



12 November 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
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SYDNEY SOUTH NSW 1235

By e-mail: submissions@aemc.gov.au

Dear Dr Tamblyn

DRAFT RULE DETERMINATION - NATIONAL ELECTRICITY AMENDMENT (VICTORIAN JURISDICTIONAL DEROGATION, ADVANCED METERING INFRASTRUCTURE ROLL OUT) RULE 2008

Origin Energy Retail Limited (Origin) welcomes this opportunity to respond to the Australian Energy Market Commission's (the Commission's) draft determination on the proposed jurisdictional derogation submitted as part of the rollout of advanced metering infrastructure (AMI) in Victoria.

Origin understands the reasoning applied by the Commission in reaching its draft determination. We further acknowledge that the merits of Victorian Government policy in relation to AMI are taken as a given in the Commission's analysis of the proposed derogation.

We would wish to make it clear that Origin does not support the *accelerated, universal* roll-out of AMI as an obligation on retailers, but we do support the retention, to the maximum possible extent, of contestability in AMI provision.

At the same time, Origin recognises the conflict between the policy position adopted and maximising the benefits and efficiencies associated with deployment of AMI. We also support the Victorian Government's efforts to align jurisdictional policies with developments at the national level.

Origin recognises the certainty sought by network businesses in undertaking the investment required, however we do not believe this ought to be at the expense of the market for AMI operating where it is practically able to do so.

This response is divided into three sections:

- The first examines the potential opportunities for the retention of contestability in specific small customer market segments.
- The second considers the end of the period of exclusivity and strategies to encourage a return to contestability in metering services.



- Finally, we address specific issues contained in the draft determination, primarily in relation to the analysis of the factual and counterfactual approaches to an AMI rollout.

Should the Commission wish to discuss further any of the matters contained in this submission, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Randall Brown".

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1. Retention of metering contestability for certain market segments

Origin understands the draft rule will grant distributors exclusivity over meter provision at small customer sites for the purposes of the AMI rollout. Origin understands the distributor's need for certainty in undertaking the rollout and the substantial investment this will require. However, we would ask that the Commission give consideration to certain exemptions from the exclusivity provisions promulgated by the proposed derogation. These exemptions would not prevent distribution businesses from installing AMI for the customers described, but the retailer would appoint AMI service providers under this model as the Responsible Person under current National Electricity Rule (Rule) provisions.

1.1 New connections

There is considerable scope to provide enhanced AMI to new connection customers (both in new housing estates and customers rebuilding on a brown field site. Such enhanced services include:

- the remote metering of water and gas utilising AMI;
- the provision of a home area network (including load control devices and in home displays);
- support for greater functionality in relation to embedded generation; and
- internet and home security services.

Given the incremental nature of AMI deployment, the retention of contestability for new connections should not create significant uncertainty for distributor's rollout plans at the margin. The number of new connections over the rollout period is unknown (dependent on economic activity) and therefore any assumption that distribution businesses are currently making in relation to the number of new connections are forecasts only.

1.2 Small businesses

Origin understands that the principal focus of the AMI rollout is to provide smart metering and associated services to domestic customers. There are additional functionalities that are likely to be sought by small to medium enterprises (SMEs) that may not be made available by the reduced scope minimum functionality implied in the Minister's correspondence to the Commission.

Given the dispersion of small business customers, the retention of contestability for SME customers in many cases will not greatly impact upon the location of concentrators that may be used by distributor's mesh and distribution line carrier (DLC) communications systems. Retaining contestability for these customers would allow networks, vendors and retailers to provide innovative services in energy management, which may include the use of wireless communication systems, particularly in urban areas.

1.3 Retention of customer choice in specific circumstances

In some cases, customers may seek to voluntarily pay for services above those provided under the AMI rollout for a wide range of reasons (embedded generation, load control and home area network requirements and so on). In such circumstances (and Origin believes only a modest number of small consumers may pursue this option in the medium term), the retention of customer choice of a type 4 meter installation may be highly



desirable. Again, this would allow market participants to test new technologies as they become available. Arrangements could be developed to ensure a distributor received the exit fee if customer choice was exercised in this regard. Some customers may seek and be willing to pay for advanced functionalities at the present time. Origin believes that choice for customer's who express such a preference be retained during the period of exclusivity.

These exemptions from the proposed derogation offer numerous advantages for consumers, retailers, distributors and the Victorian Government:

- They can be used as a test-bed for emerging and improving technology;
- They will provide a cost benchmark for contestable AMI provision following the expiry of the derogation;
- There is an opportunity for retailers to test advanced functionality and multi-utility metering in a green field environment for new connection customers; and
- They go some way to address some of the challenges that will inevitably present at the margin during the rollout program.

To make possible these exemptions from the proposed derogation, Origin would suggest that the National Electricity Rules (Rules) allow retailers to elect to remain Responsible Person for new connections and small business customers. If a retailer chooses to not exercise its right to appoint its own meter provider and meter data provider on a contestable basis (from a network business or third party), then the site would revert to the local distributors' mass rollout program. To avoid doubt, if a retailer did not exercise this right by the time a distributor had deployed AMI within a particular area in the case of SMEs, the retailer would not be Responsible Person, and the site subject to exclusivity of meter provision.

2. Transitioning back to metering contestability post derogation

While Origin supports the clear statements contained in the draft determination indicating that the exclusivity would expire following the end of the mass rollout program (and we note the Ministerial Council on Energy's intention to promote contestability long-term), we are concerned that the determination itself does not specify how exclusivity will come to an end or the mechanisms that would allow this to occur.

Origin considers this issue critical in the decision to grant exclusivity to one particular segment of the energy supply industry. We suggest that at the expiry of the derogation, the current chapter 7 provisions around Responsible Person would again apply (from 1 January 2014), irrespective of whether the mass rollout is completed.¹ If a retailer at that time elected to choose an alternative service provider (which may be another distributor, or a third party vendor), the distribution business would be able to levy the applicable exit fee for the unrecovered direct costs associated with its AMI installation.

The need for the proposed derogation in Origin's view is a consequence of the policy position adopted by the Victorian Government to achieve its objectives, rather than the conventional manner that AMI service provision would be managed. Noting the Commission's neutrality toward the policy adopted, Origin believes that without an

¹ Notwithstanding other changes to chapter 7 that may occur in the interim, the reversion would be relevant to the intent of current chapter 7 contestability provisions, particularly in relation to clause 7.2.2 and 7.2.3.



accelerated, universal rollout, the business as usual approach would feature contestability as a central element.

At this stage, Origin is assuming that the current chapter 7 provisions will apply at the expiry of the derogation and no other alterations to the Rules will be required to restore contestability in metering services. This certainty is required for retailers and service providers in the event that there is an intention to deploy new technologies or address changes in retail market conditions at the expiry of the period of exclusivity. Origin would welcome further discussion with the Commission on this matter prior to a final determination being made.

3. Specific comment on the draft determination

3.1 Assessment approach: Factual and counterfactual arguments

The Commission has assumed that the limited range of smart meter functionalities now proposed as part of the Victorian AMI rollout would also apply to the counterfactual arrangement. Since the variations to the Victorian project will result in meters being classified as type 5 in the market, practically, this could not apply in the counterfactual arrangement since retailers can only appoint themselves Responsible Person for a metering installation for meter types 1-4. It is unlikely that the counterfactual arrangement would result in limited functionalities, since AMI would be deployed as type 4 with associated service levels (rather than type 5). That is, daily reading (and other functionalities) would be enabled from the point of installation in those situations where the telecommunications network was the method of communicating with meters. Furthermore, Origin is unclear in the hypothetical world of the counterfactual why participants would limit, rather than maximise services to customers. Competitive pressure would determine the services levels and functionalities sought by customers and the market, rather than prescriptive regulatory processes.

Origin acknowledges that the variations to the rollout will facilitate national consistency and provide operational benefits to distributors responsible for the rollout; however the changes represent a significant diminution of functionalities and service levels that retailers were expecting when the derogation proposal was submitted. Origin is concerned that there will be no opportunity while the derogation is in place for retailers to deliver improved services and functionalities to end use customers without exemptions of the kind described in section 1 above.

3.2 Assessment of the derogation

As a general comment, Origin believes the classification of an AMI rollout as either “distributor” or “retailer” led may assist in understanding the factual and counterfactual arrangements for a rollout, but at the same time simplifies the likely outcomes that will occur in practice. Origin considers that a more accurate approach would be to describe a rollout method as either regulated or contestable in nature.

In either scenario, Origin believes that network businesses would have a considerable role to play. The key difference between the two approaches is the cost recovery mechanism. A regulated, “distributor-led” approach will result in greater certainty (depending on the quality of regulatory decision making); however, with exclusivity in place, there is a potential for higher costs of provision and significant cross subsidisation at the customer level. Conversely, a contestable approach would focus on cost



minimisation, since ultimately competing retailers (and meter providers, meter data providers and vendors) would have to recover AMI costs from the market.

Retail competition

The Commission notes on page 21 of the draft determination that the National Cost Benefit Analysis (Phase 2) of AMI assumed retailers would own meter assets and this would affect retail competition. We believe that this was a significant error in the assessment of the contestable provision of AMI and is unrealistic and remain concerned that it continues to be considered the default model when assessing meter contestability.

While Origin notes the Commission's analysis and concerns that the impact that contestable AMI will have upon competition in the energy retail market, we would query why these concerns would not also arise when the derogation expires. Origin has repeatedly presented arguments as to why contestable AMI would not degrade competition in the retail market (and more likely would enhance it) and we are concerned that similar arguments will be presented as the period of exclusivity reaches its end to justify the extension of monopoly provision of AMI to small customers, without any supporting evidence.

Economies of scale and density

Origin supports the Commission's assessment of the factual and counterfactual arrangements discussed in section 4.4 of the draft determination. The Commission does state on page 28 that "...in Europe and North America most large scale rollouts of AMI or smart meters have been undertaken by distributors". Origin agrees, but notes in these markets there is often no vertical separation between retailers and distributors (energy suppliers are simply "utilities"), the functionality of AMI is limited, which is in part due to the lack of energy market liberalisation. For these reasons, comparisons with a number of overseas markets and Australia (in particular the NEM) are of limited value given the advanced nature of competition in Australia relative to overseas jurisdictions engaged in the deployment of AMI (with perhaps the exception of New Zealand and Britain).

Competition for metering services

We address the issue of transition to contestability in metering services following the expiry of the derogation in section 2 above. However, we note the Commission's view that competition in AMI service provision will remain "...at the meter vendor and contractor level and that distributors would be likely to use a range of suppliers providing opportunities for independent metering service providers" and this is effectively a substitute for full competition in AMI provision.²

Origin agrees that this preserves some elements of competition in metering services, but it is clearly a second-best outcome, since a network business does not face the risk of losing market share (as a retailer would) and vendors tendering for such work also are cognisant of this fact. The risk therefore is that a regulator does not assess costs submitted by a distributor as efficient. Origin believes that this risk is not equivalent to

² AEMC (2008), *Draft Rule Determination - National Electricity Amendment (Victorian Jurisdictional Derogation, Advanced Metering Infrastructure Roll Out) Rule 2008*, page 32.



the risks borne by market participants exposed to competition, without the certainty of regulated cost recovery.

In response to the Commission's request that stakeholders comment on the measures outlined on page 33, Origin would make the following points:

- We support transparency of the cost of meter provision, and in Victoria, this is currently accommodated by the separation of metering costs from use of system charges (however, this is not the case in other NEM jurisdictions). Such costs are publicly available at present via the distributor's websites and the Essential Services Commission.
- Accelerated depreciation of AMI assets is supported. Origin understands that meter assets could have regulatory life of 15 years. Consequently, exit fees paid to distributors for unrecovered direct costs in the event of meter replacement will be higher under straight line depreciation over this period. Some acceleration to regulatory depreciation is therefore supported.
- Limiting exit and restoration fees to the directly incurred unrecovered costs is an appropriate approach to compensation. This will reduce barriers to entry for alternative service providers at the end of the exclusivity period for AMI installations.

Innovation

Origin is not convinced that the proposed approach to changing functionalities or improving service levels via a regulated process will result in innovation in the delivery of AMI services to consumers. While we agree with the Commission's view that measures should be implemented to facilitate metering contestability following the rollout, there is no clarity on what these measures might be, what instrument they will be enabled by or how quickly they will be brought in following the expiry of the derogation.

Furthermore, the view that in home displays will be utilised under the regulated led roll out is not consistent with the reduced scope of services available to retailers under the revised rollout program (though is supported by the functionality specification). Time of use pricing will be made available by retailers where AMI installations are read on an interval basis.

3.3 Commission's Finding

While Origin understands the Commission's finding that network businesses are best placed to deliver an accelerated, universal rollout of AMI to small customers, we do not agree with the Commission's assessment approach to some of the advantages, disadvantages and remedies to the disadvantages of a distributor led rollout discussed in section 4.8 of the draft determination.

Advantages of a distributor led rollout

Vertical efficiencies

Origin agrees that some of the difficulties that may emerge during the rollout may be managed better by distributors (and it does not necessarily follow that this would not happen under the counterfactual, since distributors are likely to deploy meters in



significant numbers under that scenario also), however the statement that “Customers already know who their distributor is...” is untrue in Origin’s view.³ Customers do have access to the network businesses’ faults and emergencies line, but to suggest that a majority of small customers are aware of the identity of their network service provider is not supported in our experience.

It is not clear to Origin why it is assumed networks would play no role (or even a limited role) in a contestable market for metering services given their experience and knowledge.

Facilitating retail competition

Origin maintains that it is unlikely that retailers would own AMI, given the risks involved in a competitive market place. Assuming however that they did, punitive exit fees to recover asset costs in the event of customer churn are inconsistent with the Energy Retail Code and the terms covering agreed damages in Victoria, meaning such barrier to competition would not comply with retail energy market regulation.⁴

We again note that this risk will exist (to the extent it is a genuine risk, which we do not believe it will be) following the expiry of the derogation and we do not believe current, or future retail market regulation would support the application of such exit fees, even though customers may face such fees from distributors to take advantage of alternative meter provision and services.

Cost recovery

Origin agrees, in principle, that regulatory cost recovery of an AMI rollout would result in only efficient costs being recovered. Although the regulator will be privy to the tendering process engaged in by distributors, such prices are set in an environment that lacks competitive pressure from the distributor’s perspective and will not be benchmarked to the competitive provision of AMI. A remedy for this might include comparisons with benchmarks (were obtainable) of AMI costs in similar markets to Victoria, where the deployment has been undertaken on a competitive basis (such as New Zealand).

Origin agrees that contestable meter provision costs would be uncertain, but they would be efficient, due to the desire of buyers of AMI services to minimise costs.

Mitigation of disadvantages

The measures described in section 4.8.3 (and discussed above) of the draft determination go some way to facilitate a transition to contestability following the period of exclusivity. Origin believes the promotion of competition and mechanisms to support it should not follow the expiry of the mandate. These measures need to be in place as soon as the period of exclusivity expires. If retailers are satisfied with the service levels and functionalities provided by distributors, there will be no change in arrangements at this time.

³ AEMC, op. cit., page 38.

⁴ Origin does not believe that unrecovered AMI costs would be considered procurement costs under section 35(c)(i) of the Energy Retail Code if every small customer was to have AMI installed.



Summary

As noted above, we challenge some of the reasoning the Commission has applied to its finding and have not commented on all of the issues that we have identified in the draft determination.⁵

While we appreciate the Victorian Government's objectives in submitting the derogation, we note that it does not satisfy section 89(b) of the National Electricity Law (a matter that the Commission is to have "regard to" when making the derogation). While we are supportive of AMI generally in the NEM, and consider the Victorian Government's policy an important development and contribution to smart metering, we believe that flexibility can be retained while a universal rollout takes place.

The comments made in this section of our response address the Commission's assessment of the draft derogation, we would encourage the Commission to focus on our comments in sections 1 and 2 above in the interests of preserving elements of contestability, which in Origin's view, will enhance the transition to contestability following the end of the exclusivity period. This we believe will maximise consumer benefits associated with AMI in the longer term.

⁵ A number of these have been previously raised during the National Cost Benefit Analysis process and directly with the Commission.