

23 July 2010



Project Reference Code: EPR0018

Australian Energy Market Commission
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positive energy

Dear Sir / Madam

RE: Australian Energy Market Commission (AEMC) Draft Report – Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure

ENERGEX Limited (ENERGEX) is pleased to provide the following comments on the AEMC's Draft Report - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure (Draft Report).

Responses to the specific questions raised in the Draft Report are provided in Appendix A. The Draft Report also raises a number of issues that warrant further consideration prior to finalisation of the AEMC's advice to the Ministerial Council on Energy (MCE).

Terminology

With the introduction of smart meter infrastructure (SMI), metering services will encompass traditional metering capability as well as other services enabled by the increased functionality of these meters. As some of these services will be mandated under the National Electricity Rules (Rules), it is important to ensure there is clarity around the terminology used in the report when referring to metering services that may or may not be mandated.

Report Scope

In undertaking this review the AEMC has become aware of other limitations and issues within the Rules. Whilst ENERGEX supports resolution of the identified issues, they should not be progressed within this consultation process. The Draft Report should be limited to the scope as detailed in the MCE's Request for Advice.

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National Regulatory Framework

Chapter 6 – Economic Regulation of Distribution Services

The development of the national regulatory framework (framework) involved extensive consultation to derive the most effective regulatory outcomes. The Australian Energy Regulator's (AER) models including the Roll Forward Model (RFM) and the Post Tax Revenue Model (PTRM) have been subject to extensive stakeholder consultation. This included considerable discussion and debate on the parameters of the models including the calculation and basis of depreciation. Depreciation based on actual spend was deemed to provide the best regulatory outcome.

The proposed changes and resulting inconsistent treatment of metering, and possibly other short life assets, in these models will create additional complexity and uncertainty for Distribution Network Service Providers (DNSPs). The concept of embedding different treatment of assets within the models may appear easy, however the practical application of reconciling the differences would be administratively complex, time consuming and costly. Investment in SMI does not warrant a revisit of issues that have already been fully debated and consulted upon as part of the development of the framework.

Ex post Reviews

The AEMC appears to have proposed ex post reviews as a method for dealing with uncertainty in relation to SMI investment. However uncertainty in relation to SMI is premised on the dynamic nature of cutting edge technology and the possibility of SMI assets rapidly becoming obsolete due to changes in technology or as a result of changes in the requirements of the sector. Ex post reviews will not resolve this issue.

The national framework was designed on an ex ante basis in order to drive efficiency improvement and provide funding certainty for DNSPs. The introduction of ex post reviews challenges this premise without providing greater certainty in relation to SMI cost recovery. In addition, the introduction of ex post reviews would also be a significant shift away from the national regulatory framework and introduce inconsistency in regulatory methods creating additional complexity and compliance costs. Ex post reviews:

- Create funding uncertainty and regulatory risk;
- Will deter a DNSP from pursuing a more costly investment that would offer benefits to consumers if there is a risk that this additional cost may not be recoverable;
- Remove some of the flexibility in the current ex ante framework that allows DNSPs to make the best decision at the actual time of investment; and
- If based on the “no hindsight” rule, would require the same information as an ex ante determination or pass through, and thus would not be any less complex or time consuming.

Addressing the practical difficulties with the current cost pass through arrangements would allow for an efficient mid-period cost recovery decision, thereby reducing uncertainty for the DNSP. This would help to alleviate some of the uncertainty surrounding SMI cost pass through and continue regulatory certainty for DNSPs by maintaining the use of Chapter 6 Cost pass through provisions without introducing a fundamental shift as proposed.

Forecast and Actual Installation of Meters

ENERGEX supports the principle that a DNSP undertaking a mandated rollout of SMI is neutral to the difference between the forecast installation and the actual timing (roll out) of the installation. However the proposed amendment to the Rules, based on unit cost by volume, fails to take into account other complexities that can impact the roll out schedule and result in commercial risk to the DNSP. When finalising an amendment to the Rules for this issue the AEMC should consult with DNSPs to ensure they are not unduly penalised by an overly simplified adjustment mechanism.

Where a DNSP undertakes a rollout of SMI as business as usual the adjustment mechanism should not apply as this investment should be treated as any other investment by the DNSP under the incentive based ex ante framework.

Timing of charges levied on Consumers

ENERGEX does not support the AEMC's view that it is inappropriate for SMI charges to be levied on customers prior to a customer having an installed and functioning smart meter. DNSPs invest large amounts of capital upfront in the distribution network to ensure appropriate levels of network safety and security of supply are maintained across the entire network. Consumers contribute to funding capital investment in the network through distribution use of system (DUOS) charges. The provision of SMI requires investment in both infrastructure and meters, with infrastructure the major component. More efficient network management tools and asset utilisation, enabled by SMI, will provide benefits to all consumers. All investment in the shared network (including SMI) requires funding through DUOS charges by the shared beneficiaries. This position is consistent with the current regulatory framework.

Unbundling of SMI charges

It is premature to commence rule changes in relation to unbundling until there is greater certainty and understanding of mandated and non-mandated smart metering services, SMI costs and customer service providers. In addition, as unbundling will be administratively costly, there needs to be greater certainty that the benefits to consumers will outweigh the additional costs.

ENERGEX looks forward to continued consultation on the national framework for smart meters and smart meter infrastructure. For further information on this submission please contact Naomi Donohue, Regulatory Affairs (07) 3223 1780.

Yours sincerely



Louise Dwyer
Group Manager Regulatory Affairs

Appendix A – Specific Questions for Comment

Chapter 2: Cost recovery during the distribution determination process

1.1: Should the AER be able to apply the proposed mechanisms to address remaining uncertainty (i.e. the roll-forward of the RAB on the basis of forecast depreciation and the cost sharing mechanism) to other distribution investments, where the potential costs and benefits of such investments are uncertain at the time a distribution determination is made?

ENERGEX believes this question is outside the scope of the MCE's Request for Advice.

In relation to the application of these mechanisms to smart metering, the AERs RFM and PTRM underwent extensive stakeholder consultation as part of the move to the national regulatory regime. As part of that consultation, feedback was provided by stakeholders and the final framework was based on the most efficient treatment and calculation of depreciation. During that consultation short life assets (including metering and information technology) were considered and the same depreciation treatment for short and long life assets was deemed appropriate.

The proportion of short life assets is small in relation to a DNSPs overall regulatory asset base (RAB). Divergence in the treatment of capex and depreciation for a relatively small component of the RAB creates additional administrative complexity that far outweighs a potential decrease in the uncertainty of the investment. There are less administratively complex methods that can be used to reduce the uncertainty associated with this type of investment such as pass throughs and longer term pilots and trials.

1.2: Do you consider that a specific information provision requirement should be included in the Rules to require DNSPs to provide annual information on the costs and operational benefits of mandated smart meter roll-outs, pilots and trials? Or do you consider that the AER's current information gathering powers under the NEL are sufficient?

Where a DNSP undertakes a non mandated rollout, that decision is no different from any other capital investment decision undertaken by the DNSP. In such circumstances the investment, like any other capital investment, will be subject to the scrutiny of the AER as part of the normal determination process. As such a non mandated rollout of SMI should not be subject to additional reporting requirements as the investment undertaken is business as usual.

The AER's current information gathering powers are sufficient. Where the DNSP undertakes a mandated rollout the AER has an interest in seeking additional information in order to gain some measure of confidence that efficiencies are being passed on to consumers. However ENERGEX is concerned that any publication of cost and benefit data must be comprehensive, fully representative and mindful of confidentiality issues.

Chapter 3: Mid period cost recovery for mandated smart meter roll-outs

2.1: Would an interim adjustment in prices be required prior to the next distribution determination, where a DNSP is required to roll-out smart meters within a regulatory control period? If so, should this adjustment be based on the forecast costs and benefits outlined in the relevant Ministerial roll-out determination or the DNSP's own forecasts?

Where there is a material impact on a DNSP's cashflow resulting from a mandated rollout of smart meters within a determination period, prices should be adjusted and based on the latest forecasts so as to ensure the DNSP is not unduly penalised.

Forecast costs and benefits should be based on the DNSP's forecasts to ensure that prices are based on the most accurate and up to date information.

2.2: Are there any other principles the AER should be required to take into account when undertaking its ex post review?

The current framework is predicated on an ex ante funding basis. This approach provides funding certainty for DNSPs and creates incentives for prudence and efficiency. The introduction of a different mechanism for one type of investment results in additional complexity and regulatory uncertainty for DNSPs.

ENERGEX appreciates an ex post review has been proposed to manage the uncertainty associated with a mandated SMI rollout. Unfortunately an ex post review does not provide a distributor with greater funding certainty as the DNSP will incur substantial costs prior to any assessment with no assurance that costs will be recouped. Under the current Chapter 6 Cost Pass through provisions the DNSP would be provided with an ex ante outcome, within which it can attempt to manage the activity.

Distribution networks require large investment upfront by the DNSP. The benefits of this investment accrue back to the consumer at a later date through greater network security and reliance, managed network augmentation and proactive management of the network contributing to reduced costs overall. Investment in SMI is exactly the same.

It is unclear how the information requirements and complexities of an ex post review would be less than that of a pass through. If the issue for the AER is that of timing, the AER should seek an extension under Clause 6.6.1(k) of the Rules.

Chapter 4: Mid period cost recovery for mandated smart meter pilots and trials

3.1: Are any further amendments to the cost pass through provisions required to provide for the recovery of the efficient costs of mandated smart meter pilots and trials?

ENERGEX does not believe the Rules need to be amended to require the AER to consider the classification or pass through of mandated smart meter pilots and trials specifically. Clause 6.2.6(c) of the Rules already provides scope for the AER to apply components of Chapter 6 Part C to alternative control services. It is unrealistic to presume the Rules can be continually amended to deal with innovation in investments.

3.2: Should our proposed amendments to the cost pass through provisions, to extend the AER's decision making timeframe and require the AER to consider the efficient and prudent costs of a mandated smart meter pilot or trial, be extended to all pass through events?

ENERGEX believes this is out of scope of the AEMC mandate but does see merit in the issues being pursued in another forum.

Chapter 5: Cost recovery for mandated smart metering services which are classified as alternative control service

4.1: Is greater prescription required in the Rules to provide for the recovery of the efficient costs of mandated smart metering services, where these services are classified as an alternative control service?

If a distributor is mandated to roll out an investment, cost pass through provisions should apply regardless of service classification. ENERGEX refers to the previous response for question 3.1.

Chapter 6: Incentives under the current regulatory regime

5.1: Are any changes to the Rules required to ensure the incentives under the current regulatory regime are appropriate for mandated SMI?

Where SMI is rolled out as a mandate ENERGEX believes the costs should be excluded from EBSS as the costs are not controllable by the DNSP. Where a DNSP chooses to roll out SMI as part of its own capital investment strategy then the normal incentive mechanisms should apply.

Chapter 7: Tariff issues associated with mandated SMI

6.1: What principles should the AER be required to have regard to for the efficient allocation of costs and in determining whether to require a DNSP to unbundle mandated smart metering services from DUOS charges?

The principles must promote consumer long term benefits resulting from any changes. That is the benefit of additional information should be greater than the additional costs resulting from the increased administration complexity and processing costs for the DNSP. Understanding the allocation of DUOS costs to services and service providers must also be considered as it is still unclear how services may be provided and charged for. While this uncertainty exists there seems little benefit in attempting to unbundle costs when we do not know how they need to be unbundled and allocated.

Prior to any large scale unbundling of DUOS costs there needs to be a clear understanding of the costs and benefits that will arise as a result of the unbundling. Greater understanding of what parties will be undertaking which services and the most efficient allocation of costs across all parties (consumers and service providers) needs to be considered prior to the progression of any rules.

6.2: Should Rules on the unbundling of mandated smart metering services be made at this time, in light of the current uncertainty regarding the future contestability of smart metering services?

No as per the response to question 6.1.

6.3: Is it appropriate to allow the AER to back end depreciation? What factors should the AER be required to have regard to when determining to back end depreciation for mandated SMI assets?

It is inappropriate for the AER to alter the framework upon which there was extensive consultation. The introduction of differing treatments for assets creates increased administrative complexity to data management and operation of the AER RFM and PTRM. Short life assets are a small component of the RAB and this should be considered when determining how much additional complexity is warranted for an appropriate solution. The issue of uncertainty is not confined to SMI but is more pronounced at this time due to the evolving technology of SMI at this time.