

05 February 2010



Project Reference Code: EPR0018

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
www.aemc.gov.au

Dear Sir / Madam

RE: AEMC Draft Statement of Approach - 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 Statement of Approach for the Request for advice on Cost Recovery for Mandated Smart Metering Infrastructure (SMI).

ENERGEX generally supports the approach that the review of cost recovery for SMI, should commence with an assessment of the appropriateness of Chapter 6.

In determining the appropriateness of Chapter 6 for the cost recovery of SMI, the AEMC will need to be mindful of:

- the increased uncertainty in relation to SMI investment compared with traditional investment regulated under Chapter 6;
- uncertainty in regard to whether SMI will be operating in a commercial (contestable) environment or regulated as part of a DNSP's network;
- the integral nature of SMI to distribution network infrastructure; and
- the integral nature of future SMI costs to a network's capital and operating requirements.

In the case of SMI the increased uncertainty and risk of cost recovery relates to:

- uncertainty in relation to reliability of SMI i.e. technical failure and obsolescence;
- uncertainty in relation to asset life and performance of SMI;
- uncertainty of flow-on impacts of SMI on future network developments;
- stranded costs associated with current metering infrastructure following a mandated rollout of SMI;
- additional risk introduced by potential contestability following a mandated rollout preventing a DNSP from recovering costs associated with the mandated SMI rollout.

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Reference: 09-10 AEMC Draft Statement of Approach for SMI Cost Recovery

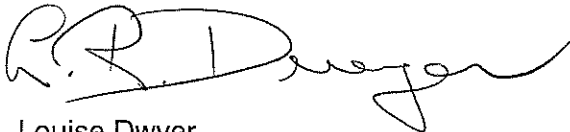
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In addition ENERGEX believes that certainty in relation to cost recovery for DNSP's needs to be maintained and therefore the review of Chapter 6 needs to be constrained to the issue of SMI cost recovery. In the event that Chapter 6 cannot accommodate the uncertainties associated with SMI, ENERGEX believes an alternative approach should be implemented to ensure full cost recovery of expenditure associated with pilots and rollouts.

Detailed responses to the specific questions raised in the Draft Statement of Approach are provided in Appendix A. ENERGEX also notes there is some inconsistency with terminology throughout the document and references to either smart metering services or metering services need to be clarified.

ENERGEX looks forward to continued involvement in the development of the national framework for smart meters and smart meter infrastructure.

Yours sincerely

A handwritten signature in black ink, appearing to read 'L. Dwyer', with a stylized flourish at the end.

Louise Dwyer
Group Manager Regulatory Affairs

Appendix A – Specific Questions for Comment

Ch 2: Proposed Approach and Decision Making Criteria

We are interested in stakeholder views on our decision making criteria. In particular:

1. Are our proposed decision making criteria appropriate for the development of our advice? Are there any additional criteria that should be included?

In regard to the decision making criteria ENERGEX makes the following observations:

- The least cost basis may not necessarily be the most efficient option.
- Given the uncertainty of benefits to be realised, that is which party, timeframe and scale, the assessment of benefits would be problematic.
- ENERGEX also notes that demand side benefits need to be considered in the context of each jurisdiction's retail price regulatory framework and the ability to pass on appropriate price signalling to end customers.
- ENERGEX supports the opportunity for stakeholder engagement and it is ENERGEXs' understanding that Ministerial determinations will be subject to public consultations. Capital governance of a DNSP must be left to the DNSP within the frameworks reviewed by the AER at each distribution determination.
- ENERGEX supports the view that the NEL and NER framework for cost recovery (in particular Chapter 6 of the NER) should be applied to all costs to ensure consistency in the application of cost recovery provisions and to provide certainty for DNSP.
- However, it is also important to note the degree of uncertainty regarding the technology of smart meters and smart grids and the risk associated with SMI compared to historical network investment. In this regard the principles of cost recovery for SMI should acknowledge and make consideration of these issues.

We are interested in stakeholder views on the proposed scenarios and variables we intend to use. In particular:

2. Do our proposed scenarios capture the relevant range of potential circumstances that should be considered in preparing this advice? Are there other scenarios or variables that should also be considered?

ENERGEX considers that the proposed scenarios seem appropriate but notes that the resolution of cost recovery issues may be significantly impacted by contestability of meters. The nature of contestability may impact on the timeframe within which a DNSP would be able to recoup its investment in SMI, and the network's ability for essential network intelligence.

Ch 3: Issues for Consideration Recovery of efficient DNSP costs

We are interested in stakeholder views on our assessment of the distribution determination process and the pass through provisions in Ch 6 of the Rules. In particular:

3. What issues may arise in regards to the recovery of the 'stranded costs' associated with DNSPs' existing metering infrastructure, following a mandated smart meter roll-out?

ENERGEX notes the AEMC's discussion of the AER's RFM and the issue of stranded assets. ENERGEX does not believe there would be a market for the current metering infrastructure (i.e. type 6 meters) as the type 6 meters would become technologically obsolescent following smart meter rollouts.

In relation to the recovery of costs associated with stranded assets consequential to a mandated rollout of SMI, the following methods could be applied:

- 1) Stranded metering assets remain in the RAB so that the DNSP continues to earn a return on and of these assets until their value is fully depreciated. The benefit of this option is that it will continue to spread the costs associated with the stranded assets over a longer period therefore reducing customer impact.
- 2) Remove stranded assets from the regulatory asset base and recoup the written down value as part of the cost recovery process of a mandated smart metering rollout.

A significant issue impacting on a DNSPs ability to recover costs, and the timeframe over which those costs can be recovered, is that of contestability. DNSP's need to be assured of cost recovery in this event.

4. Are there any other issues that we should consider when assessing the current cost pass through provisions in the Rules, particularly in regards to the materiality threshold and timeframes that apply?

ENERGEX is concerned with the current regulatory position of the AER which sees the application of the materiality threshold for general nominated events. It is currently a very arbitrary approach in terms of quantum and timing, which does not allow DNSPs to recover the efficient costs required to respond to unforeseen events. An alternative criteria needs to be developed to recognise the efficient expenditure required by a DNSP within a determination period.

ENERGEX has raised comments in regard to the materiality issue as part of its Regulatory Proposal for the regulatory period 2010 – 2015.¹

¹ ENERGEX Regulatory Proposal for the period July 2010 – June 2015, page 295

Classification of metering services as alternative control services

We are interested in stakeholder views on our assessment of the potential issues for cost recovery in those jurisdictions where metering services are classified as alternative control services. In particular:

5. With the exception of the current arrangements in the ACT, are there concerns with metering services becoming classified as alternative control services in other jurisdictions that we should consider in developing our advice?

ENERGEX believes there are several issues with metering services becoming contestable including the major issue of load control and the required network intelligence which impacts on network security, reliability and safety. If the regulatory framework classified energy data services as standard control services and the variable metering service (provision/installation of type 5-7 meters) as an alternative control service there would be a significant increase in administrative costs, including the requirement to establish detailed processes and systems to capture customer specific data.

ENERGEX submits that the administrative cost of providing the variable metering service as an alternative control service would far outweigh any benefit to customers diverging from the cost averaging approach currently applied as a standard control service. ENERGEX considers that the change to regulatory arrangements would require a full review via a release of a Regulatory Impact Statement. ENERGEX also submits that a full assessment against all the factors under clause 6.2.2 must be considered. In particular, ENERGEX believes that, clauses 6.2.2(c)(2), 6.2.2(c)(3), 6.2.2(c)(4) and 6.2.2(d)(1) would strongly suggest that these services be classified as standard control services.

ENERGEX acknowledges that if costs can be separately identified and other administrative issues addressed, it would be possible to address the 'bundling' concerns without a change of classification through having a separate fixed charge for metering services. However, ENERGEX is concerned that this would generate significant administrative burden and require system and process changes for limited benefit to customers.

ENERGEX has only recently undertaken a Framework and Approach process for the classification of its services. Under clause 6.2.3 of the Rules, a classification forms part of a distribution determination and operates for the duration of the regulatory control period. The distribution determination for the 2010-15 regulatory control period for ENERGEX is in its final stage with the final decision expected in April 2010. Any change in classification would be actioned as part of the Framework and Approach process for the regulatory control period commencing 1 July 2015.

It should also be noted that the application of Chapter 6, Part C Cost Recovery provisions is only applicable for Standard Control Services.

Cost recovery by a DNSP of retailer costs

We are interested in stakeholder views in regards to cost recovery for retailer costs. In particular:

6. What issues may arise in regards to the recovery of retailer costs via distribution charges for mandated smart metering pilots/trials?

Where a DNSP is required by legislation to engage a retailer and thereby incurs legitimate operational expenditure then it is appropriate for the DNSP to recover this expenditure. If Retailers are to recover costs associated with SMI through regulation, then distribution businesses must be provided with certainty of costs approved to ensure that additional risks associated with retailer costs are not borne by the DNSP.

The obligation to account for operational network benefits

We are interested in stakeholder views in regards to the consideration of the operational network benefits that may arise from a smart meter roll-out. In particular:

7. How will the time delay between when smart metering costs are incurred and when benefits are realised, affect the distribution determination and cost pass through process?

Regulators will need to be mindful that in assessing DNSP expenditure in relation to metering and associated communication infrastructure there may be a considerable time lag for recognition of real benefits.

It must be recognised that anticipated benefits of smart meters, in particular benefits related to reduction in demand, are dependant upon the actions of not only a DNSP but also consumers and retailers, and the responses to market developments.

8. What are the implications of the expected uncertainty, in relation to the quantum of benefits that can be achieved through a mandated smart meter roll-out, for the effectiveness of the existing Rules?

A regulator must be cognisant of the uncertainty regarding smart meters and not reduce allowed expenditure for a mandated smart meter roll out on the basis of assumed benefits that may or may not be realised at some point in the future.

9. What type of information may be required by the AER to assess whether operational network benefits are being realised within a reasonable timeframe? Should the AER be required to adopt a monitoring role to assess whether the benefits anticipated at the time of a roll-out determination are being realised?

ENERGEX queries why the AER would be the responsible entity for monitoring benefits outside of the normal assessment of efficiency. Assessments of benefits should not be tied to costs incurred in response to the requirements of a Ministerial determination.

Incentives under the current regulatory regime

We are interested in stakeholder views in regards to the incentives under the current regulatory regime. In particular:

10. Is an EBSS appropriate for a mandated roll-out of smart meters, considering the MCE's requirement for the prompt pass through of benefits to consumers?

11. To what extent are the current incentive mechanisms in the Rules likely to be effective in facilitating the revelation of recovery of efficient costs associated with a Ministerial determination?

The appropriateness of the current incentive schemes cannot be determined at present due to the significant uncertainty relating to SMI. The contestability of SMI and provision of services will have a dramatic impact on whether the current incentive schemes can facilitate the desired outcomes in relation to efficiency revelation and sharing.

12. What types of technology risks may DNSPs face in rolling out mandated smart metering infrastructure? What incentives do DNSPs have under the current regulatory regime to manage these risks?

ENERGEX believes the technology risks facing DNSPs include:

- integration with smart grids;
- uncertain asset life of smart meters and communications devices;
- smart Metering Infrastructure communications productivity if other parties install meters that are not properly integrated;
- rapidly changing technology; and
- unforeseen cyber risks associated with the smart meters.

Due to the significant uncertainty relating to SMI and its future operating environment it is difficult to determine how the current regulatory framework will accommodate this level of uncertainty.

Consideration of alternative regulatory approaches

We are seeking stakeholder views in regards to alternative regulatory approaches. In particular:

13. What alternative regulatory approaches should be considered in regards to the cost recovery of expenditure required to comply with a smart meter roll-out or pilot determination?

SMI investment through a mandated rollout will be in response to a government mandate. On this basis a DNSP needs to be guaranteed that in assessing and approving cost recovery for SMI mandated rollouts consideration will be given to the requirements of the mandate. DNSP's should be able to recover the actual costs to fulfil the government mandate. This may be achieved by providing a true up mechanism following the mandated rollout.

Pricing methodologies of DNSPs

We are interested in stakeholder views in regards to the pricing methodologies of DNSPs. In particular:

14. Are there any particular mechanisms for smoothing tariff impacts over time that we should consider in developing our advice?

Current regulatory arrangements provide for smoothing of costs over the determination period.

15. What potential issues may arise from the unbundling of metering charges from DUOS charges?

In relation to unbundling of costs, ENERGEX has identified significant administrative barriers as metering costs are not currently captured on a customer specific basis. To manage this ENERGEX would need to undertake significant changes to processes, systems and functions including:

- cost capture - Identification and separation of variable and fixed costs;
- pricing - tariffs and associated pricing processes;
- financial - management and operation of a separate regulatory control framework; and
- billing and B2B - alteration to accommodate a separate meter charge/service.

This raises the question as to whether customers would see any real benefits from the unbundling of metering services

16. What incentives are there under the current regulatory regime for DNSPs to alter their tariff methodologies, to facilitate the realisation of the potential demand side benefits of mandated smart meters?

There is a wide body of research that identifies time-varying electricity tariffs as a valuable tool to assist in reducing demand during peak periods. However the incentive to change network tariff structures is largely influenced by the ability and willingness of retailers to pass these pricing signals to customers. To realise the full potential of demand side benefits both network and retail tariffs need to be aligned.