



CitiPower Pty
ACN 064 651 056
www.citipower.com.au

Head Office: 40 Market Street Melbourne Victoria
Telephone: (03) 9683 4444 Facsimile: (03) 9683 4499 DX 433 Melbourne
Postal address: Locked Bag 14090 Melbourne Victoria 8001 Australia



Powercor Australia Ltd
ACN 064 651 109
www.powercor.com.au

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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South, NSW 1235

Dear Mr Pierce,

AEMC Draft Report – Cost recovery for mandated smart metering infrastructure

CitiPower Pty and Powercor Australia Ltd (“**the Businesses**”) welcome the opportunity to comment on the Australian Energy Market Commission’s (**Commission**) draft report on cost recovery for mandated smart metering infrastructure (**SMI**) (**Draft Report**).

The Businesses note that the purpose of the report was to determine whether Chapter 6 of the National Electricity Rules (**the Rules**) most efficiently accommodates cost recovery for SMI expenditure. The Businesses have reviewed the Draft Report and generally support the Commission’s overall assessment that the existing processes are adequate for cost recovery and that no fundamental changes are required to support the Ministerial Council on Energy’s (**MCE**) policy on smart meters.

However, the Businesses make three general comments with respect to the Commission’s proposed amendments. Firstly, the Businesses submit that the Commission’s approach in proposing amendments which are not specific to smart metering services but are of a more general application is beyond the scope of the MCE’s request. Such wholesale changes to the framework require a more comprehensive assessment of the impact on the current regulatory regime.

Secondly, the Businesses do not consider that the broad discretionary powers proposed by the Commission for ex post cost recovery are warranted. Ex post cost recovery is fundamentally inconsistent with the current prospective incentive based framework as it does not provide sufficient incentive for businesses to efficiently manage expenditure on these investments. Providing the AER with wider discretionary powers increase regulatory risk thereby reducing incentives to invest which ultimately impact the long term interest of customers.

Finally, the Businesses submit that the proposed amendments fail to fully take into consideration the mandatory nature of SMI. The nature of obligations is largely dictated by policy decisions made by Ministers under Part 8A of the National Electricity Law (NEL). Therefore proposed amendments should be mindful that policy decisions often restrict the degrees of freedom the Businesses have in making decisions with respect to SMI.

With respect to the Commission's specific recommendations, the Businesses submit the following comments:

Cost recovery under the distribution determination process

Revenue adjustment mechanism

The Businesses note the Commission's concerns regarding the incentive to delay rollout of smart meters under the current distribution determination process and acknowledge the unique nature of the smart meter projects in comparison to capital expenditure items typically incurred by distributors.

In any event, the Businesses submit that a revenue adjustment mechanism must be revenue neutral to the difference between the forecast profile of installation and the actual timing of the rollout.

Roll forward of RAB on basis of forecast depreciation and cost sharing mechanism

The Businesses note the Commission's concern that the uncertainty with respect to the costs and benefits of SMI may result in the over recovery of costs. The Commission has proposed two measures which seek to address this concern:

1. Allowing the AER to roll forward the regulatory asset base (RAB) on the basis of forecast depreciation for all assets with economic lives of 15 years or less; or
2. Introducing a cost sharing mechanism which would allow the AER to vary the proportion of any over (or under) spend which is retained by distributors and subtracted (or added) to the distributor's allowed revenue at the next distribution determination. The Commission proposes that the mechanism also be applied across all types of network expenditure.

With respect to the discretion to roll forward the RAB, the Businesses submit that rolling forward the RAB on the basis of forecast depreciation would weaken the incentive for distributors to efficiently manage capital expenditure. The Commission has not made a comprehensive assessment of the impact of the changes on the incentive properties of the current regulatory framework, and the Businesses reiterate that general amendments to the Rules are beyond the scope of the MCE's request.

With respect to the cost sharing mechanism, the Commission have not proposed a clear method for varying the proportion of any over or under-spend by distributors

that may be carried over. A general discretion to simply vary the proportion without reference to a precise method for which the discretion will be exercised does not provide distributors with any certainty with respect to the AER's decision making process, and creates the risk that decisions will be exercised in a different manner across regulatory control periods.

The risk that the AER will change the way in which it deals with over or under spend results in investment incentives being distorted. Such risk will need to be considered in the Businesses decision making process and may lead to an increase in the cost of an investment, thereby impacting the long term interest of customers.

Finally, the Businesses submit that seeking to define the requisite level of "substantive uncertainty" which would allow the AER to invoke these powers is inherently difficult. Broad discretionary powers allowing the AER to determine the existence of "uncertainty" undermines investment certainty and creates greater regulatory risk for the distributors.

Regulatory risk would also increase where the above proposals extend across all network assets and expenditure. The Businesses reiterate its objection to the proposed general application on the basis that the proposals are beyond the scope of the MCE's original request.

Mandatory reporting requirement

The Businesses note the Commission's proposal to introduce mandatory annual reporting by distributors with respect to costs and network operational benefits of SMI.

Firstly, the Businesses are concerned about the ambiguity of the meaning of 'costs' and 'network operational benefits' of SMI. These terms have not been defined by the Commission and have the potential to be broad in scope. The Businesses are concerned that this may lead to unnecessary information requests and submit that the terms 'costs' and 'network operational benefits' are narrowly defined to ensure that distributors understand the scope of information required to satisfy the obligation.

Secondly, the Businesses submit that the current information gathering powers under the NEL are adequate for the purposes of collecting information with respect to a narrowly defined mandate on the costs and benefits of SMI.

However, should the Commission consider it absolutely necessary to draft additional information gathering powers, these must be strictly limited to information which the AER consider is reasonably necessary for the performance or exercise of its functions or powers.

Mid period cost recovery for mandated smart meter roll-outs

Defer recovery of SMI rollout

The Businesses note the Commission's proposal to allow the AER to defer the recovery of SMI expenditure to the making of the next distribution determination and to allow temporary interim increases in accordance with a defined methodology if the AER considers there is a material cash flow risk for the distributor. The purpose of the proposal is to allow the AER to take into account the operating and capital expenditure objectives in assessing the expenditure, and to allow the AER more time to make its determination.

The Businesses object to the Commission's proposal to defer recovery of the SMI rollout to the next distribution determination. The Businesses reiterate that ex post cost recovery is fundamentally inconsistent with the current prospective incentive based framework and increases regulatory uncertainty thereby reducing investment incentives and increasing the cost of capital. While the Businesses note the Commission has proposed a 'no hindsight' rule, the rule is artificial as it is inevitable that regulatory decisions will be informed by subsequent experience and information.

The Businesses submit that there is a high risk that the costs of an SMI rollout may impact on the Businesses' ability to raise capital to fund the rollout during the period before the next regulatory determination. While the Commission has sought to address this concern by proposing an interim adjustment to prices based on either the forecast of costs and benefits by the Minister or the distributor, it is not clear why this is necessary given the current regulatory arrangements with respect to cost pass-through.

Finally, the Businesses acknowledge that the timeframe under which the AER is to make a determination on a cost pass-through application may be inadequate for dealing with a SMI rollout. While the purpose of the 60 business day timeframe was to minimise the regulatory risk of delay by the AER, the complexities of SMI make it difficult for the AER to estimate reasonable costs of expenditure in such a short timeframe.

The Businesses propose that a separate assessment of SMI expenditure be conducted and an economic incentive scheme for SMI be introduced into the price review process. The AER would be required to make a draft determination within three months which will be included in the price review, and a final determination within six months. Any such determination would be open to merits review. To facilitate the determination in the price review process, the Businesses propose that the AER have the power to reopen the price determination once under specific circumstances limited to making adjustments for SMI only. It is noted that the nature of SMI is subject to state policy decisions which may be frequent and immediate. Therefore, the Businesses propose that the AER assess only those SMI decisions which make substantive changes to the program.

Mid period cost recovery for mandated smart meter pilots and trials

Extension of time for AER

The Businesses note the Commission's proposal to extend the timeframe in which the AER must make a decision on cost pass through applications for smart meter pilots and trials.

The Businesses submit that the timeframe provided under the current cost pass through provisions are adequate. The Commission has already recognised that expenditure in relation to SMI pilots and trials are small in scope and complexity and it is submitted that the AER is well within its capacity to review and determine issues within the 60 business day time frame.

Efficiency assessment of costs

The Businesses note the Commission's proposal to allow the AER to make efficiency assessments with respect to cost pass through applications for smart meter pilots and trials.

The Businesses do not agree that such a provision is necessary as the current cost pass through provisions allow the AER to make efficiency assessments under 6.6.1(j)(3) and provide the AER with a broad discretion to consider any other factors the AER deem relevant: cl 6.6.1(j)(8). In addition, the mandatory nature of SMI is such that the Businesses have relatively less freedom in developing project plans for SMI than they do in typical network projects. Any assessment of cost pass through applications for SMI must be cognisant of the fixed timelines and the policy decisions made by the state government.

Removal of 'dead zone'

The Businesses acknowledge the potential problem of cost recovery in the last 13 months of a regulatory control period, known as the 'dead zone', and accept the Commission's proposal to allow distributors to seek cost recovery for pass through events in the following regulatory control period, when a pass through event occurs in the last 13 months of one regulatory control period.

Cost recovery for mandated smart metering services classified as alternative control services

The Business submit that the Commission are correct in highlighting the risk that in the event that SMI services are classified as alternative control services, the AER may not apply the current cost pass through provisions in designing the cost recovery mechanism. The Commission's proposal to mandate the provision of cost pass through arrangements in any distribution determination for alternative control services is supported.

Tariff issues associated with mandated SMI

Guidance on use of x-factor to smooth tariff impacts

The Businesses are supportive of the Commission's proposal to include guidance on the use of the x-factor to smooth out recovery of SMI charges, as long as the outcome is revenue neutral.

Back-end recovery of SMI costs

The Businesses note the Commission's proposal to allow the AER to modify distributors' proposed depreciation schedules to effectively defer depreciation associated with SMI.

The Businesses are concerned that the longer depreciation is deferred across regulatory periods, the greater the risk that costs of SMI will eventually be stranded. This will be exacerbated by the likelihood of new technology being introduced, and is complicated by the potential for future contestability in smart metering services.

The Businesses submit that a comprehensive review of the regulatory framework at the expiry of the exclusivity arrangements for smart metering services would need to be undertaken before any proposals to allow the AER to modify depreciation schedules can be validly considered.

Should you have any further questions in relation this submission, please do not hesitate to contact me on (03) 9683 4282 or at rherrmann@powercor.com.au.

Yours sincerely



Rolf Herrmann
Manager Regulation