667, and I was asking you if we can take it that that
6 accurately reflects your assessment? A. Fairly accurately. I think my only qualification -
7 ---

8 MR. HOLMES: Madam, if I might just clarify, I think the witness is under a misapprehension as
9 to this document, which would be sensible, I think, to clarify. It looks as though, although
10 Mr. Avery is responsible for the email at the top of the email chain, the text which then
11 follows is in the body of an email from Colin McCann to Mark Clare, and is not, in fact, an
12 email from Mr. Avery himself.

13 THE CHAIRMAN: Yes, it starts "Mark", and then is concluded at the bottom of 669 "Colin".
14 A. Yes, I am grateful for that help. It's redacted on my version, so I can't see who the
15 email is from.

16 MISS CARSS-FRISK: I am afraid, madam, in my copy as well, it is redacted in such a way that
17 that was not apparent, so I had been under the same understanding as Mr. Avery. (To the
18 witness) Mr. Avery, be that as it may, I think you have agreed that the sentiment as stated,
19 albeit not formulated by you, at the bottom of p.667 does represent the position, or the
20 assessment that was made within British Gas at the time? A. Yes, I think the word
21 "assessment" is a good description. Clearly we couldn't be certain of what National Grid's
22 position and reaction would be if we had not moved forward with the MSAs, how that
23 would have impacted the signing, or at least the timing of the signing of the contract with
24 UMS. We assessed that there was certainly a significant risk that if we didn't sign the MSA
25 we wouldn't be able to proceed as we had wished with the UMS deal, whether that would
26 have meant that the deal didn't happen at all or whether it would have meant that it
27 happened, but that the terms were further discussed or the start date was delayed, we can't
28 be sure. My suspicion is that it would have been the latter, that if we'd have not signed the
29 MSA there would have needed to have been further discussions on the contract terms within
30 the UMS contract. I think the question I was asked was, was that argued at the time, and I
31 think the "at the time" phrase is probably important as well, because clearly our view was
32 developing as we understood National Grid's position through meetings that I had with
33 Colin Shoesmith and Mark Clare was having with Edward Astle. The bottom line is we
34 weren't absolutely sure how National Grid would react, and there was clearly a significant

1 risk to proceeding with the UMS contract on a timely basis if we had not taken the strategy
2 set out in this paper.

3 PROFESSOR STONEMAN: Before we move on, if I could ask you this: some earlier
4 questioning assumed that paras.1 and 2 on p.669 and also the concluding paragraph on that
5 page were written by Mr. Avery. We now discover they were not. Do you want to change
6 and go back to that question later in the day to try and put this right?

7 MISS CARSS-FRISK: Yes. Just to be clear, Mr. Avery, on that basis, and indeed it should be
8 fairly put to you, absolutely, so far as the point about Mr. Taylor's view is concerned, I
9 think my questions remain as they were, which is that referring to this email it would appear
10 that at the time Mr. Taylor had a view as to what was likely to be Ofgem's view, but did not
11 actually have any certainty as to that. I do not know if you want to have another chance to
12 comment on that. A. I think the answer that I gave to the previous question remains the
13 same, the fact that it was Colin McCann writing to Mark Clare on this point rather than me
14 probably does not change the answer that I gave and the fact that Iain Taylor wouldn't have
15 written to Mark Clare in those terms if he hadn't been sure that there was an issue that was
16 serious enough to merit bringing it to his managing director's attention.

17 Q I also asked you about the concluding section of the email, about whether there was an
18 assessment at the time that British Gas really did not have a realistic alternative, and I
19 suspect that you would say that your answer stands in relation to the question of how the
20 position was assessed within British Gas at that time? A. Yes, because my answer
21 referred to a realistic alternative in terms of securing next year's budget, which probably
22 now makes more sense given that it was Colin McCann that wrote the email rather than me,
23 because it would have been his budget that he was trying to ensure was secured.
24 Fundamentally, the point that I made in the answer is still the same.

25 Q Just looking at para.13 of your statement briefly again where you refer to this email as a
26 note from you to Karen Keenan, when you produced this statement did you actually believe,
27 as I did (as it turns out wrongly), that this was a note from you, because that is what you
28 seem to be saying in para.13? A. I did, because the copy of the document that I was
29 given is exactly as it appears in this witness statement, which appears as from Neil Avery to
30 Karen Keenan, copied to Colin McCann, and it does say that it is a forward of the Legacy
31 deal negotiating brief. The bit of the email that I can't see is obviously what must sit
32 beneath that, which was presumably the original email from Colin McCann to Mark Clare,
33 and was written presumably at a slightly different date. It would be interesting to know if
34 the date was materially different. I suspect it wasn't, given how fast things were happening

1 at that time. It's helpful to understand how that email was produced, but I don't think it
2 materially alters the situation. Colin McCann was the director that I was reporting to at that
3 time. No doubt, even if the words in the final email were his, the content would have been
4 substantially mine, so I don't think it materially either anything in the witness statement or
5 in the answers to questions that I've already given.

6 Q Thank you. Moving on then finally to what you say about maintenance in section J of your
7 statement, you explain that British Gas's real interest in CMOs being able to carry out
8 maintenance was so as to be able to replace a meter. That is your para.104. Is that a fair
9 summary? A. I don't think it is quite a fair summary. Our real interest at that time was to
10 save the costs of maintenance which we were being charged through the P&M contracts. As
11 part of the bundled price of then £15 meter we were being charged £1 a meter for a service
12 which, in reality was not required because no one was maintaining credit meters. We saw
13 this as an opportunity to save £12 million by making our CMOs responsible for
14 maintenance, but in fact not requiring them to do maintenance – I am talking now about
15 credit meters, it is a slightly different issue on prepayment – not requiring them to undertake
16 maintenance but in the event that there had been a faulty credit meter they would have
17 called on it and replaced it with a CMO meter. The outcome of that would have been a £12
18 million a year saving for British Gas, relatively little cost or effort, and for the CMOs it
19 would not have impacted the volume of work that was going to them.

20 Q But, of course, that was not permitted by Grid? A. It was not permitted by Grid. We had
21 been in discussions with them during 2001 before the MSAs were even raised, to use that
22 opportunity of unbundling maintenance and using our CMOs to be the designated
23 maintainer even though they did not actually do the maintenance. We pushed National Grid
24 to agree to unbundle maintenance; they considered it and came back to us, I believe in June
25 or July 2002 to advise us that they would not allow us to unbundle maintenance for I think
26 what they referred to as “operational and legal reasons”. But I should say that those
27 discussions around maintenance themselves were not directly connected with the
28 negotiation of the MSAs, they were something we had been pursuing regardless of the
29 MSAs, although during discussions with the MSAs we did raise the maintenance issue, but
30 it was closed off to us outside of the MSAs and before the MSAs were agreed.

31 Q Now, under the MSAs, when Grid themselves attended on a maintenance visit but in fact
32 replaced a meter, it is right is it not, that then that meter would go on the New/Replacement
33 contract so there would still be, or there would be rental from Grid for that meter on that
34 basis? A. If National Grid attended on a maintenance visit and completed a meter

1 exchange they would have put a new and replacement meter in which the rental would have
2 continued, I guess the important point though, which I think I did reflect in my witness
3 statement at 105 is that that was a choice that was available to British Gas when that call
4 came in from a consumer, we could have directed it to National Grid or we could have
5 directed it to our CMOs, our CMOs would have needed to replace the meter, they could not
6 maintain it, but that was a choice for British Gas as to whether it allowed National Grid to
7 install a new or replacement meter, or whether we asked our CMOs to do so.

8 Q Sometimes you would use Grid, for example, if it was an emergency and you would use
9 their out of hours service, I think that is what you say in para. 105? A. Yes, I think there
10 is a slight difference between emergency and out of hours. We get calls, for example, on
11 prepayment meters out of hours that needed attending because the consumer was off-supply
12 and that would be urgent because we needed to get supply gas restored for that consumer
13 quickly and that might have gone to National Grid because it would have been cheaper than
14 incurring the cost of putting that to the CMO. The emergency, I think that you raise, in
15 these terms would typically be if there was a gas escape then that was a different matter, and
16 my recollection is that the meters are then fitted under our post-emergency replacement
17 maintenance – I have forgotten what the phrase is now, you might correct me – but it is a
18 different set of rules which apply for replacing meters following a gas emergency from an
19 urgent job.

20 Q At any rate, when Grid does attend and it replaces a meter that meter would then come off
21 the free allowance under the glidepath, would it not? A. If National Grid put a meter in
22 for British Gas it would be one of the glidepath allowances, correct.

23 Q So in that sense it is fair to say, is it not, that for Grid to retain maintenance for itself did
24 have a blocking effect for the CMOs, did block off a route to the market for them to that
25 extent? A. No, I do not think that is quite right for two reasons: first, it was still a choice
26 for British Gas as to whether to use National Grid to undertake those visits, so you could
27 say that by British Gas choosing to use National Grid that may have blocked off a job for
28 the CMOs. Secondly, the volumes that were agreed in the CMO contracts remained
29 unchanged regardless of the specific action on an individual meter whether British Gas
30 directed that to the CMO or directed it to National Grid. So if we directed one job to
31 National Grid we would need to direct another job to the CMO in order to maintain the
32 volumes that had been agreed under their contract, so I do not think it would be right to say
33 that it automatically resulted in the CMOs doing fewer jobs. It might have resulted in them
34 doing different jobs, but not necessarily fewer jobs.

1 MISS CARSS-FRISK: Thank you, Mr. Avery.

2 THE CHAIRMAN: Mr. Vajda?

3 Cross-examined by Mr. VAJDA

4 Q Mr. Avery, were you in court yesterday? A. No.

5 Q So today is your first day here? A. I came on Friday see the surroundings, but no, I
6 wasn't here yesterday.

7 Q Are you being paid while you are here, or not? A. I have agreed, as I have set out in my
8 witness statement some reimbursement of my time by National Grid, yes.

9 Q Are you being paid by National Grid today, that is my question? A. National Grid are
10 reimbursing me for my time today, yes.

11 Q The answer to my question is "yes" you are being paid by National Grid today? A. I will
12 need to – as with everything else I have done in connection with this case I agreed National
13 Grid would reimburse me for the time that I am spending. I am not here as an employee of
14 Consumer Focus, I am taking today as annual leave, and so I will bill National Grid for the
15 time that I have spent on this case, including today, yes.

16 Q Good, well that is very helpful, Mr. Avery. If you were not here yesterday you probably do
17 not have – and this is the bundle I would like you to take, M1. Could I ask you to go to tab
18 21. We are now in 2009, and it is quite difficult to recall events that took place in 2003?
19 A. Yes.

20 Q This document is an email from Mr. Lewis – do you have it? A. I do, but my version is
21 fully redacted.

22 MR. HOLMES: This document has been claimed as confidential by British Gas as I understand
23 it.

24 MR. VAJDA: I think in that case we probably have no alternative but to go into closed session.
25 I would try and cross-examine in a way not to reveal anything confidential on the transcript.

26 MR. HOLMES: I am so sorry, madam, that does not quite resolve the problem, because the
27 document is confidential to Mr. Avery as well, he cannot look at the document without the
28 Tribunal ruling as to his entitlement to do so.

29 THE CHAIRMAN: Even though he was employed by British Gas at the time, and he is a copy
30 recipient of the email.

31 MR. HOLMES: I am sorry, I should have clarified madam, we have no objection to him seeing
32 the document, I was simply informing the Tribunal so that it was aware of the problem.

33 MR. VAJDA: It seems that no party here has an objection to Mr. Avery looking at the document,
34 and it may be a bit difficult, but I will try -- I am not going to ask many questions but --

1 The first thing is that we will have to get a copy of it. What I will try and do and ask some
2 general questions without actually revealing any figures, but if the Tribunal thinks that is
3 too risky a strategy and wants to go into Camera, I understand.

4 THE CHAIRMAN: Let us give an unredacted copy of this to Mr. Avery, and let us go into
5 Camera. Then you will not be restricted in your questions.

6
7 (Proceedings continued In Camera)

8
9 (After the short adjournment)

10
11 THE CHAIRMAN: We are still in Camera, I see. Is that necessary now?

12 MR. VAJDA: My remaining questions are on maintenance and they relate to ----

13 MR. HOLMES: I am so sorry, madam, very briefly before we continue with cross-examination,
14 can I clarify the position in relation to the bundles in the light of the confusion which
15 emerged before the lunch break?

16 THE CHAIRMAN: Yes, Mr. Holmes.

17 MR. HOLMES: We have discussed the matter with counsel for Ofgem and with our solicitors,
18 and it appears that the correct bundles did find their way to Ofgem and that Ofgem's junior
19 counsel had been working from the correct versions, but unfortunately they did not find
20 their way to Miss Carss-Frisk. I make that clear only to avoid any perception of a failure on
21 the part of National Grid's solicitors to convey the correct bundles. Thank you.

22 THE CHAIRMAN: You now have the correct bundle, Miss Carss-Frisk?

23 MISS CARSS-FRISK: I am told that that is not actually correct. The bundles apparently came to
24 us, i.e. to counsel, directly, I am told.

25 THE CHAIRMAN: Do you now have the right bundle?

26 MISS CARSS-FRISK: I am afraid I do not as yet. We are yet to procure another volume. We
27 have done our best to compare obviously the volume I have to a correct one, but I do not yet
28 have one, I am afraid.

29 THE CHAIRMAN: If there is someone who is prepared to lend their unredacted bundle to
30 Miss Carss-Frisk, that would be very helpful. Thank you very much, Mr. Randolph.
31 Mr. Vajda, are we ----

32 MR. VAJDA: I think we can be in open court. I am going to be asking Mr. Avery some
33 questions on paras.103 to 105 of his witness statement, which is at p.621. I will be going to
34 some documents. What I have to say I do not know, or cannot remember, is whether the

1 documents I am going to will be confidential or not. I am happy to be in open court. If I
2 see it is confidential, I will just ask Mr. Avery to read it and I will try and avoid mentioning
3 anything confidential at all. I can just be done through the documents. If I reach a
4 difficulty ----

5 THE CHAIRMAN: Then we will have to ---

6 MR. VAJDA: I will try and avoid that.

7 THE CHAIRMAN: Why do we not ask the other people if they want to come back on, but carry
8 on so that we do not waste any time, Mr. Vajda.

9 MR. VAJDA: (To the witness) Have you got p.621 in front of you? A. I have, yes.

10 Q This is a topic headed "Maintenance". Do you agree with me that maintenance is really an
11 issue that concerns PPMs not DCMs in terms of cost? Is maintenance a bigger cost issue
12 for PPMs or DCMs? A. Yes, maintenance is a bigger costs issue for prepayment meters,
13 yes.

14 Q You mention a figure at para.103, which I can mention because it does not seem to be
15 confidential, of 50p, the amount of rental attributable to maintenance of a DCM. Can I ask
16 you, and ask the Tribunal as well, to go to the Decision, which should be in bundle CB1,
17 para.2.20 onwards, which is at p.13. Do you have that? A. I do.

18 Q Perhaps I could ask you, Mr. Avery, to read very quickly 2.20 to 2.22, and the Tribunal as
19 well. (After a pause for reading) Now the point that Ofgem make at 2.22 is that although
20 the forward looking annual maintenance costs were 25p per year for DCMs, they were
21 much higher for PPMs, do you see that? A. Yes, I do.

22 Q £16.95 per year, or about 35 per cent of the annual rental cost, and that is quite a significant
23 figure, is it not? A. It is.

24 Q Have you any reason why you did not alert us to PPM costs in your section on
25 maintenance? You just deal with DCMs, it is slightly curious. Was there a particular
26 reason? A. Perhaps I could take a moment to remind myself of what I said in that
27 paragraph.

28 Q Just at 103, you mention PPMs at the bottom of the page, but that is a slightly different
29 point. A. (After a pause) Well I think it is in the context of the issue that I was
30 addressing in that part of the witness statement, which is as I think we discussed before
31 lunch, the financial opportunity to British Gas to realise savings from unbundling
32 maintenance came from the opportunity we saw at the time of avoiding paying National
33 Grid initially the £1 and subsequently the 50p element of their maintenance charge and that
34 would give British Gas up front savings without having to do anything else. Prepayment, as

1 I allude to in para.105, was an entirely different issue, where there was genuine
2 maintenance work to be done, and there would have been a cost to British Gas whoever had
3 done that maintenance – the credit was an opportunity to save the money, prepayment was
4 an issue around where the best value came.

5 Q At the moment, you see, because you make a point that I am going to have to debate with
6 you, you say: "... the benefit to us was not sufficient to make arguing the point
7 worthwhile." Is that simply you are just looking at DCMs, or are you looking DCMs and
8 PPMs there? What is your evidence on that? A. The value that we had identified was
9 £12 million per annum saving from unbundling credit meters. My understanding is that the
10 response that we received in 2002 from National Grid related to the unbundling of all
11 meters – prepayment and credit – and they confirmed that they were unwilling for us to do
12 so, so although there was still some benefit to it, we could not move forward on that basis
13 and relatively speaking the savings that could be achieved from unbundling maintenance
14 were small compared to the overall savings that British Gas could achieve from progressing
15 with the MSA deal.

16 Q Have you got an idea, are you able to tell the Tribunal how much British Gas was paying
17 National Grid on maintenance for your meters? A. For credit meters, yes, there are
18 numbers quoted here.

19 Q Perhaps I could ask you to take up WS5, this is in Mr. Lewis's evidence at p.2475?

20 THE CHAIRMAN: Am I right in thinking, Mr. Avery, that when you say that the charge for
21 maintenance is included in the overall rental? A. Yes.

22 Q They just say to you: "This element of the charge represents maintenance", does that mean
23 that when there is a maintenance visit there is no separate charge imposed? A. Yes, that
24 is correct.

25 Q It is just paid for, as far as they are concerned out of the conglomeration of all those 50ps or
26 25 ps? A. As far as National Grid is concerned, yes. The overall rental charge for the
27 meter included the provision of the meter, the installation cost roll-in and the ongoing
28 maintenance of it, so yes, that is correct.

29 MR. VAJDA: For your note, madam, the significant figure is the £16.95 per year of PPM
30 maintenance cost, which is at the Decision at 2.22, so it is quite a large sum. Now, if we go
31 to 2475 at para. 20, this is Mr. Lewis who says that:

32 "At the time, the charges made by National Grid for maintenance on BG's meters
33 was between £ [Confidential] and £ [Confidential] per annum".

1 That is a significant sum, is it not? A. It is. For clarity those numbers are redacted in my -
2 --

3 MR. VAJDA: I apologise.

4 THE CHAIRMAN: Have you not got a marked-up copy?

5 MR. VAJDA: I have. It is my fault. I have it in yellow. I apologise.

6 THE CHAIRMAN: We will make sure those are redacted from the transcript.

7 MR. VAJDA: The reason I ask you whether you regard that as significant is because if we now
8 go back to your statement at para. 44 -- I am reminded, I am going to try and ask you a
9 question which does not disclose ----

10 THE CHAIRMAN: Do you have those paragraphs? A. Yes, I do. I have them marked in
11 yellow. They are in the special bundle that was given to me.

12 THE CHAIRMAN: Do you have those, Miss Carss-Frisk?

13 MISS CARSS-FRISK: I do, yes.

14 MR. VAJDA: All I want to ask you is that the figure there that you see - and I am not going to
15 read it out - is of a similar order to the figure in Mr. Lewis' statement, is it not? A. The
16 figures are of similar order, but the opportunity for British Gas is entirely different. One is
17 a cost and the other is a benefit.

18 Q That is probably going to be a matter for submission. My point at the moment is that you
19 were paying large sums to National Grid for maintenance which were bundled. We see the
20 total in para. 20. Sums of this order are, one would have thought, significant even for a
21 company like British Gas. A. Yes. Just to clarify my earlier answer, the sum that we
22 were paying National Grid for maintenance of prepayment meters -- there wasn't an
23 opportunity to save all of that money because there would've been a cost of maintaining
24 those meters whoever had done the maintenance. The figures that were quoted unredacted
25 in para. 44 of my witness statement represent a total benefit which British Gas has been able
26 to achieve - in other words, a gap -- the differential between cost and income which is an
27 entirely different figure to take into account than the total cost of prepayment maintenance.

28 Q If we go back to para. 103 of your statement, we focus again on the words 'the benefit to us
29 was not sufficient to make arguing the point worthwhile'. I understand your point in
30 relation to DCMs on its own, but the position in relation to DCMs and PPMs was different,
31 was it not? You did argue about it. A. We did argue about bundling of maintenance with
32 National Grid for probably around twelve months.

33 Q It was worth arguing about. A. It was certainly worth arguing when the benefit was £1
34 per meter and there was no other deal on the table. At that point we were just looking at

1 unbundling maintenance before the MSA deal had ever come along. By the time the MSA
2 deal came along, the opportunity on maintenance had been reduced and the prize, if you like
3 -- the bigger benefits available through the MSA deal in our view then, and in my judgment
4 now, significantly outweighed the potential savings from unbundling the maintenance -
5 credit or prepayment.

6 Q Mr. Avery, why do you keep on referring to the £1 for DCMs? We have seen that
7 maintenance is the significant cost for PPMs, is it not? Really the DCM figure is the trivial
8 figure. It is the PPM figure we have got to focus on, is it not? A. No.

9 Q Why not? A. The £1 for credit maintenance, as I've said did give British Gas a potential
10 benefit of £12 million per year with no consequential cost. We were being charged at that
11 time £1 -- within the £15 rental, £1 per meter per year for maintenance of a credit meter, for
12 which no work was being done in return, and therefore 100 per cent of the cost could be
13 saved. For prepayment the equation was entirely different. There was a cost and the
14 opportunity to save that cost would have been much more limited, or may even have been
15 more expensive because of the cross-subsidy between National Grid prepayment meters and
16 National Grid credit meters.

17 THE CHAIRMAN: So what you are saying is that as far as the £1 included in the price of the
18 rental for the DCMs, that was an over-recovery on the part of National Grid as to the cost to
19 them of providing that service? A. That was certainly our judgment. For British Gas
20 there was an opportunity to save 100 per cent of that cost by using CMOs to replace credit
21 meters instead of maintaining them.

22 MR. VAJDA: Can you tell us, why did you include prepayment meters in the invitation to
23 tender? A. Because at the time of the invitation to tender, which was 2001, we were still
24 negotiating with National Grid for unbundling of maintenance, credit and prepayment, and
25 therefore we needed to ensure that our CMOs, if appointed or when appointed, would be
26 able to undertake that responsibility.

27 Q We saw the document before lunch, the January 2003 document of Steve Lewis, which also
28 refers to prepayment, the two-thirds figure. A. Yes.

29 Q That is 2003, so that was after the letter of intent, was it not? The letter of intent was signed
30 in December 2002? A. That's correct, yes.

31 Q You were still working on that assumption, were you not? A. Sorry, can you clarify
32 which assumption?

1 Q Yes, the assumption that you wanted to get the CMOs to do PPM work and to replace most
2 of the PPMs on maintenance visits? A. By January 2003 the opportunity to unbundle
3 maintenance had gone. That had been rejected by National Grid in 2002.

4 Q Yes, but your internal document that Steve Lewis wrote still refers to that, does it not?
5 A. I think the document I was referred to before lunch stated what the assumption was in
6 January 2003, stated what the assumptions had been at the time of the ITT volumes in
7 2001/2.

8 Q I think we will have to go back to the document, but I hope we will not have to go into
9 Camera. It is the M documents. A. My copy was redacted.

10 Q This was a passage I did not take you to this morning because it deals with maintenance.
11 Could you just read to yourself, and could I ask the Tribunal to read, para.7.3 at p.124. It
12 looks as if it was still something that internally you were wishing to, as it were, discuss with
13 National Grid? A. No, I think that's a slightly different aspect.

14 Q I am looking at the last sentence of para.7.3, which obviously I am not going to read out.
15 That leads me to suggest that this was a matter still open for negotiation? A. It wasn't
16 still open for negotiation. We had had confirmation at that stage from National Grid that
17 they wouldn't allow us to unbundle maintenance. I think the point in Steve Lewis's paper
18 saying that if Transco – sorry, I can't read it, can I – it is a hypothetical comment in Steve's
19 words in para.7.3, which wasn't the situation at that time. The opportunity wasn't there for
20 British Gas to do that. We may have wished that it was, but it wasn't.

21 Q We can put away the M bundle and obviously it will be a matter ultimately for the Tribunal
22 to evaluate. What I would like you to do is to take up, which you may still have, witness
23 bundle 5, and go to flag 19. There are a couple of emails at 2904. I do not know who
24 invented this system, but you have to read emails from the bottom up. I think the first email
25 in time is from David Halsey to British Gas. Can you read it to yourself to refresh your
26 memory, and perhaps I can ask the Tribunal to read that, it is the "Colin" email.
27 A. (After a pause) Yes.

28 Q Then we have an email on top, which I take it is from you, Neil Avery. You do not seem to
29 be very happy about this, do you, because you say:
30 "Can you confirm what the dispute/escalation procedure is if we chose to withhold
31 payment ..."
32 You were not happy with that and you were trying to see what you could do to browbeat
33 National Grid, were you not? A. Yes, we were looking at whether there were any other
34 options to achieve a different outcome on this discussion.

1 Q In the end you failed, did you not? A. We did, but to some extent, as I have said, it was
2 superseded by the MSA discussions at that point, but we did fail in the objective of
3 unbundled maintenance, that is correct.

4 Q You may not be able to answer this question, but I will put it to you. My clients, Siemens
5 and CML, were only informed by British Gas of National Grid's decision in March 2003.
6 Are you aware of that detail? A. No.

7 Q All right, I will not explore that with you. Just coming back to 103 in your statement, it is
8 clear, is it not, that the maintenance issue was worth arguing about, was it not? A. It was
9 worth arguing about if there had been a way in which we could achieved a different
10 outcome, but the fact was we'd had a rejection on maintenance unbundling from National
11 Grid. We had explored alternative ways in which we could challenge that discussion and
12 had been unable to find any, so it wasn't worth arguing in the sense that there was no other
13 outcome we could achieve.

14 Q There is one other document that I perhaps should take you to, which is exhibited helpfully
15 to your witness statement, at p.641. Happily we do not need to look at the confidential bit,
16 but could we just go to p.642:

17 "BGT raised the issue of maintenance indicating that this would create access for
18 replacement."

19 Can you explain what was meant by that? A. I didn't write it, because this is National
20 Grid's record, their notes.

21 Q You were present at this meeting? A. Oh yes, yes, I was at the meeting, I am saying it's
22 not my notes of the meeting, it's National Grid's notes of the meeting.

23 Q So we take it from that that National Grid were aware that the maintenance issue would
24 create an access for replacement issue, is that your evidence? A. Sorry, can you repeat
25 that question?

26 Q Yes, your evidence is that because it is the National Grid note that National Grid were well
27 aware that the issue of maintenance would create access for replacement, that effectively
28 maintenance was tied up with placement and National Grid were aware of that?
29 A. Presumably so, it is written in their notes.

30 Q Well, what do you think National Grid meant by that? You were at the meeting, you know
31 about this industry, so let us hear your answer? A. I can't be sure, because as I say I
32 didn't write the document. My expectation, my belief would be that during those
33 discussions in the MSAs we would also raise the opportunity of unbundling maintenance in
34 the hope that that part of MSAs would also be segmented off. This survey was still ----

1 Q When you say “segmented off” do you mean unbundled? A. Unbundled, yes.
2 Q So your negotiating position was that you wanted maintenance unbundled? A. That had
3 been our stance throughout, yes.
4 Q And this was going on during the negotiation of the Legacy contracts, because this was the
5 meeting of July 2002? A. It was, yes.
6 Q So you are arguing for a separation of the maintenance charge from the rental charge, and is
7 that why they, i.e BGT indicated that they would like the maintenance option to be
8 expressed as a transaction charge? A. Yes, I believe that we saw the opportunity there of
9 avoiding paying National Grid for maintenance of meters in the same way as we had seen in
10 2001/2 when we had raised it with them on their P&M contracts, and we were looking to
11 see if that could be reflected in the structure of the MSAs. But we effectively hit the same
12 road block there as we had done with the P&M contracts that National Grid had said that
13 they were unwilling to allow third parties to undertake maintenance on their meters.
14 THE CHAIRMAN: Well that is a different point though, because here you are talking about
15 National Grid maintaining it but charging per visit when they actually do the maintenance
16 rather than bundling it in as an across the board payment? A. Yes, sorry, I correct my
17 earlier comment. There are probably two elements in bundling the maintenance. First,
18 could we get someone else to do it and therefore reduce the amount of rental that we are
19 paying; secondly, could National Grid express it as a transactional charge rather than as a
20 bundled charge which would have, I suppose, essentially have the same effect, it would
21 have allowed British Gas to save money on its maintenance and direct work elsewhere.
22 MR. VAJDA: Now, if we go back to para. 103 of your statement at p.621, will you accept that
23 when you say “the benefit to us was not sufficient to make arguing the point worthwhile”,
24 that that is not accurate? A. Well it is accurate in the context that I explained previously.
25 Q You stand by that statement in the light of documents I have shown you do you? Would
26 you like to qualify it? A. No, I wouldn’t like to qualify it, I would like to explain it.
27 Q All right, can you explain it? A. Paragraph 103 was purely about bundling of
28 maintenance on credit meters, and that, as I have said previously gave us an opportunity to
29 save £12 million per annum at no additional cost. The opportunity to realise that benefit
30 was blocked off to us by National Grid’s position on unbundling of maintenance as
31 communicated in that email from David Halsey that we have already looked at. We could
32 not challenge that position any further because we couldn’t find another way of challenging
33 it, so there was no benefit in continuing the debate because we could achieve no other
34 outcome.

1 Q So this debate that you were having with National Grid was it a debate simply on DCM or
2 did it include PPM? A. I believe it would have covered maintenance of all meters but the
3 opportunity that we saw, for the reasons I have described, to British Gas, the financial
4 opportunity related to credit meters.

5 Q So why is it that when the opportunity was “blocked off” to you, as you put it, British Gas
6 nonetheless appointed CMOs for PPMs? A. I am not sure I understand the question.

7 Q Your evidence in your statement is that you have to distinguish between maintenance
8 benefits in relation to DCMs, I think your evidence in relation to DCMs is that you have
9 been charged for nothing effectively and you wanted to have that unbundled ---- A. Yes.

10 Q -- and you failed to achieve that? A. Yes.

11 Q You said in relation to PPMs, perhaps I have misunderstood your evidence, that it was of no
12 concern to British Gas. Is that your view, that the £16.95 that you were paying per year
13 that was of no concern, or was that part of these negotiations in 2002 with British Gas?

14 A. If we had unbundled maintenance, if National Grid had been willing to allow
15 maintenance to be unbundled, that would have opened up, that would have delivered the
16 benefit for credit meters and given us the choice of how we did maintenance on prepayment
17 meters, but that wasn’t the reality that we were in. They were not prepared to unbundle
18 maintenance for the reasons that we have discussed, and my belief is – I would need to
19 work through the numbers but my belief is – there wasn’t a great opportunity for cost
20 saving for us on prepayment maintenance because the cost was as much as, or possibly
21 higher than, the charge for prepay maintenance.

22 THE CHAIRMAN: Had the tenderers, in submitting their tenders in response to the ITT had they
23 had to quote for what they would charge for maintenance for the PPMs?

24 MR. VAJDA: Yes, I am not sure, it may be that I will have to explore this with Mr. James,
25 because I think Mr. Avery feels slightly uncomfortable about the detail, otherwise I am
26 happy to go to the tender documents with you, Mr. Avery, but obviously you are here to
27 assist the Tribunal. If you are able to speak to the ITT I will take you to it, otherwise I will
28 leave it to Mr. James? A. Yes, as I said previously I wasn’t involved in the detail of the
29 structure of the CMO charges in the ITT. I am aware that we intended to include
30 prepayment maintenance because that predated the decision from National Grid. I am not an
31 expert on the detailed charges so I will do my best to answer a question if you want to direct
32 it.

33 Q Before madam chairman asked you a question you gave a long answer, or you gave a long
34 statement in relation to a question that I asked you but you did not actually answer the

1 question. My question, and I put it to you again, is this: the argument that you had with
2 British Gas, that we have seen in the email, was that an argument that was limited to DCMs,
3 or was it an argument that covered DCM and PPM? A. I assume you mean the argument
4 we had with National Grid?

5 Q Yes, the argument British Gas had with National Grid? A. I am sorry if I didn't answer it
6 previously. The debate was around unbundling, the opportunity we saw relating to credit
7 meters, for the reasons I have described, but I think if we had unbundled we would have
8 unbundled for both credit and prepayment.

9 Q So the argument was in relation to maintenance on DCM and PPM? A. Yes, it was about
10 unbundling maintenance in total.

11 Q Thank you.

12 PROFESSOR STONEMAN: While there is a pause there, can I ask you a little bit further about
13 this? Further down in para. 105 in your statement, do I take this as reading that the
14 unwillingness of National Grid to unbundle maintenance meant that they basically shot
15 themselves in the foot? Given that they would not unbundle maintenance your CMOs could
16 not do maintenance work, except on their own meters? A. Yes.

17 Q I assume then that if you get a call for maintenance on a National Grid meter ----?
18 A. Yes.

19 Q -- the fact that nobody else can do maintenance upon it, but you have a CMO obligation for
20 an amount of work, you are more likely to send a CMO operator out to replace it rather than
21 maintain it? Is that what that paragraph says? A. For credit meters that would certainly
22 be the case. For prepayment meters, I think as we have already discussed, it was probably
23 cheaper for British Gas to allow National Grid to do the maintenance on a prepayment
24 meter rather than send a CMO out to replace that pre-payment meter and result in British
25 Gas paying a higher rental charge to the CMO for its prepayment meter that it had fitted
26 than it would've done if it had retained the National Grid meter in situ.

27 PROFESSOR STONEMAN: So, you are saying that you would rather stay(?) with National
28 Grid? This says it the other way round. I thought we were talking about DCM. Let us talk
29 about DCMs here. A. DCMs? We would rather replace the meter. But, to some extent
30 the maintenance issue was irrelevant because we weren't getting calls to maintain credit
31 meters -- or, only in minimal numbers.

32 Q Would that impact in any way on the age of the meters that were being replaced as opposed
33 to maintained so that by bundling in maintenance you are putting in an incentive to take out
34 meters by CMOs rather than repair them via National Grid, even if they could be easily

1 maintained because CMOs were not enabled to maintain them. A. I think that's right,
2 although the extent of the issue would've been very small because of (a) the very small
3 number of maintenance jobs on credit meters, and (b) the even smaller number of those
4 maintenance jobs which could've been addressed by in situ maintenance which I think is
5 getting to a number that is close to zero. It is not zero, but it's very small.

6 Q Thank you.

7 MR. VAJDA: Could we just look at para. 104? Just the last sentence,

8 "Rather we intended every time they attended a maintenance call they would
9 switch out the meter whether or not it really needed replacing".

10 You are, of course, referring there to DCMs? A. Yes.

11 Q Do you accept that that was the same position that you were intending for PPMs? A. At
12 the ITT stage that's correct.

13 Q Because it was on the ITT stage that you were proceeding on the 'first visit fit' principle,
14 were you not? A. We were, and the reason for that with prepayment was that at that time
15 we believed that British Gas was getting -- well, we knew that British Gas was getting a
16 large number of calls from prepayment consumers ... in prepayment meters. We believed
17 that that was an issue with the installed meter stock. So, part of our response to our
18 colleagues elsewhere in the business in terms of what they wanted from the meter
19 unbundling project -- the appointment of commercial meter operators project was to reduce
20 the costs of prepayment consumers by reducing unnecessary telephone traffic into our call
21 centres. When we got the tenders back from the CMOs it was clear that if we'd adopted
22 that strategy which we'd originally based the ITT on, we would've been significantly
23 increasing British Gas' costs because that would've resulted in a more rapid replacement of
24 National Grid prepayment meters which, due to the cross-subsidy, were cheaper than the
25 tender prices for prepayment rentals from CMOs. So, that was the reason fundamentally for
26 moving away from that strategy.

27 Q Why did you award CMOs any PPM contracts if, as you say, the Grid PPM meter was
28 cheaper than the CMO? Why did you award the CMOs anything at all for PPMs? A.
29 (After a pause): I think there are probably a couple of reasons why we would have wanted
30 to do that. Firstly, we need a level of activity for CMOs to do in order to make their
31 business case viable. I think it's been referred to elsewhere. There is obviously a significant
32 value in prepayment meters. So, they make up more than the ... defraction of the population

33 ----

1 Q Pausing there. You knew that PPMs were important to CMOs in terms of the viability of
2 their business? A. Yes.

3 Q Then the second reason? (After a pause): You said there were two reasons. A. I did. I
4 was interrupted. I'm now trying to remember what the second reason was. (After a
5 pause): Sorry. It's come back to me now. As I say, two reasons: one was about the total
6 volume of work; the second was, of course, that there would've been prepayment meters
7 that were coming up due for replacement, either as a result of customer request and
8 exchanges, or as National Grid policy meters that would need replacing. Our vision had
9 been to move all of our metering work across to our CMOs. So, ultimately we did have to
10 take that hit of prepayment meters being slightly more expensive through CMOs than they
11 were through National Grid. I don't believe we had an option and I don't think that National
12 Grid contracts would have allowed us to do that - to have put all the credit meter work into
13 CMOs and left the prepayment meters with National Grid. Because of the cross-subsidy ...
14 obviously I don't believe that was an option that was available to us.

15 Q So, just to understand, the BG vision was effectively to have a one-stop shop thing with the
16 CMO maintaining all the meters in the area. That was the vision. A. Gas and electricity,
17 yes.

18 Q Yes. Thank you. If we go then to para. 105 ----

19 THE CHAIRMAN: Can I just ask how much longer you are going to be, Mr. Vajda?

20 MR. VAJDA: Yes, you can. We are on para. 105. I apologise. We started at five past two. I
21 would say another five or ten minutes. Obviously, maintenance is an important issue. There
22 is a dispute as to how important maintenance is in this case, but I will certainly go as quickly
23 as I can. I note the comment of the chair. (To the witness): The point that you make at
24 para. 105 is that by reserving maintenance for itself, National Grid did not block off a route
25 to market. Now, my first question is: how does that square with the meeting note that we
26 saw at p.642 where BGT was saying that the issue of maintenance would create access for
27 replacement? That rather suggests that it would. A. It didn't create -- It didn't block off
28 a route to market in the sense that British Gas could still have directed that job to its CMO
29 to do, and replace that meter with a CMO-owned meter.

30 Q So, when you are saying that British Gas could direct it to a CML, are you saying 'could' as
31 a matter of law or 'could' as a matter of economics? A. Well, 'could' in all senses of the
32 word. But, in terms of economics, it would not have been a wise outcome.

33 Q Why would it not have been wise for British Gas to direct it to the CMO as a matter of
34 economics? A. Because it would have resulted in a higher rate of replacement of

1 prepayment meters than was strictly necessary and that would have increased British Gas'
2 cost base because we would have been renting more higher priced CMO meters and less
3 lower priced National Grid meters.

4 Q Is there not another reason? Because maintenance had not been unbundled you are having
5 to pay -- You are going to have to pay National Grid to maintain the meter in any case, are
6 you not? So, why would you cause a CMO to go out, because then you would have to pay
7 two lots of maintenance as opposed to one? A. No. We'd only ever be paying one lot of
8 maintenance on a meter. If it was a National Grid meter we'd be paying maintenance to
9 National Grid. If it was a CMO meter, we'd be paying maintenance to the CMO.

10 Q Yes. But, just let us look at what you have said at para. 105:

11 "In retaining maintenance for itself National Grid did not block off a route to
12 market".

13 What did you mean by that? A. I meant that although National Grid retained the right to
14 do maintenance on its own meter, if there was a faulty meter, British Gas could have chosen
15 to direct that job to its CMO and asked its CMO to install its own meter instead of the faulty
16 National Grid meter.

17 Q But National Grid reserved the right to itself, did it not, to come in and maintain the meter?
18 You were having to pay for that because the maintenance had not been unbundled from the
19 meter charge. A. We were having to pay National Grid for maintaining its own meters,
20 yes.

21 Q Yes. So, there would have been no economic reason for you, given that you were already
22 paying National Grid to maintain the meter, to incur a second maintenance charge from a
23 CMO. A. But my point is we wouldn't have been incurring a second maintenance charge
24 from the CMO. The CMO would have been installing its own meter, for which we would
25 have then taken on the maintenance charge for that CMO owned meter and stopped paying
26 the maintenance charge from the Transco meter or National Grid meter which had been
27 removed.

28 Q The point is that by National Grid maintaining maintenance, they were able either to
29 maintain the meter or replace it? A. If the job was directed to them, yes.

30 Q If maintenance had been unbundled the CMO could have gone in, could have been directed
31 to go in and replace it? A. They could, but as I've said in statement 105, that remains an
32 option for British Gas, even though maintenance had not been unbundled.

33 Q Do you know how that actually worked out in practice, or are you not familiar with the
34 details? A. Well, I can only speak obviously for the time that I was at British Gas up to

1 the back end of 2004/early 2005, and for the reasons I think I have described, British Gas
2 determined that the least cost solution for it on prepayment meters was to allow National
3 Grid to maintain them because if we had have used a CMO to replace the meters we would
4 have increased our prepayment rental costs due to the price differential between National
5 Grid prepayment meters and CMO prepayment meters, but that was an issue around the
6 prepayment rental price rather than specifically the unbundling of maintenance.

7 Q Your overall vision had been to get CMOs to do everything, DCM and PPM, had it not?

8 A. At the time of the ITT, that's correct. Our strategy post the ITT, when we saw the prices
9 and the gap between the price of a National Grid prepayment meter and a CMO prepayment
10 meter, we had to change that approach.

11 Q Did you take account of potential rebalancing? Are you familiar with that? Did that play a
12 part in your decision making? A. Do you mean the rebalancing of a National Grid cross-
13 subsidy?

14 Q Yes. A. British Gas was keen for the subsidy to be unwound, and that would have
15 opened up the prepayment market more effectively to us, but that was obviously a
16 regulatory issue. So, yes, we did consider it, and if the economic situation had changed and
17 the cross-subsidy had been unwound then no doubt we would have revisited our policy in
18 that area.

19 MR. VAJDA: I have no further questions.

20 THE CHAIRMAN: Mr. Randolph, have you got anything you wish to ask?

21 MR. RANDOLPH: Yes, a few short questions.

22 Cross-examined by Mr. RANDOLPH

23 Q Good afternoon, Mr. Avery, I am counsel representing Meter Fit, just in case you had not
24 grasped that. Can you turn to your witness statement, tab 2, bundle WS1, and go to para.53,
25 p.607. Do you have that? A. I do.

26 Q This is in a general section E, on CMO contracts. A. Yes.

27 Q Just before I ask you the question on the substance, at the bottom of that paragraph you
28 usefully set out who was doing what. A. Yes.

29 Q And it is right, is it not, that Chris Drew, who has not given evidence in these proceedings,
30 led the initial negotiation for Meter Fit? A. He did, yes.

31 Q And David James led it for Capital Meters, but then you came in at the renegotiation?
32 A. With Meter Fit, that's correct.

33 Q With Meter Fit, and so you can assist the Tribunal with regard to that renegotiation? A. I
34 believe so.

1 Q In so far as the commercial negotiation of the original Meter Fit contract was concerned,
2 were you kept in contact? A. Yes, very much so, Chris Drew reported to me, but he
3 conducted the negotiations.

4 Q At the beginning of that paragraph you say:
5 “In respect of the claim that MSA restrict the ability of CMOs to compete
6 effectively with National Grid I believe that this is also untrue.”
7 A. Yes.

8 Q You stand by that proposition, do you, you have got no reason to rethink? A. I’ve no
9 reason to change that view, no.

10 Q Can I just take you to a document that you, yourself, have exhibited, or which has been
11 exhibited to your witness statement, at p.759. Just so that you do not think that I am taking
12 you by surprise and so that you can see what it is – I may be able to take it more shortly.
13 Do you recognise this document? A. Yes, I’ve attached it to my witness statement, I am
14 aware of it. This was British Gas’s submission, it was completed after I left the company so
15 I didn’t have any part in its content.

16 Q Exactly, and as you point out in your very useful index to the exhibits, this is, as you say,
17 Centrica’s response, and it is dated 3rd February 2006, so it is after you left the company?
18 A. Yes.

19 Q Just so that we know, you mentioned just before Mr. Vajda sat down when you left the
20 company. I think you gave a fairly large time period for that. When did you leave? A. I
21 left in April 2005. I actually finished my responsibilities in terms of the job that was
22 relevant to these discussions in October 2004. I did around five months in an interim role
23 before I left.

24 Q So October 2004, which in terms of Meter Fit would mean that you had relatively little
25 exposure to the renegotiated Meter Fit agreement, because of course that was renegotiated
26 in June 2004? A. It was. I completed the renegotiations, and once they were done, and
27 two other areas of business were wrapped up I then moved into another role, that’s correct.

28 Q It may be for that reason, but I will put it to you in any event, there is a discrepancy between
29 your evidence in your witness statement and what this part of the document says. If you go
30 to p.758, just to play you in, the s.26 question is:
31 “The evidence provided to Ofgem suggests that BGT initially favoured a shorter
32 contract duration of 10 years for credit meters and 5 years for prepayment meters.
33 Why did you enter into the legacy contract which has a duration of 18 years for

1 credit meters and 7 years for prepayment meter? Has the 18/7 year duration
2 affected the rate at which BGT replaces meters?"

3 Part of the response to that can be seen on p.759, and it is that last paragraph that I would
4 like to concentrate on. It is, in fact, the last five lines where Centrica/British Gas says in its
5 s.26 response after you have left the company:

6 "These glide path limitations ..."

7 That is the glide path limitation under the MSAs –

8 "... are likely to have significant financial impacts on both BGT and the CMOs.
9 Meter Fit, for example, would like to undertake higher meter replacement volumes
10 which BGT cannot accommodate because of the impact on the Legacy MSA glide
11 path."

12 So British Gas, your old employers' evidence to Ofgem was that Meter Fit would like to
13 undertake higher meter replacement volumes but British Gas could not accommodate that
14 because of the impact of the Legacy MSA glide paths. Do you have any reason to suggest
15 that that statement of your ex-employer is wrong? A. Not really. That's a very small
16 point of detail. Clearly British Gas could have accommodated it by operating within
17 tolerance bounds, but they've chosen not to. In principle, I agree with what you say.

18 Q They chose not to, because it was not economic to do so? A. I would think that would be
19 the case, yes.

20 Q Then my question to you is: how does that tie with your general statement at para.53 that
21 you do not accept the claim that the MSAs restricted the ability of CMOs to compete
22 effectively with National Grid, because if British Gas, your ex-employer, is saying that they
23 could not accommodate Meter Fit's wish to look for higher meter replacement volumes,
24 they could not accommodate that because of the impact of the Legacy MSA glide path,
25 surely that shows, does it not, that the MSAs did restrict the ability of at least Meter Fit to
26 compete with National Grid, because it simply was not able to replace the higher number of
27 meters it wanted to? That is what BG is saying, is it not? A. Clearly, I can only – in
28 terms of my witness statement, I can only comment on the situation up to the time at which
29 I left British Gas. I can see the words that are written there, but it would be wrong of me to
30 speculate on what British Gas's position after I left was. Up to the time that I did leave, my
31 view was, and still is, that the MSAs and the volumes that British Gas were allowed to
32 exchange within the MSAs specifically for Meter Fit, allowed Meter Fit to compete
33 effectively with National Grid, and to undertake the number of exchanges that we
34 contractually agreed with them.

1 Q But that is not the position of your ex-employer after you left, because they have said
2 exactly the opposite? A. Yes, I have no other knowledge other than the words that are on
3 that page.

4 Q No, but the trouble is that of course you have your witness statement, and this is exhibited, I
5 have not conjured it out of thin air. You exhibited this document to your witness statement,
6 so is it fair to say that in retrospect, and had you taken into account this last paragraph that I
7 had taken you to, you would not have phrased para.53 in the way that you did, or at least
8 you would not have referred to that paragraph? A. No, because I think the comments that
9 I have already made hold good, that with regard to Meter Fit British Gas had agreed a
10 volume of meters which were due to be exchanged by Meter Fit at the rate at which the
11 Meter Fit business would grow, and within the MSAs we were able to honour those
12 commitments. If the MSAs had not been in place would British Gas subsequently at some
13 later point have asked Meter Fit to do more meters, or agreed to a request for Meter Fit to
14 do more meters? I don't know, I have no way of knowing whether British Gas would have
15 wanted to have accelerated the rate of Meter Fit exchanges at some later point in time. I can
16 only say that to the point we agreed the MSAs and indeed through to the renegotiation of
17 the Meter Fit contract we were able to accommodate our obligations to Meter Fit and
18 negotiated a price with them which reflected those obligations.

19 Q Thank you, but that does not quite answer my question, which was: the terms of para.53,
20 when you say that you do not agree that the MSAs restrict the ability of CMOs to compete,
21 that is contradicted by later evidence from British Gas where they specifically say that
22 Meter Fit wanted to undertake higher meter replacement but could not because BG could
23 not allow them to do that because of the impact of the Legacy MSAs. It may be that you
24 cannot explain that because you were not there, but that is British Gas's evidence, and you
25 have no reason to suggest that that evidence is wrong? A. No, as I said I can't really
26 comment on circumstances which may have happened after I left the company

27 Q Thank you very much, I think we can leave that.

28 PROFESSOR STONEMAN: Can I interject there? "Compete" is one of these strange words that
29 means all sorts of different things to different people? A. Yes.

30 Q Could you tell me what your interpretation of the word is in this context? A. Yes, what
31 was in my mind when I wrote those words in the witness statement was that the CMOs were
32 able to enter the market, establish themselves in the market and attract sufficient business at
33 the right price that enabled them to sustain a viable business and complete the obligations of
34 the British Gas contract. I cannot speak for what would have happened with CMOs and

1 other suppliers, or what would have happened with CMOs outside of or beyond the five
2 year term of the contracts or, indeed, after I left.

3 MR. RANDOLPH: Just picking up on your answer to Professor Stoneman, I was going to go to
4 this in any event, but I wonder if you can turn on in this document, this document from your
5 ex-employer, at p.764 in the bundle. This is the question asked of British Gas:

6 “Evidence provided to Ofgem suggests that your meter operators MOs initially
7 had difficulty meeting the policy replacement requirements under the Legacy
8 MSAs.”

9 So the question is relating to policy? A. Yes.

10 Q “Could you explain why this happened and update us on how this situation was handled and
11 whether this is a recurring issue for your MOs?” Then at the bottom of the response we
12 have this from British Gas: “It is BGT’s view that although these additional volumes ...” so
13 it talks about additional volumes coming in:

14 “... will make CMOs’ policy replacement targets more achievable, the revised
15 total number of available meters for policy replacement is still vastly lower than
16 BGT had expected during the Legacy MSA negotiations and lower than necessary
17 to allow the CMOs to achieve reasonable economies of scale.”

18 I think you were responding to Professor Stoneman about what you saw as being to
19 “compete”, would you agree that amongst other things to “compete” is to allow an
20 undertaking, a CMO to achieve reasonable economies of scale, or would you say that is
21 excluded from your definition of “competition” or the ability to “compete”? A. No, I
22 don’t think it is excluded. It is part of the equation isn’t it? There is the volume of meters
23 that they are able to do, the cost associated with accessing those meters which will vary
24 depending on the economies of scale and the densities of the operation and the payment that
25 they are receiving for undertaking those activities, and I think viewing those three legs of
26 the stool together I believe, as I said in the witness statement, that the contracts with the
27 CMOs allowed them to operate effectively on that basis.

28 Q Yes, but of course what British Gas is saying, and again it may be the question that you
29 produced your witness statement after this document, but you left before it was created, and
30 so insofar as there are differences between them you cannot say that British Gas’s answers –
31 you are not suggesting to the Tribunal that British Gas’s answers to the s.26 questions are
32 wrong? A. No, the only areas I could challenge British Gas’s response to the s.26 would
33 be where those responses related to dates and activity before I left.

1 Q Indeed, but neither of the passages to which I have taken you relate to periods before you
2 left? A. That's correct.

3 Q Thank you. Paragraph 55 of your witness statement. I am making good progress madam,
4 so far as time is concerned at least (Laughter) and I hope that is taken in a self-deprecatory
5 fashion. Just so that I can get a feel for this section of the witness statement, so Meter Fit,
6 section 54 to 64, so far as I understand it, and tell me if I am wrong, 54 through to 60 deals
7 with the original position under the original agreement and a little bit later, but pre-
8 renegotiation. Is that right? A. Yes.

9 Q And 56 I note is yellow, and so I am not going to refer to that, and also I am not going to
10 refer to the figures in 57, but when you are talking about those figures those arose and the
11 changes in those figures arose between 2002 and the renegotiation period, because at 57 you
12 say all this was happening before the MSAs were in place, and you refer to an increase in
13 the meter price; we are not going to talk about what that increase was. But there is no time
14 line here given in your witness statement, do you have an idea of when that was? A. Yes,
15 I do. I think the point I am trying to convey in that part of the witness statement was that
16 the problems which Meter Fit had during the first 12 months of its operation from
17 November 2002 through to October 2003 obviously predated the MSAs, so the issues they
18 were facing were unrelated to the MSAs. The difficulties they had experienced in the first
19 12 months of operation were not as a consequence of, or in any way related to the MSAs
20 which were not in existence at that time. The price renegotiation, and I will not mention the
21 figures, and the renegotiation of other terms in the contract were to address the problems
22 that had occurred in the first 12 months of operation.

23 Q Right, so when we are talking about the change, and you later on talk about the
24 renegotiation, and what else happened under the renegotiation, that is all part and parcel of
25 the same process, it is after the first year and so effectively one is looking at November, or
26 end of 2003 to June 2004 with the renegotiation period? A. That's correct.

27 Q Thank you. Now, at para.55 you say: "The volumes that were negotiated with Meterfit..."
28 – just pausing there, those were the volumes that were originally negotiated with Meter Fit,
29 is that correct? A. That's correct.

30 Q '--that were available to them and remained available to them even after the MSAs were
31 signed' Now, is your evidence that they remained available to them and did not change -
32 for ever? Or, is your evidence that they did change at some point? A. (After a pause):
33 I think, if I can just separate the two points in time -- The volumes which were negotiated
34 with Meter Fit and were in their contract were available to them in the first year.

1 Obviously, the numbers of meters that they fitted in the first year were significant for
2 reasons that I think have been discussed elsewhere. They were significantly below what the
3 contract originally provided. Therefore that led to the renegotiation. The renegotiation
4 then took as its starting point the contracted volumes to Meter Fit in what would then have
5 been Years 2, 3, 4, and 5 of the contract. To the best of my recollection those volumes in
6 Years 2, 3, 4, and 5 of the contract also remained available to Meter Fit post the
7 renegotiation.

8 Q Indeed. But, they were different from the original volumes by definition. You have got the
9 original volumes in the 2002 agreement ---- A. Yes.

10 Q -- and then those volumes are renegotiated after the first year. Between 2003 and 2004 you
11 have a change in the volumes. A. My recollection - and obviously I don't have the
12 figures in front of me - is that the volumes in the original contract for Years 2, 3, 4, and 5
13 remained, I will say, broadly unchanged in the renegotiated contract. I think there might
14 have been some minor adjustments to them, but essentially the volumes for the four
15 remaining years of the contract remained unchanged.

16 Q Two points: first of all, your evidence is that you were in charge of this renegotiation. A.
17 Yes.

18 Q But, obviously, you cannot be expected, four/five years on, to have the figures in your head.
19 The evidence from National Grid in these proceedings is that those figures change. There is
20 a question mark as to how much, but they changed. That was dealt with in submissions this
21 morning. A. Right.

22 Q Madam, insofar as Mr. Avery cannot recall presently what those figures were -- I can put
23 them to him to the extent that the confidentiality rests in my client. My client has waived
24 the confidentiality in them. What I am concerned about is that Mr. Avery's evidence just
25 now was 'a small change, but there has been a change'. I am very happy to put those
26 figures to you - because this is not a memory test -- but ----

27 THE CHAIRMAN: The figures went up slightly.

28 MR. RANDOLPH: No. No.

29 (Laughter)

30 THE CHAIRMAN: In those years. No. No. No. In those years.

31 MR. RANDOLPH: Ghastly giggle from counsel.

32 THE CHAIRMAN: That was the point - it depended on whether you looked ----

33 MR. RANDOLPH: The two/three/five ----

34 THE CHAIRMAN: Yes.

1 MR. RANDOLPH: Yes, indeed. Absolutely. But, overall ----

2 THE CHAIRMAN: Overall they went down.

3 MR. RANDOLPH: Very important. They went down. Yes. Yes. (To the witness): Would you
4 accept that, Mr. Avery?

5 (Laughter)

6 MR. RANDOLPH: As madam chairman said quite correctly, they went down. A. Yes. My
7 recollection is, to be clear, that the volumes for two, three, four and five were not reduced,
8 but that we did not agree to add back on the shortfall in meters which had not been fitted in
9 Year 1 - or at least not all ----

10 THE CHAIRMAN: Under the original version of the contract, if there had not been this
11 renegotiation -- If there had been a shortfall in the first year in terms of volumes actually
12 replaced compared to contractual amounts -- What was the position under the contract?
13 Was that then rolled forward into the next year? A. No. To the best of my recollection it
14 wasn't rolled forward. It was covered under this term that we actually negotiated out under
15 the renegotiation which was that British Gas had to effectively reimburse Meter Fit for the
16 loss that it had incurred as a consequence of under-shooting the volume target in Year 1.
17 So, the commercial settlement, which was covered as part of the renegotiation, addressed
18 the shortfall in meters from Year 1. So, the only relevant issue then was the ongoing
19 volumes for Years 2, 3, 4, and 5. So, the contract was designed effectively to keep Meter
20 Fit - and, indeed, Onstream, because they had the same commercial term - business case
21 viable and intact through ensuring that if they didn't fit enough meters, they were protected
22 from the financial consequences -- or, largely protected from the financial consequences.

23 MR. RANDOLPH: Thank you. But, at present you are unable, because of the passage of time, to
24 actually recollect those figures. So, when you say that your recollection is so-and-so -- I do
25 not accept your evidence that effectively there was very little change. I am very happy to
26 put those figures to you, but it may just add time. I will just put it to you that from the
27 figures that National Grid have produced - total figures across Years 1 through to 5, and not
28 2, 3, 4 -- The total figures between the original volumes and the revised volumes - there is a
29 difference of some 45,000 meters. But, you cannot comment on that. A. Yes, I can
30 comment on it because I think I already have - that the under-shoot in Year 1 was addressed
31 as part of the financial settlement that was covered in the renegotiation.

32 Q Yes. A. Therefore, the relevant volumes were Years 2, 3, 4, and 5 and there was no
33 reduction made to those volumes.

1 Q On that basis. But, if you look at totals -- if you compare the original contract - 1, 2, 3, 4,
2 and 5 - to the revised contract, taking into account what actual meters were switched out - 1,
3 2, 3, 4, and 5 -- If you just do the math (as our American colleagues would say), there is a
4 lower volume. A. Yes, but otherwise British Gas would've been paying twice, wouldn't
5 they? They would've been paying once in the commercial settlement for the under-
6 performance in Year 1, and then again in Years 2, 3, 4, and 5. So, the decision was taken to
7 deal with Year 1 as per the contract through a commercial settlement and ensure - which
8 was the whole purpose of the renegotiation with Meter Fit, which was to ensure that there
9 was a viable business which could be taken forward, and in that regard I think it was
10 successful -- to ensure that the volumes were stable and achievable for Years 2, 3, 4, and 5.

11 Q Actually I do not question at all the rationale for the renegotiation. I am just talking about
12 the objective fact - reduction of volumes overall. A. I don't think I can add anything
13 further to what I've said.

14 THE CHAIRMAN: I think you have taken that as far as you can.

15 MR. RANDOLPH: I have put my point. I have put my point to you. Now, in terms of the
16 renegotiation, it was not just however we want to see the volumes. It was not just that
17 which changed, was it? I mean, you were in charge. A. Yes. Yes.

18 Q In para. 61 you talk about the car park. A. Yes.

19 Q I do not think we need trouble the Tribunal with the car park. So, that is one thing which
20 changed. Was there anything else that changed? Do you remember? A. Yes. There
21 were a number of things that changed. There was a change to the -- Obviously, the car park
22 dealt with the way that work was issued. There was a change, as I've already mentioned, to
23 the term that entitled Meter Fit to compensation for under-shooting the volume targets.

24 Q Just pausing there -- I think you mention that at para. 64. Is that the under-shoot? A.
25 Yes. Correct. The Take or Pay provisions.

26 Q Good. What else? A. There were changes effectively to the penalty payments for under-
27 shooting -- or, for under-performing on both the quality of work, quality of data, KPI
28 performance in terms of the number of appointments met and kept. I believe there were
29 also some changes to the way in which the caps of the contract operated.

30 Q Yes. Exactly. So, by that you mean the volume caps, do you? A. Yes.

31 Q Do you recall anything more about the volume caps? A. Yes. I need to reference the
32 statement but I think it is ... (overspeaking) ...

1 Q The point is that it is not mentioned in the statement. That is what I am trying to get to.
2 A. I believe it's mentioned in an attachment to the statement which was a note that I sent. I
3 might need some help in finding the right attachment.

4 Q I am sure Mr. Holmes will be able to take you to it. The first question (before I get to the
5 substance of it) is: Given the fact that you spend four or five paragraphs dealing with the
6 renegotiation and what it did, why did you not mention the volume cap? Secondly, what
7 was the volume cap insofar as you can recollect? A. Insofar as I can recollect, I think
8 there were probably two caps actually. I think there was a cap at [Confidential] percent
9 which constrains the amount by which Meter Fit could or would be allowed to over-shoot
10 the annual contract volumes.

11 Q And before you answer the first question, which is why you did not mention that in your
12 witness statement, do you recall why that volume cap was brought in to the renegotiated
13 contract? A. I do, yes. I have now found the document that I was referring to. It is at
14 p.746.

15 Q This is all redacted for me. A. On p.746, the second bullet, "Car Park Volumes" is not
16 redacted.

17 Q I have got "Car Park Volumes". A. It says here, which was my recollection, that the
18 introduction of the car park, which was a mechanism that had been introduced to give
19 Meter Fit a better density of operation to ensure that it had sufficient work available to keep
20 its operatives productively employed. As a consequence of that, British Gas effectively
21 gave away the control which it previously had on the way in which the contract operated
22 whereby it had issued, not quite but essentially, individual jobs to Meter Fit to do. So the
23 renegotiation of the contract, which I think helpfully introduced the car park concept,
24 helped Meter Fit manage its productivity. It was coupled with something to replace the
25 control that had otherwise been lost as a consequence of the difference in the way that the
26 work was being issued, and we replaced the control that had previously been issued on a job
27 by job basis with a control over the total volumes of work which Meter Fit was allowed to
28 do in the year.

29 Q That, Mr. Avery, is not the volume cap, is it, that you and I were discussing – in other
30 words, the [Confidential] per cent – whereby effectively a material breach is triggered if
31 Meter Fit over-sold, if you will, over-placed its meters beyond the volumes. In fact,
32 unfortunately, on this very sheet you have got material breach triggers underneath your car
33 park volumes, which had nothing to do, I think you would agree, with that volume cap
34 figure, and that seems to be pretty much all redacted, so that does not really help us. Would

1 you agree that the [Confidential] per cent volume cap is not the same as the volume point
2 that was mentioned in that car park volume point? It is a different point, is it not? A. It's
3 not the same, but it is entirely linked to it. Until the car park operation had been introduced,
4 British Gas controlled the volume of jobs which Meter Fit did by the way in which jobs
5 were issued. Simplistically, they couldn't do any more jobs than the total number of jobs
6 that we gave them. Once we had opened up the car park arrangement, they had a portfolio
7 of jobs to go for and British Gas would have had no control over the number of jobs that
8 they did. In order to replace the control that had been lost as a result of that change in
9 operation, two caps were introduced to the contract, and those are the ones which would be
10 noted on that page but have been redacted.

11 Q I see. So your evidence is – despite the fact this is not mentioned in your witness statement

12 ----

13 PROFESSOR STONEMAN: Could I just interrupt there. In the middle of p.747, the document
14 we are looking at, it says “Annual Benchmark Volumes”. Has that been redacted in your
15 copy?

16 MR. RANDOLPH: No. I have got “Material Breach Triggers”, and (iii) by the look of it:

17 “(iii) failure to attain 70% or more of benchmark volumes for the installation of
18 gas prepayment and credit meters and [redaction] ...”

19 and that is it, and that is not the same as, I think, the [Confidential] volume cap.

20 PROFESSOR STONEMAN: It says “The Amendment Agreement includes”, and it is not
21 redacted here:

22 “... new annual benchmark volume targets for weighted gas and electricity
23 prepayment and credit meters and sets out the consequences if MFNE/MFNW fail
24 to meet, or exceed, specified volumes.”

25 MR. RANDOLPH: That is the same. Are we back not in Camera.

26 PROFESSOR STONEMAN: This is not redacted in my copy, which is why I can read it.

27 MR. RANDOLPH: Absolutely, good.

28 PROFESSOR STONEMAN: Would you like to see my page?

29 MR. RANDOLPH: I would love to see your papers, Professor Stoneman!

30 THE CHAIRMAN: Can we try and get to the point, which I think is, why did it matter to British
31 Gas if Meter Fit replaced more meters in the car park – why did it matter how many of the
32 meters in the car park, once you have given them the car park, they replaced? A. I guess
33 there are a couple of reasons. Clearly, as we discussed elsewhere, British Gas did have to
34 balance the MSA – the volumes we were allowed to exchange under the Legacy MSAs with

1 the numbers that we contracted to with the meter operators. That was an important
2 balancing issue for us. If significantly more meters had been exchanged than the number
3 that we contracted that would have pushed us into the tolerance bounds which would have
4 increased the cost. Clearly we didn't want that to happen. So I think that was clear and I
5 would think not in dispute. Also though, we do want to ensure that the meter operator
6 operated effectively and delivered a quality service to British Gas in terms of the jobs that it
7 did, the volumes of jobs that it did, and that the focus was on delivering good quality work,
8 not going for the maximum number of jobs that it could do, and effectively picking out the
9 easiest jobs out of the portfolio that had been given to it. I think you would expect any
10 tendering party to retain some control over volume in the work that they are giving to its
11 sub-contractor, and that is what British Gas was doing through those caps.

12 Q The meters in the car park are meters which you have decided you want to have replaced?

13 A. They're a pool of meters from which the replacements should be drawn. That didn't
14 mean that we would all of them replaced in one year, otherwise that might have given us
15 problems in meeting their volume obligations in subsequent years.

16 MR. RANDOLPH: Thank you very much. That is all the questions from me. Professor
17 Stoneman, I was being incredibly slow. I was looking at the wrong page. I do have the
18 version that you were looking at, but I still think that it does not quite deal with the
19 [Confidential] point.

20 PROFESSOR STONEMAN: I think that is where the [Confidential] comes in.

21 MR. RANDOLPH: Yes, although I do not think [Confidential] were actually mentioned. I do
22 have it so we are *ad idem* on that point. Thank you very much indeed, Mr. Avery.

23 THE CHAIRMAN: Thank you. I have a few questions.

24 MR. VAJDA: Madam, there was an oversight on my part. Those next to me point out that there
25 is one document I failed to put to Mr. Avery. Could I put it with your leave?

26 THE CHAIRMAN: Yes, go ahead, Mr. Vajda?

27 Further cross-examined by Mr. VAJDA

28 Q Mr. Avery, do you have witness bundle 5. It is an email and it is at tab 15, p.2782.

29 A. Yes, I have that.

30 Q It is an email from somebody in your team, Steve Lewis. Could I just ask you and the
31 Tribunal to read the second paragraph of that email. (After a pause) You will see that the
32 second reason that Mr. Lewis gives for the maintenance is:

33 "As we continue to pay for maintenance on these meters, we will be asking
34 Transco to continue to maintain their meters, rather than our Meter Operator

1 attending and replacing the Transco asset on call-out. Meter Operator PP activity
2 will, therefore, initially cover customer driven work ...”

3 The question I want to ask you is how you square that with what you say at para.105 of your
4 witness evidence, which is at p.621, where you say:

5 “If a call comes in from a customer that requires a meter to be maintained British
6 Gas’ call centres can direct the call to whoever they like.”

7 A. Yes. I think the two align perfectly well, as we discussed previously when the call comes in
8 British Gas does have the option of directing that call to its CMO. If it does direct it to the
9 CMO the CMO would need to go and replace the meter. Replacing the meter would
10 increase British Gas’s costs for the reasons previously discussed so it took the decision not
11 to direct those calls by and large to its meter operator, but to direct them to National Grid
12 and to maintain the meter where that could be done. I think that is what Steve is saying.
13 The only point I would take issue with really is the first part of that, the second sentence
14 which says: “As we continue to pay for maintenance”, I think we discussed in counsel’s
15 questions previously that it wasn’t specifically the fact that we were continuing to pay for
16 the maintenance, we would have had to pay for the maintenance whether we directed the
17 job to the CMO or not. If National Grid were unwilling to unbundle the issue was we
18 directed it to National Grid in order to avoid increasing ongoing pre-payment meter rental
19 costs.

20 MR. VAJDA: Thank you very much.

21 THE CHAIRMAN: Just following on from that point, if you look at p.763 of your witness
22 statement, this is a document which I think Miss Carss-Frisk took you to, this is another of
23 the questions that BG answered in the investigation. There it says: “BGT suspects that
24 instead of carrying out routine maintenance” and we are talking here about prepayment
25 meters, “... such as battery replacement, meters are being unnecessarily exchanged.” So
26 that suggests that it was not the policy as far as prepayment meters were concerned that you
27 would have a first visit if National Grid went out to the meter. Is that right? A. Yes, I
28 think that is right. British Gas’s preferred outcome, if I can describe it that way, would be
29 that National Grid went out and maintained the meter, rather than fitted a replacement.
30 Clearly in some situations it would be necessary to fit a replacement because it was not
31 possible to maintain the meter. My interpretation of what British Gas said in their response
32 here is that they believe that some meters were replaced that could have been maintained. I
33 have no way of knowing whether that is true, obviously.

1 Q No. You did say in your witness statement that at the time you were negotiating the MSAs
2 you did not expect that there would be anything more than a tiny fraction of meters on the
3 New/Replacement contract with National Grid? A. Yes, that is correct, because we
4 thought we would have commercial meter operators in place, and the intention would be
5 that jobs that needed a meter to be exchanged would be directed to the CMOs. I suspect
6 that may have proved difficult for call centres to have made the judgment in all cases based
7 on the information that the customer gave them, so potentially some jobs may have gone to
8 National Grid that perhaps could have gone to a CMO and the inference in this statement on
9 p.135 is that even perhaps some jobs that should have gone to National Grid to maintain the
10 meter appear to have gone to National Grid and resulted in a replacement, but I have no
11 knowledge of that from the time I was at British Gas, but obviously that appears to be an
12 issue that they have encountered subsequently.

13 Q In para. 46 you say that the original business case for the CMOs assumed a programme
14 lasting 13 to 14 years of replacement? A. Yes.

15 Q It may be that you cannot answer this, but the invitation to tender, I gather it was published
16 in the official journal? A. Yes.

17 Q Was British Gas bound by the procurement rules at the time, do you know? A. I am
18 pretty sure we would have been. I couldn't say for sure but my assumption is that we would
19 have been, yes.

20 Q Would it have been apparent from the invitation to tender that that was the timescale that
21 you were anticipating for the replacement of the meter stock? A. I think it would have
22 been easily deduced from the information in the ITT because the number of customers that
23 British Gas had was not a great secret, it was probably fairly well known and taking into
24 account the number of exchanges we were planning to be done you could pretty much work
25 out what the expected rate of replacement would be. So "yes" I think is probably the
26 answer.

27 Q I am just wondering then why National Grid would then have thought that you were able to
28 do this replacement programme at such a fast rate when you were negotiating with them in
29 eight years or five years or seven years if the tender had contemplated 13 to 14 years?
30 A. I believe I have touched on this in this part of the witness statement, appointing
31 commercial meter operators was a new activity for British Gas and clearly as we
32 subsequently found the mobilisation was quite difficult so in developing the business case
33 for appointing the commercial meter operators we needed to ensure that we had volumes in
34 it that the commercial meter operators could sustain and which were going to be accepted

1 by the Board as a reasonable way forward, but that is not the same as saying that was the
2 fastest that we could go. Clearly if we had decided to move away from an exchange rate
3 of 13 to 14 years to one that was five, six, seven or eight years we would have needed to
4 have sat down with our commercial meter operators having been appointed and negotiate a
5 ramp up of activity and there would have been a cost in consequence.

6 Q Would you not have had to re-do the procurement exercise? A. That was not the advice
7 we had at the time, but I can't probably comment further. My understanding was that the
8 volumes in the ITT didn't constitute a commitment, they were an indication of volumes, and
9 were the basis on which commercial meter operators were asked to submit their tenders, but
10 the prices were then negotiated and adjusted to reflect the actual mix of jobs which were
11 being issued to them and the actual volume of work that we required them to carry out.

12 THE CHAIRMAN: Yes, thank you. In para. 53 of your statement, half way down, you say:

13 "Furthermore the opportunity to change a meter exists only once: as the CMO
14 contracts assure the CMO that it will recover revenue over the meter's life."

15 Could you just explain how the CMO contracts assured that? A. Yes, I will answer it as
16 best I can. It may be that there are some points of detail here on the way in which the CMO
17 contracts -- in the detail of negotiation that I wasn't party to. But, I guess David James
18 would've been, and may be able to add something to this answer. It was important for
19 British Gas, obviously, to be able to negotiate as low as possible a rental with the CMOs.
20 Clearly, one of the exposures for the CMO is its risk - the fact that it is going to incur a cost
21 in putting a meter in up front that it is not subsequently going to be able to recover. I think
22 that risk occurs in probably three ways: the risk that this churns, and the customer moves to
23 another supplier, and the risk that there is going to be a functionality change -- in other
24 words, we change the meter from a prepayment to a credit or a credit to prepayment, and
25 the possibility that a newer or better meter will come along with some advanced technology
26 that we want to replace it with. So, what we were trying to avoid was having the CMOs, by
27 and large, pricing for a risk that may not materialise so that essentially the price that they
28 charge for the rental of the meter should assume that the meter would be in situ for its
29 natural life, by and large, and that the exposure to those risks (for example, new technology)
30 would be covered by a technology replacement charge - I can't think exactly how it was
31 termed - where the CMO, even in what was referred to as the secondary period of the
32 contract beyond the first five years where they had the primary obligation to install meters -
33 - They could continue to earn revenue on that meter in Years 6 through to 20, and if that
34 meter was taken out to be replaced during that period through better technology, for

1 example, then they would be entitled to a replacement charge, and then churn risks were
2 obviously covered in other ways. The onus was on the meter operator to seek to continue to
3 rent that meter to the new supplier.

4 THE CHAIRMAN: During the secondary period, if you had appointed a different CMO after the
5 first five years, then that CMO would be then replacing a certain number of meters per year,
6 but you would be continuing to rent some meters that had been installed in the primary
7 period by that CMO. A. That's correct.

8 Q But, apart from the technological reason for replacing the meter, if a meter had been
9 replaced by your new contracting partner at the end of the five year primary period, was
10 there a payment to be made to the original CMO? A. Yes. My recollection -- I think it
11 would depend on the reason for the replacement. If it was replaced, I believe, as a customer
12 request - an exchange, in other words, of credit for a prepayment - I don't think they
13 would've been compensated for it. But, I will defer to David, or others who are perhaps
14 closer to that part of the negotiation. Certainly the intention underpinning the CMO
15 contracts was that once the CMO put the meter in, it would be in until it was no longer
16 required, and it was not the intention to appoint a second meter operator after five years,
17 coming in and replacing those meters which the first CMO had installed. The contract was
18 designed to prevent that happening. I probably wasn't quite close enough the detailed
19 mechanics of the contract terms and with the passage of time I can't be absolutely certain as
20 to how those mechanisms worked, but the principle was there to protect the CMO from
21 losing the future rental stream from the installed meter stock.

22 Q Thank you.

23 MR. SUMMERS: Mr. Avery, good afternoon. I wonder if you could help to develop the linkage
24 between paras. 93 and 94 of your statement where you talk about the introduction of smart
25 metering. You describe in para. 93 a National Grid proposal for a scheme which would
26 have allowed the introduction of some flexibility into the MSAs, which was then rejected
27 by Mark Clare on the grounds that he did not want to pay up-front for flexibility. Then,
28 suddenly, in para. 94, without more ado, we have got a trial lasting three years involving
29 50,000 customers - which, by what we have heard in court this afternoon, is quite a large
30 number. A. Yes.

31 Q What needed to be done to the MSAs to enable that trial to take place? A. Yes. Perhaps I
32 should clarify. The trial was already underway by the time the MSAs were negotiated. The
33 trial started in 2001 and ran until 2004. So, there was no specific impact of the trial on the
34 MSAs themselves. Prior to the MSAs we had replaced, in agreement with National Grid,

1 some National Grid meters with smart meters for the purpose of this trial, and done a
2 similar activity on the electricity meters. Through 2001, 2002 and 2003 we were evaluating
3 the benefits that we were seeing as a result, in terms of the cost to serve those consumers,
4 reductions in meter reading cost, reductions in debt cost, reductions in billing cost,
5 improved cashflow, any advantage in terms of reduced customer churn from that trial. The
6 purpose of the trial - rather than to test the technology itself - was to demonstrate whether
7 smart metering at that stage would deliver benefits to justify a national deployment.
8 Clearly, when we started the discussions on the MSAs we weren't sure whether the business
9 case would prove attractive, or not. It subsequently proved that it didn't. But, when we
10 were commencing discussions on the MSAs we wanted to give ourselves the flexibility to
11 deploy smart metering if we needed to do so. By the time we got to the point of signing the
12 MSAs, as I think I reflected in one of the papers we discussed this morning, we had
13 determined an alternative strategy, if necessary, for deploying AMR smart metering which
14 would allow us to replace meters as they became due for exchange and to retro-fit smart
15 devices on to meters that were already enabled to take AMR. So, I think the direct answer to
16 your question is that the trial itself pre-dated the MSAs and therefore didn't really affect
17 them. The outcome of the trial could've been significant, but it wasn't because there wasn't
18 a business case.

19 Q Were the meters then removed after the trial? A. I think the devices were removed, or at
20 least disabled. So, it was a meter and a module attached. But, you could effectively turn off
21 the communication part of the meter and the meter could continue to operate as a manual
22 meter, manually read. I don't believe that it was necessary to go and physically remove the
23 module and that you could just leave it (overspeaking) ...

24 Q I see. So, it did not impact on the subsequent performance of the meter itself. A. No, it
25 didn't, no.

26 Q Thank you. Professor Stoneman wants to ask a question.

27 PROFESSOR STONEMAN: It is my fault. I was asked earlier whether I had any questions and I
28 said, 'No'. The answer to this might be confidential, and so we might have to have it written
29 down: I am fascinated by the way that British Gas was so attracted by short-term gains from
30 the MSA contract, perhaps at the cost of long-term disadvantage. All of the calculations
31 are in terms of net present values. A. Yes.

32 Q Is it possible to inform us what the discount rate was that was being used in these net
33 present values? Would this be a matter of private or public information? A. I don't
34 know. I guess it wouldn't have been public information. I'm not even sure, to the nearest

1 percent, that I can be absolutely certain of it because the discount factor used in the NPV
2 calculations varied over time, depending on our finance colleagues' view of the future value
3 of money essentially. But, essentially it reflected the cost of capital to British Gas. I think
4 that's probably the easiest way to answer the question. So, if you were not investing this
5 pound on a smart meter, or you weren't investing this £1 on a Legacy contract, what would
6 be the cost of that £1 that you save, if I can describe it that way, if you were getting that £1
7 from the shareholders or you were getting that £1 from lenders. So it was – I don't know if
8 I should say ----

9 THE CHAIRMAN: No, I do not think you should say anything further than that for the moment.
10 I think if we want more detail perhaps it can be dealt with in correspondence and then
11 British Gas will have an opportunity to express a view as to that information. Mr. Holmes,
12 any re-examination?

13 MR. HOLMES: Madam, before I begin, in relation to your question about the charging
14 arrangements for the like for like replacement under the CMO contracts, may I give you a
15 quick reference to the correspondence bundle. This matter is, in fact, covered by a letter
16 sent by Ofgem on 6th October 2008 to National Grid's solicitors, which is at CR3, tab 191.
17 I do not ask you to turn it up now. I should say it was referred to in Mr. Turner's opening.
18 Just for your record, I believe that question is addressed in that correspondence.

19 THE CHAIRMAN: Which question is that?

20 MR. HOLMES: You asked Mr. Avery, if I understood your question correctly, what charge
21 would apply if a CMO's meter was replaced by another CMO appointed outside the primary
22 period of the CMO contracts, and that question is canvassed and covered in the
23 correspondence to which I referred.

24 THE CHAIRMAN: Thank you.

25 Re-examined by Mr. HOLMES

26 Q Mr. Avery, just a few short questions. Miss Carss-Frisk began with some questions about
27 British Gas's discussions with Ofgem in the run-up to the MSAs, and she took you a
28 document in which it was recorded that Iain Osborne considered that Ofgem was unlikely to
29 oppose the implementation of an accelerated replacement programme. Could you turn,
30 please, to p.739 of the exhibit accompanying your statement. This is an email from you to
31 Paul Bysouth of 28th November 2003, with a paper by Mark Clare attached to it. A. Yes.

1 Q And on p.742 the document states in the final sentence at the end of the first paragraph:
2 "Ofgem have also indicated during discussions that they would not support an
3 aggressive exchange programme."

4 I wonder if there is anything you would like to add to your answer about the documentary
5 evidence at the MSA negotiations of contacts with Ofgem? A. Yes, I think the question I
6 was asked was had I received – I believe the question I was asked was had a I received any
7 confirmation or otherwise from Ofgem around what would be appropriate for exchanging
8 meters and what wouldn't, how older meters should be – as I referred to earlier, my
9 understanding was that there were discussions between our regulatory team and their
10 colleagues at Ofgem on the issue around a more rapid meter exchange programme than
11 would have been necessary to do the same as had been done by National Grid, the historical
12 volumes. I spoke earlier, I think, about the email that Iain Taylor had sent, the British Gas
13 head of regulatory had sent to Mark Clare in 2002, and of course this paper is 12 months
14 further on in December 2003. So I think this shows clearly at that stage that British Gas
15 still believed that Ofgem had concerns of an accelerated exchange programme. I believe
16 that was probably reinforced by other contacts. I am aware that at the point of renegotiation
17 the Meter Fit contract, Paul Bysouth, my director, had written to Gordon Waters of UU,
18 also setting out what would be the youngest meter that we could exchange. I think he
19 settled on 12 years and said that ten would be regarded as premature replacement. My view
20 and understanding was that those positions – which is also reflected in this Centrica
21 executive paper – had been developed as a consequence of discussions between regulatory
22 and Ofgem.

23 Q That brings me to my next question. Miss Carss-Frisk asked you whether you were
24 suggesting that Ofgem had given British Gas any specific guidance about an age based
25 strategy of meter replacement, and you replied that there was no documentary evidence of
26 such guidance. Can I take you back to a document that Mr. Vajda took you to in bundle
27 M1, tab 21. You will remember that this is an email from your colleague, Mr. Steve Lewis,
28 of 3rd January 2003, and you were one of the recipients ----

29 THE CHAIRMAN: Mr. Holmes, we are not sitting in Camera at the moment. Do we need to do
30 so in order for you to ask this question?

31 MR. HOLMES: I think perhaps we do, although the passage to which I intend to refer the witness
32 is – it is very difficult to see how it could possibly be controversial. It is the final sentence
33 of the first bullet on the top of p.121. It may be that it will be possible to put the question to

1 Mr. Avery without revealing the contents of the bullet. (To the witness) Could you read
2 the final sentence of that bullet? A. Yes.

3 Q Does it lead you to revise your answer in any way? A. I haven't seen this document
4 before because obviously the previous version I saw of it was entirely redacted. I think the
5 question was around, "Had there been documentary evidence?" and I interpreted that
6 question as meaning from Ofgem to British Gas. I am aware that there is considerable
7 documentary evidence recorded by British Gas with concerns around a more accelerated
8 meter exchange from Ofgem, and sometimes specifically around the age of meters that we
9 believed would be acceptable to the exchange, and those statements have been based on
10 what we understood to have been discussions which had taken place with Ofgem. So
11 perhaps I should clarify my earlier statement. My belief is that the position that British Gas
12 took in terms of its age replacement policy and the age of meters which it would allow
13 CMOs to exchange was as a consequence of discussions that had happened between our
14 regulatory team and Ofgem. I didn't personally have any documentation which confirmed
15 what Ofgem had said to our regulatory team.

16 Q Thank you, Mr. Avery. Miss Carss-Frisk asked you whether the rental price under the
17 Legacy MSAs was still above the level offered by CMOs, and you agreed with that
18 proposition. Could you please view the final sentence of para.45 of your statement.

19 THE CHAIRMAN: Just a minute, Mr. Holmes, that is all in yellow in my copy.

20 MR. HOLMES: I am so sorry, madam, I am afraid that I failed to apprehend that.

21 THE CHAIRMAN: Could you read that paragraph, Mr. Avery. A. (After a pause) Yes, I
22 have.

23 MR. HOLMES: Is there anything you would like to add as regards the comparative prices
24 available to British Gas under the CMO contracts with an accelerated replacement
25 programme and the Legacy MSAs respectively? A. If I again can clarify, I think the
26 MSA price for British Gas was equivalent to – and I am now hesitating as to whether I can
27 say the number of years. I thought it appeared elsewhere unredacted in the witness
28 statement, but it appears to be highlighted in yellow, so perhaps I can only refer to the
29 words actually in the witness statement in para.45. It does say that the threat of - how can I
30 answer this question with out using the words ----

31 Q Well if it assists you in para.52 there is a reference to a seven year replacement programme?
32 A. Thank you. Yes, I thought that the seven years had been recorded in my witness
33 statement without having been redacted; it appears to have been redacted in one place but
34 not in the other.

1 THE CHAIRMAN: Well that is a slightly different point that is being made in para. 45. Here in
2 para. 52 we are talking about the net present value expressed in terms of equivalence to
3 accelerated meter replacement programme? A. Yes, I probably need a little help now
4 reminding me what the actual question was I need to answer.

5 MR. HOLMES: Of course, the question is that you in your evidence in response to a question
6 posed by Miss Carss-Frisk as to whether the rental price under the Legacy MSA was still
7 above the level offered by CMOs, you answered “Yes” and I was asking whether in the
8 light of para.45 there is anything you would wish to add to that answer? A. Thank you,
9 yes, I understand the question. For an individual meter the rental price for a Legacy MSA
10 meter is clearly higher than the average rental price for a CMO meter. For British Gas, of
11 course, it is not particularly interested in what the cost of an individual meter is, it is
12 interested in what its overall metering costs are across the population. The advantage which
13 the MSAs gave British Gas was a big up front reduction in its overall metering costs, which
14 could only have been achieved by, there is reference in para.52 of my witness statement, a
15 rapid seven year meter replacement programme. So the MSAs did achieve benefits for
16 British Gas and therefore consumers which would not otherwise have been available.

17 Q Thank you, Mr. Avery. On smart meters, Miss Carss-Frisk asked you whether there was a
18 concern within British Gas in 2003 about the possible impact of the Legacy MSAs and the
19 scope to deploy smart meters. You answered by reference to a paper at p.684 of the exhibit
20 accompanying your statement, could I ask you again to review the paragraph on p.684:
21 “Changes in Metering Technology”? A. (After a pause) Yes.

22 Q In the light of that paragraph can you please clarify how British Gas compared the impact of
23 the Legacy MSAs on smart metering with the option of accelerated replacement under the
24 CMO contracts on smart metering? What were the respective impacts of an accelerated
25 replacement programme under the CMO contracts and under the Legacy MSAs respectively
26 as you saw them? A. I think, if I have understood the question correctly, but perhaps I
27 can just replay the question to make sure I have understood it, the way in which we assess
28 the impact of a smart metering deployment on the CMO contracts and the way in which we
29 assessed the impacts of a CMO deployment on the Legacy metering stock, are you referring
30 to a rapid deployment of AMR or a normal rate of AMR deployment?

31 Q I have in mind the discussion in the paragraph to which you refer in the third sentence:
32 “This applies equally to meters installed under the new 5 year commercial meter operator
33 contracts.”? A. I think my point here was that the Legacy MSAs effectively allowed us
34 to replace credit meters at one-eighteenth of the installed stock every year, and that if we

1 chose to go faster than that to deploy AMR there would be a cost. We believed we could
2 avoid that cost by sticking to the one-eighteenth, coupled with retrofitting devices on
3 younger meters which were already in situ. We followed the same logic on meters installed
4 with our commercial meter operators where, if we had chosen a rapid deployment of smart
5 metering on CMO installed meters that required removal of CMO meters that would have
6 incurred a similar cost, because we would have exposed ourselves to the technology
7 replacement charge that I referred to earlier. So our analysis of the best way of deploying
8 smart metering took into account both the Legacy contracts and the CMO contracts and
9 concluded that we could have a common approach which fitted both contracts, because the
10 consequences to us of operating outside of them were broadly similar.

11 Q Thank you. If you would turn to para. 103 of your statement. Mr. Vajda asked you a
12 number of questions about the 50 pence per meter provision made in respect of the amount
13 of rental attributable to maintenance of a DCM. Can you just clarify for the Tribunal under
14 which contract was that 50 pence provision made? A. That was under the P&M
15 contracts.

16 Q And do the MSAs identify any separate maintenance component? A. No.

17 THE CHAIRMAN: But under the MSAs it is still the case that if they go out to maintain a meter
18 and they do actually maintain the meter? A. Yes.

19 Q Is there then a separate charge under the MSA for that visit? A. No.

20 Q So the maintenance cost is still part of the rental charge but it is just not expressed as a
21 separate or identified as a separate component? A. It is not separately identified.

22 MR. HOLMES: You were asked by Mr. Vajda whether you knew that PPMs were important to
23 CMOs for the viability of their business, and in your response you stated that National Grid
24 would not have allowed all credit meter work to go to the CMOs, while leaving PPM work
25 with National Grid. Can you just clarify reasons why, in your view, National Grid would
26 not have allowed credit meter work to go to the CMOs while leaving PPM work with
27 National Grid? A. It relates back primarily, there may be other reasons, but primarily I
28 believe to the cross-subsidy between credit and prepayment that if that happened National
29 Grid would be left with costs of maintaining its prepayment portfolio which exceeded the
30 revenue it was earning exclusively from that prepayment portfolio because part of the costs
31 of prepayment are effectively subsidised from credit. That is my understanding of the
32 situation.

33 Q Mr. Randolph took you to British Gas's response of 3rd February 2006 to some questions
34 put to it by Ofgem during the Administrative procedure and asked you how that was

1 consistent with your claim at para.53 that you did not believe that the MSAs restrict the
2 ability of CMOs to compete effectively with National Grid. He took you only to the first
3 sentence of that paragraph. I wonder if you could look at the subsequent sentence, and if
4 you could explain the relevance to the observation in the first sentence of the fact that
5 British Gas had chosen a replacement rate of fourteen years? A. Yes. I believe, if I recall
6 correctly, that counsel's questions related to a comment from British Gas made after my
7 departure that Meter Fit wanted to increase the number of meters that it would fit. In
8 response to that, and as confirmed in my witness statement in para. 53, the contracts were
9 negotiated with CMOs based on a replacement rate of around fourteen years. It was that
10 rate which underpinned volumes in the contracts, and that rate against which the price for
11 meters being fitted by CMOs was calculated. A different term and a different rate of
12 replacement would doubtless have led to a different price. So, my understanding would've
13 been that CMOs would've priced their submission in the knowledge of the number of
14 meters that they would be getting to exchange, and would've tendered with a price that
15 allowed them to create a viable business case. That, madam, as I mentioned in response to
16 your colleague's question, was my understanding of the term 'compete'. It allowed them to
17 deliver the business case that they had tendered for. Any changes to that, either with the
18 MSAs being present, or not, would've been a subsequent negotiation.

19 Q Mr Randolph put it to you that Meter Fit's volumes had been reduced as a result of the
20 renegotiation which took place in the course of 2004. Could you turn, please, to the
21 document at p.754 of the exhibit to you statement? (After a pause): Could you read,
22 please, the paragraph under the heading 'Actions Already Take' - the first paragraph under
23 that heading? (Pause whilst read): You will see the final sentence of that paragraph,
24 "Given the commercial difficulties experienced by UU, a commitment to allow
25 them to operate at 100 percent volume was given during the recent
26 renegotiations".

27 A. That's correct, yes. The first part of that paragraph said that there was potentially an
28 option to reduce Meter Fit's volumes to 90 percent, which was the floor of the contract
29 (which I think we discussed earlier). In discussions that I had with colleagues at Meter Fit
30 and United Utilities during the renegotiation we agreed that notwithstanding the flexibility
31 within the contract, we would allow them to operate at 100 percent of the volume for the
32 remainder of the contract.

1 Q So, how does that affect, if at all, your answer to Mr. Randolph's question? A. I was
2 asked a number of questions on that point. I am probably struggling slightly to remember
3 which answer and which question ----

4 Q He put to you specifically that Meter Fit's figures were reduced across the period of its
5 contract. A. Yes. I think I made clear in my answer, but to re-confirm -- There was no
6 reduction in the number of meters which Meter Fit were allowed to install from the point of
7 the renegotiation through to the completion of the contract.

8 Q Thank you. One final question arising out of Professor Stoneman's question: he said that he
9 was fascinated by the way that British Gas was so attracted by the short-term gain arising
10 from the MSA contract, perhaps at the cost of long-term advantage. Was that how you saw
11 matters at the time? A. Probably not quite. I think the MSAs clearly delivered
12 significant up-front savings. In the later years of the MSAs that did mean that British Gas'
13 total metering costs would have been slightly higher than they would have been if we'd've
14 embarked on an accelerated meter exchange and made full use of the lower CMO prices.
15 But, the only way that I have been aware of in business that you can effectively compare
16 value today with value tomorrow is to use discounted cashflow techniques where you
17 calculate the net present value of the decision that you are taking. On that basis, as recorded
18 elsewhere in my witness statement, the MSAs gave the best deal available to British Gas. It
19 reduced British Gas' total metering costs by more than could have reasonably been
20 achieved by any other means. Therefore it was the right decision to take to enter into them.

21 Q In this connection you offered at one stage during your evidence, in response to questions
22 asked by Miss Carss-Frisk, to expand on your analysis of the pros and cons of the Legacy
23 MSAs from the point of view of smart metering. Would you care to do so now? A. The
24 pros and cons of the MSAs from the point of view of smart metering -- I think the issue that
25 I was alluding to there - and please correct me if I am going off on the wrong tack - was
26 whether the MSAs -- The rate of AMR deployment - smart metering deployment - would
27 adversely affect the smart metering business case. That was fundamentally the issue. My
28 belief on that, having been closely involved with the AMR pilot and the development of the
29 business case, was that the savings from deploying smart metering come from reduced
30 meter reading costs, better billing, reduced back office activity in dealing with amended
31 bills, faster cashflow, lower debt, and perhaps some reduction in customer churn. All of
32 those benefits accrue on a per meter basis. If you install one smart meter you save a little on
33 meter reading, a little on the billing, a little on the better cashflow, and you reduce the risk
34 of churn. So, in that respect the benefits of smart metering are linear. They accrue meter by

1 meter. I am struggling to think why anyone would assert something different. I was puzzled
2 by that e-mail that I was drawn to, as to why the benefits would be anything other than
3 linear. The only area on benefits that I could conclude that are not totally linear are where
4 the savings become so big that you can close a call centre or you can close an office and
5 you achieve some fixed cost saving over and above the variable costs that you save from
6 deploying individual meters. But, that has to be on a massive scale to save enough money to
7 close one of British Gas' 1,000 seat call centres. So, we concluded that the AMR smart
8 metering business case -- the benefits were linear and therefore that the business case, at
9 least as far as costs were concerned, is not significantly impacted by the rate at which you
10 deploy -- Sorry. -- as far as benefits are concerned. As far as cost is concerned, clearly, as
11 with any other project, there are some up-front costs of mobilising a project, but in smart
12 metering they are fairly small compared with the big cost which is the cost of the smart
13 meter itself and the cost of ongoing communications with that smart meter. So, in much the
14 same way as the benefits are linear, the costs of smart metering are also broadly, and
15 therefore the business case itself is not unduly affected by the rate at which you deploy. If it
16 had been a fantastic business case, then clearly by deploying more quickly you would bring
17 the benefits forward but if the business case is not sound the rate of deployment will make
18 no difference, it will still be an unattractive business case whether you deploy in seven years
19 or whether you deploy in 18, I think that is evidenced by the fact that when British Gas
20 reviewed the results of the pilot there was no business case for deploying smart metering in
21 electricity, which was not part of the MSAs. If that evaluation had shown a positive
22 business case for electricity and a poor business case for gas, then British Gas would
23 presumably have gone forward with deploying AMR smart metering in electricity, but it
24 didn't, and the reason it didn't was because there was no business case. So I think that
25 evaluation was looked at in some depth. The MSAs didn't prohibit the deployment of smart
26 metering at the time when British Gas undertook the trial. The reason for not going forward
27 with it was that there wasn't a strong business case and if that had changed subsequently
28 and I have remained in the industry and I don't believe it has yet changed in terms of the
29 business case for a supplier – and there might be a difference if you look at UK PLC, but in
30 terms of a supplier that business case has not changed, and therefore the approach which we
31 had worked out in terms of the way in which smart metering could be deployed which
32 would work for CMO meters as well as National Grid meters remains valid.

33 MISS CARSS-FRISK: Madam, I am sorry, I am slightly concerned that this is really straying
34 into examination-in-chief rather than picking up points fit for re-examination.

1 MR. HOLMES: Madam, you will be pleased to hear in any event that I have concluded my re-
2 examination.

3 THE CHAIRMAN: Yes, thank you very much, Mr. Avery.

4 (The witness withdrew)

5 THE CHAIRMAN: It is obviously too late in the day to start with Mr. Shoesmith. I am slightly
6 concerned that we have rather overrun with Mr. Avery and I do not want the timetable to
7 get too far away from the timetable that was settled at the beginning of the hearing.

8 MR. TURNER: No, my discussion with my learned friend was that her expectation was we might
9 be able to get all the way through the factual witnesses including perhaps even all or some
10 of Miss Frerk today. We may have to rethink that, but we will proceed as quickly as we
11 can.

12 THE CHAIRMAN: Well we will start at 10.30 tomorrow with Mr. Shoesmith.

13 MR. VAJDA: Can I hand in the note – it is the bit of the opening that I had to compress
14 yesterday.

15 THE CHAIRMAN: Thank you.

16 (Adjourned until 10.30 a.m. on Wednesday, 21st January 2009)