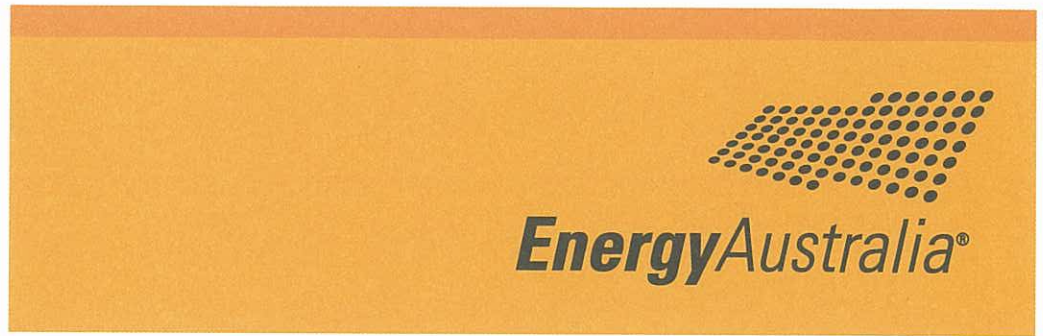


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5 February 2010

Dr. John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submission lodged at www.aemc.gov.au

Dear Dr. Tamblyn,

**Re: EPR0018 Draft Statement of Approach: Request for Advice on Cost Recovery for
Mandated Smart Metering Infrastructure**

EnergyAustralia appreciates the opportunity to comment on the AEMC's draft Statement of Approach (SOA) for the Ministerial Council on Energy's request for advice on cost recovery for mandated smart metering infrastructure (SMI). The MCE's request for advice sets out an appropriate list of topics for review.

EnergyAustralia considers that it is important to ensure that the economic regulation in Chapter 6 can accommodate the recovery the costs faced by distribution network service providers of a mandated rollout of Smart Metering Infrastructure. EnergyAustralia is playing an important role in the smart meter and smart grid arena. We are currently involved in carrying out smart metering trials - the funding for which has been approved by the Australian Energy Regulator (AER). The result of these trials will assist the NSW Government determine whether or not to mandate rollout of SMI in NSW. We therefore have a very active interest in this review as it has large implications for our business should any mandate for the rollout of SMI in NSW be made.

At this early stage, our comments on the draft Statement of Approach (SOA) focus on how the AEMC's SOA responds to the MCE's request for advice. In general we think that the SOA is a well considered and comprehensive response to the request for advice. We have some comments regarding the AEMC's general approach which we hope will be helpful. We are concerned that, in several important respects, the SOA goes beyond the scope of the MCE's request and canvasses issues which cannot be fully considered as part of this review. In this regard, we have highlighted several areas where we suggest that the SOA could be better reflect the intention of the MCE's request for advice. The table attached to this letter contains more detailed comments on the wording of the questions set out in the draft SOA .

Our comments on specific topics are structured in the same order as presented in the draft SOA. Our concerns start with the AEMC's discussion about the purpose of the mandate.

1. Purpose of the mandate

The draft SOA sets out a description of the purpose of the mandate. However that description actually articulates the purpose of an accelerated roll-out. Presumably the underlying policy purpose of a mandate must be to address the fact that the potential benefits of an accelerated smart metering are split between various stakeholders in such a way as to make it uneconomic for one party alone to invest in the smart metering infrastructure. The purpose of the mandate is to allocate the costs to one party, in this case, the distributor, while noting that the benefits, including societal benefits, will be spread among a range of parties. This is confirmed in the MCE's Smart Meter Decision paper in June 2008 which noted "...benefits were split between parties in such a way that individual parties were unlikely to independently establish a positive business case."¹

Recognising the purpose of the mandate is important for this review as it has very important implications for the approach to economic regulation. There will be short and long term benefits that will be both "societal" and "private" (benefits to retailers, generators as well as distributors). Distributors cannot be attributed with or accountable for realisation of these outcomes. It is critical that this is taken into account when considering the regulatory mechanisms for passing on benefits to customers and reconciling distributor cost recovery requirements.

2. Approach to providing advice

The AEMC states that "*We will have regard to the characteristics of a smart meter roll-out that may impact the effectiveness of cost recovery arrangements*" [emphasis added].² The AEMC then goes on to discuss that the type and nature of the costs and benefits of the mandated smart meter infrastructure, and the degree of certainty in relation to each of those at the time of a Ministerial determination, may affect the effectiveness of the cost recovery arrangements in the current Rules. The AEMC points out that the timing of the costs will occur up front but that the "cost savings" will occur later and will arise from a number of factors. The AEMC states that this will present difficulty for the AER in its economic regulation functions.

EnergyAustralia is concerned that the AEMC may have assumed that the characteristics of an accelerated smart meter roll out are fundamentally different to other activities carried out by DNSPs in the ordinary course of its business such that the regulator will require a different approach or different tools to do its job. We do not believe this to be the case and strongly urge the AEMC not to proceed on this assumption without testing it further.

In our review, this assumption should be tested by by the AEMC, examining the characteristics of an imposed mandate for distributors to accelerate a smart meter rollout to determine if there are any unique attributes which are fundamentally different from other distribution activities, services and expenditures. This is an important starting point and having examined whether there are any differences the scope of the review then needs to consider whether the provisions in chapter 6 efficiently accommodate these factors.

Rather than presupposing these characteristics present an unusual or different task for the regulator., we consider that the AEMC may benefit from asking stakeholders to present their views on the differences, if any, between a SMI rollout mandate and other services performed by distribution network service providers including the regulatory obligations placed on distributors. The AEMC expresses the view that a mandated roll out presents a shift in the position of DNSPs from that of an initiator of proposals to an agent of the Minister. We consider that this may be a little simplistic. A DNSP's regulatory proposal responds to many different drivers, but the overwhelming majority are grounded in regulatory obligations. For NSW DNSPs one of the major drivers is the Design, Reliability and Planning licence conditions imposed by the Minister for Energy. Obviously the DNSP has discretion in terms of how it plans to meet those licence conditions, but that planning must be directed to meeting the required standards within the Minister's specified timing. This type of discussion will assist the AEMC in considering whether the AER will face more "difficulty" from an SMI mandate compared to its current economic regulation function.

¹ MCE Smart Meter Decision Paper, 13 June 2008, p1

² AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, page 7

We consider that there are two fundamental considerations in a review about SMI cost recovery:

- Is there anything different about SMI and the related services compared to the other distribution services?; and further,
- Is there anything different about a Ministerial mandate to rollout SMI compared to other regulatory obligations placed on distributors?

We note that it is the MCE's policy for contestability to be introduced following the end of the mandate.³ The issue of contestability is a key area of difference with the SMI rollout compared to other regulatory obligations placed on distributors. We support the AEMC's inclusion of scenarios that allow for the consideration of contestability as it will have an important impact on the timing of cost recovery for SMI.

3. Decision making criteria

The AEMC has proposed a set of criteria to use in assessing the effectiveness of the current Rules in accommodating cost recovery for mandated SMI rollout taking into account 'reasonably achievable network operational benefits' and passing these through to customers. The AEMC states that these criteria will guide its approach and the development of recommendations. We appreciate the AEMC setting out the decision making criteria in such a way but have a few concerns about the scope of several of the criteria.

Recovery of costs

The MCE's request for advice is clearly focused on finding out whether the current Rules are robust enough to efficiently accommodate the recovery of the efficient costs of smart metering mandated by a Ministerial Determination. Further, the AEMC itself notes that one of the NEL's Revenue and Pricing Principles state that a regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in providing direct control network services and complying with a regulatory obligation or requirement or making a regulatory payment.⁴

We welcome the AEMC's decision to have regard to these principles. A key aspect of the MCE's request is whether the regulatory framework will allow a DNSP to be able to recover all the costs that it has incurred under a mandated SMI roll out. However, none of the AEMC's decision making criteria in the draft SOA reflect this objective. The set of criteria could be improved by specifically having a criterion that addresses this objective of ensuring that the DNSP will be able to recover efficient costs. The attached table includes wording for such a criterion.

Support potential benefits being realised in practice

The AEMC's third criterion includes the statement that "*The regulatory framework needs to ensure that the benefits are realised to the maximum extent possible and promptly passed through to customers, to ensure their long term interests are supported*".⁵

This criterion suggests that the AEMC will be looking into whether the regulatory framework is designed to facilitate the realisation of benefits of SMI. We note the comments made by the AEMC further in the draft SOA

³ MCE, Smart Meter Decision Paper, 13 June 2008

⁴ AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, page 10

⁵ AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, page 11

commenting that “We will also consider the potential options for facilitating the pass through of network tariff signals by retailers”.⁶

The statements by the AEMC suggest that it will be making a judgement about whether the regulatory incentives provided under chapter 6 will deliver benefits to the “maximum extent possible”. Whilst this may be a legitimate issue for the regulatory framework more broadly, We question whether this criterion appropriately reflects the MCE’s request for advice regarding cost recovery. The MCE’s request for advice does not ask the AEMC to look into whether benefits will be realised or not. Further, the MCE has not asked the AEMC to consider options for facilitating benefits – merely whether any benefits will be passed through and how these would be reconciled in the evaluation of efficient cost recovery.

We would suggest that the AEMC redraft this criterion to focus on whether the regulatory framework allows for the appropriate consideration of tangible distributor benefits in determining efficient cost recovery by distributors. This would better reflect the intention of the MCE’s request for advice. Our doubt with the scope of this criterion leads us to have concerns with the inclusion of question 16 in the draft SOA, which will be discussed in turn.

Consistency in treatment across different types of costs

We consider that this criterion should be amended so that consistency is maintained for all aspects of the regulatory framework, not just the assessment of costs. That is, any deviation in the regulatory treatment of smart meter infrastructure, including costs and benefits, would need to be justified on the basis that the mandated roll out is sufficiently different from other investments so as to warrant a different approach.

4. Ability of the AER to assess network benefits

In discussing the AER’s information requirements the AEMC states that “we intend to also assess the ability of an economic regulator to determine the quantum of benefits that are ‘reasonably achievable’ in circumstances in which there is a high degree of uncertainty”.⁷ Subsequently, the AEMC poses the question (Question 9) “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?”.

The AER already has a clear role in relation to monitoring and reporting on network revenue or pricing determinations and various aspects of a DNSP’s performance.⁸ As we have highlighted in section 2, consideration must first be given to whether there is anything fundamentally different about the task undertaken by the regulator in the context of an SMI roll out before considering whether additional functions may be required. In this light, we question whether it is appropriate for the AEMC to raise the issue of a monitoring role to assess whether benefits are being realised. Again, we consider that the MCE is interested in whether there are mechanisms in the Rules for benefits to be accounted for and passed on. This is a different task to assessing whether the ‘anticipated benefits’ are being realised. We request that the AEMC amend the scope of Question 9.

5. The pricing methodology of DNSPs

The MCE is seeking advice on the smoothing of the costs of smart metering and the discussion in the draft SOA reflects this. However, Question 14 in the draft SOA states “Are there any particular mechanisms for smoothing tariff impacts over time that the AEMC should consider in developing its advice?” As currently drafted this question could be interpreted as being about network tariffs in total. We consider that this question needs to be limited to the smoothing of SMI cost recovery and not broadened to include total network tariffs.

As mentioned previously we are concerned about the scope of Question 16 which asks “What incentives are there under the current regulatory regime for DNSPs to alter their tariff methodologies, to facilitate the realisation

⁶ AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, Page 31

⁷ AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, Page 24

⁸ Section 15(1)(a) of the National Electricity Law.

of the potential demand side benefits of mandated smart meters?'. Further we note the AEMC's comment that "We will also consider the potential options for facilitating the pass through of network tariff signals by retailers".⁹

MCE's request for advice asks the AEMC to look into whether there are mechanisms in the Rules for the benefits of a SMI mandate to be passed through to consumers.

We do not believe that the MCE has asked the AEMC to look into whether potential benefits will be realised or not; or for any options for facilitating pass through of network tariffs. There is no reference in the MCE's request for advice on incentive for changing the tariff methodologies or facilitating the benefits of demand side management. We consider that the AEMC line of questioning may be pre-emptive given the early stage of the introduction of smart metering. Further we consider that this issue is not within the scope of the MCE's request for advice and we request that the AEMC reconsider including question 16 in the Statement of Approach.

EnergyAustralia looks forward to participating further in the consultation for this important review.

If you have any queries about these comments please contact Ms. Jane Smith, Executive Manager, Regulation & Pricing on 02 9269 4171.

Yours sincerely



TREVOR ARMSTRONG
Executive General Manager
System Planning & Regulation

⁹ AEMC, Draft Statement of Approach - Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, December 2009, Page 31

	Issue in draft Statement of Approach	Comments from EnergyAustralia
	Characteristics of an SMI mandate	<p>Perhaps the first question to ask stakeholders is whether there are any differences between a mandated smart meter rollout and other regulated distribution services.</p> <p>We propose that the following questions be included in the Statement of Approach:</p> <ul style="list-style-type: none"> • Is there anything different about smart metering assets and services compared to the other distribution services?; and further • Is there anything different about a Ministerial determination compared to other regulatory obligations placed on distributors?
Q1	<p>1. Are the proposed decision-making criteria appropriate for the development of AEMC advice?</p> <p>Are there any additional criteria that should be included?</p>	<p><u>A new criterion</u></p> <p>The MCE's Request for Advice (RFA) is clearly focused on finding out whether the current Rules are robust enough to efficiently accommodate the recovery of the efficient costs of smart metering mandated by a Ministerial Determination (refer to para 7 of the RFA). The regulatory framework for a mandated roll out should ensure that the DNSP is able to recover all the costs that it has incurred under a mandated SMI roll out.</p> <p>The draft criterion could be improved by specifically having a criterion that addresses this objective. We suggest that a further criteria be added such as</p> <p><i>- Ensure that, as a minimum, the DNSP is able to recover the costs that it has incurred in meeting the requirements of the Ministerial determination.</i></p> <p><u>Re: criterion 6:</u></p> <p>The meaning of this criterion as currently worded is unclear. Is the focus of regulatory consistency for costs only?</p>
Q2	<p>2. Do the proposed scenarios capture the relevant range of potential circumstances that should be considered in preparing this advice?</p> <p>Are there other scenarios or variables that should be considered?</p>	<p>Another scenario is where the DNSP considers that there would be benefits in providing SMI services/ functionalities that are beyond the SMI mandate.</p> <p>What if the DNSP considers that there are synergies in having services/ functionalities that are in addition to the specifications in the mandate? The regulatory framework needs to be able to accommodate such scenarios.</p>
	Recovery of efficient DNSP costs	
Q3	<p>3. What issues may arise in regards to the recovery of the 'stranded costs' associated with DNSPs existing metering infrastructure, following a Ministerial determination?</p>	No comment at this stage.

Q4	4. Are there any other issues that the AEMC should consider when assessing the current cost pass through provisions in the Rules, particularly in regards to the materiality threshold and timeframes that apply?	<p>We consider that it may be beneficial to also ask the question:</p> <p><i>“What is an appropriate materiality threshold for the pass through of mandated SMI costs”</i></p> <p>We note that the AEMC refers to contingent projects in its draft SOA, Another question that may be added is:</p> <p><i>“Are there other mechanisms that could be considered for passing through the costs of smart metering”.</i></p>
	Classification of metering services as alternative control services	
Q5	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 the AEMC should consider developing its advice?	<p>Given that the cost pass through provisions only apply to standard control services of the NERs) and need to be specifically applied to alternative control services (see clause 6.2.6(c) through a distribution determination, a more specific question is:</p> <p><i>“What cost recovery approaches should apply to metering services that are classified as alternative control services”.</i></p>
	Cost recovery by a DNSP of retailer costs	
Q6	What issues may arise in regard to the recovery of retailer costs via distribution charges for mandated smart metering pilots/trials?	No comment at this stage.
Q7	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?	<p>Distribution network services require huge capital costs that are incurred up front and the benefits are enjoyed for a long time. We question to what extent the “delay” in smart metering benefits is any different to the timing of benefits for other distribution network services?</p> <p>Perhaps the question should be:</p> <p><i>“Are there differences in the timing of the occurrence of costs and realisation of benefits resulting from smart metering that are different to the DNSPs other distribution services. If so, do they require a different regulatory treatment?”</i></p>
Q8	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?	The draft question is appropriate.
Q9	<p>What type of information may be required by the AER to assess whether operational network benefits are being realised within a reasonable timeframe?</p> <p>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?</p>	<p>The AER already has a clear role in relation to monitoring and reporting on network revenue or pricing determinations and various aspects of a DNSP’s performance.¹⁰ As we have highlighted above, consideration must first be given to whether there is anything fundamentally different about the task undertaken by the regulator in the context of an SMI</p>

¹⁰ Section 15(1)(a) of the National Electricity Law.

		roll out before forming any view about whether additional functions may be required.
	Incentives under the current regulatory regime	
Q10	Is the EBSS appropriate for the mandated roll-out of smart meters, considering the MCE's requirement for the prompt pass through of benefits to consumers?	No comment at this stage.
Q11	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?	No comment at this stage.
Q12	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?	No comment at this stage.
	Consideration of alternative regulatory approaches	
Q13	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?	No comment at this stage.
	Pricing methodologies of DNSPs	
Q14	Are there any particular mechanisms for smoothing tariff impacts over time that the AEMC should consider in developing its advice?	The MCE request for advice is focused on the efficient allocation of costs (item 9.3); depreciation profiles (12.1) so as to smooth out the costs of the actual SMI – not the smoothing of the total network tariffs. Draft question 14 could be broadly interpreted as referring to network tariffs. We suggest that this question be redrafted along the lines of: <i>“What constitutes the efficient allocation of costs of a smart meter roll out? How may costs of smart metering be appropriately apportioned”.</i> <i>“Are there any particular mechanisms for smoothing out the costs of the smart metering infrastructure. Could adjustments to the depreciation profiles be used to smooth the impacts of smart metering costs.”</i>
Q15	What potential issues may arise from the unbundling of metering charges from DUOS charges?	No comment at this stage.
Q16	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 no reference in the MCE's request for advice on incentive for changing the tariff methodologies or facilitating the benefits of demand side management. We consider that the AEMC line of questioning may be pre-emptive given the early stage of the introduction of

		<p>smart metering. Further we consider that this issue is not within the scope of the MCE's request for advice and we request that the AEMC reconsider including question 16 in the Statement of Approach.</p>
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