



National Stakeholder Steering Committee

23 July 2010

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

Dear Mr Pierce

Draft Report – Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure (Ref No: EPR0018)

The National Stakeholder Steering Committee (NSSC) is pleased to make this submission on the Australian Energy Market Commission's (**Commission**) draft advice to the Ministerial Council on Energy (**MCE**) regarding whether chapter 6 of the National Electricity Rules (**Rules**) most efficiently accommodates cost recovery for smart metering infrastructure (**SMI**) mandated by a Ministerial determination (**Draft Report**).

The NSSC is a stakeholder group comprising distributor, retailer and consumer representatives. As an expert industry and consumer body, this submission reflects the common views of NSSC stakeholders in relation to issues raised by the Draft Report.

In this submission the NSSC responds to the draft findings of the Commission and the Commission's proposed changes to the Rules, as stated in the Draft Report. The NSSC's responses to the specific questions raised by the Commission in the Draft Report are provided in the Annexure attached to this submission.

1 Context

1.1 The legislative and regulatory arrangements

Legislative and regulatory arrangements underpin the issues raised by the MCE for the advice of the Commission.

The *National Electricity (South Australia)(Smart Meters) Amendment Act 2009* introduced a head of power into the National Electricity Law (**NEL**) allowing jurisdictional Ministers to make a Ministerial smart meter roll out determination about the provision of smart metering services by a regulated distribution system operator.

Without limiting the Minister's general power to make a determination about the provision of smart metering services, a Ministerial smart meter roll out determination may specify:

- the date or dates by which, and the location at which, smart metering services, or different classes of smart metering services, must be provided;



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- the date or dates by which required smart metering infrastructure, or different classes of smart metering infrastructure, become operational.

Smart metering services is a defined term in the NEL meaning services provided by means of required smart metering infrastructure that are specified as smart metering services under the Rules.

Required smart metering infrastructure is a defined term meaning smart metering infrastructure that is specified under the Rules to be required smart metering infrastructure.

Smart metering infrastructure is a defined term meaning infrastructure (and associated systems) associated with the installation and operation of remotely read electricity metering and communications, including interval meters designed to transmit data to, and receive data from, a remote locality.

In addition, the MCE published the *National Electricity Amendment (Ministerial Smart Meter Roll Out Determinations) Transitional Rule 2009 (Transitional Rule)*, to be made by the South Australian Minister, which provides for Distribution Network Service Providers (DNSP) to be the responsible person for all relevant metering installations installed pursuant to a Ministerial smart meter roll out determination. It is presented as rule to be placed in chapter 11 of the Rules.

Accordingly, the NEL (and Transitional Rule) provide that a jurisdictional Minister can require a DNSP to provide smart metering services using required smart metering infrastructure (commonly referred to as a “mandate”), where the scope of the services and infrastructure that the Minister might require is found in the Rules.

The Commission has been asked to consider whether chapter 6 of the Rules most efficiently accommodates cost recovery for a DNSP the subject of a mandate.

The legislation does not prohibit a DNSP or retailer from choosing to install a smart meter for a customer outside a mandate. If a DNSP did so choose, as a commercial decision the cost recovery arrangements for a DNSP may be regulated under the normal provisions of chapter 6. If a retailer chooses to install a smart meter the commercial outcomes would be unregulated. The Commission has not been asked to consider these matters.

1.2 NSSC work relating to the legal and regulatory framework

The MCE has established the NSSC as an expert group to advise it on a range of matters necessary to implement its policy on smart metering, its Statement of Policy Principles, and the recent amendments to the NEL.

In accordance with its scope of work, the NSSC considered a specification of ‘smart metering services’ and ‘required smart metering infrastructure’ at its meeting on 26 May 2010. The following description of these specifications does not represent a concluded position of the NSSC and is included here for background purposes. Ultimately it is expected that the NSSC will refer a specification of ‘smart metering services’ and ‘required smart metering infrastructure’ to the MCE for consideration as part of a Rules change proposal that the MCE might make to the Commission.

- (a) Smart metering services



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As the Commission notes at page 64 of its Draft Report, mandated SMI has the potential to facilitate a range of services, including but not limited to remote connect/disconnect services, remote load control services, smart metering data services and supply capacity limiting services. In addition, the range of services can be considered at a more detailed level. For example, supply capacity limiting services can be further disaggregated into export supply capacity limiting services, import supply capacity limiting services and emergency supply capacity limiting services.

The NSSC has contemplated that the Rules specify 'smart metering services' at the higher level, recognising that once the Minister has required the particular service at this level there will be no discretion for the Minister to prescribe the mode of operation of that service at particular premises (ie to require the service to be provided at the lower level). The DNSP would decide the mode of operation of the service at particular premises it would need to justify the costs (particularly back office costs) of that decision. It is expected that the Minister would undertake a cost-benefit analysis at the higher level and the AER would test the decisions and costs of the DNSP at the lower level.

(b) Required smart metering infrastructure

The NSSC has contemplated that once a Minister has mandated one or more smart metering services be provided by a DNSP at nominated supply points, that DNSP would be obliged to install SMI at those supply points that complies with a minimum requirement set out in the Rules. The scope of the minimum requirement baselined by the NSSC has been informed by the development of a 'SMI Minimum Functionality Specification' which specifies the business requirements for SMI components. That Specification has been developed taking into account the indicative costs and benefits using the Phase 2 CBA study managed by NERA Economic Consulting as an initial baseline in considering any changes to the initial list of minimum functionality requirements endorsed by MCE in December 2007.

(c) Placement

The NSSC has contemplated that these specifications of smart metering services and required smart metering infrastructure should appear in chapter 11 of the Rules, alongside the Transitional Rule. The Transitional Rule is a tool for implementing a jurisdictional Ministerial determination for a mandate. As these specifications are also such tools, and only have purpose for a mandate, one option is that they should be placed with the Transitional Rule. However, in relation to this matter the NSSC recognises that the view of the Commission would be most relevant.

2 Submission

2.1 *Introductory remarks*

By way of introductory comment, the NSSC supports the Commission's overall assessment 'that the existing processes for cost recovery are reasonably adequate and have the potential to accommodate the recovery of the efficient costs of SMI mandated by Ministerial Determination'.¹ The NSSC also supports the Commission's more specific draft findings, particularly that:

¹ Draft Report, Summary at page ii

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- the Rules should be amended to provide for an explicit revenue adjustment at the time of the next distribution determination, which makes the DNSP neutral to the difference between the forecast profile of installation and the actual timing of the rollout (although some modifications to the proposal are proposed);
- Ministerial rollout determinations should be aligned with the start of the distribution determination process;
- only technical amendments to the cost pass through arrangements in chapter 6 of the Rules are required to promote recovery of efficient costs of mandated smart meter pilots and trials;
- the Rules should be amended to allow recovery of costs associated with a mandated pilot made within the 'dead zone' prior to the next regulatory control period (and currently prevented by the cost pass through arrangements).

The NSSC does, however, have the following concerns with the Draft Report:

- the smart metering services the subject of the Commission's discussion, particularly in relation to those services that might be the subject of a distribution determination, classification as alternative control services and tariff unbundling, is not sufficiently clear;
- the Rules changes recommended in the Draft Report should *not* extend beyond smart metering;
- requiring DNSPs to report on the costs and benefits of smart metering may not present the 'full picture' of smart metering costs and benefits and there needs to be a clear expression of such both by the Commission in its Report and by the Australian Energy Regulator (**AER**) in its publication of any reporting;
- the AER should not be granted the discretion to roll forward any component of the regulatory asset base (**RAB**) on the basis of forecast depreciation, but its discretion must be limited to the cost sharing mechanism and must be exercised only where the degree of uncertainty in relation to smart metering costs is materially greater than for network investments;
- no ex-post review should be introduced to the Rules;
- the Commission's proposal to make the DNSP revenue neutral to the difference between forecast profile of installation and the actual timing of the rollout, does not take into account valid reasons for any difference;
- the principles for recovery of costs of alternative control services should be the same as for standard control services as the guidance in the National Electricity Law (**NEL**) is insufficient;
- the Commission's proposals to address cost uncertainty in relation to smart metering do not address the issues of investment certainty;



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- the proposed maximum period for making a cost pass-through determination for smart meter pilots and trials is too long;
- the NSSC disagrees with the Commission's view that it is inappropriate for individual smart metering charges to be levied on customers before a customer has an installed and functioning smart meter; and
- the Draft Report does not adequately address recovery of retailer pilots and trial costs.

2.2 Discussion

These concerns are discussed further below.

1 Further clarity regarding the services under consideration

In its submission to the Commission on the Draft Statement of Approach,² the NSSC noted that the distinction between 'metering services', 'smart metering services' and 'network services' required deeper consideration. Clarity concerning the services under consideration is important, and the NSSC considers that the Draft Report could be more precise in this regard.

- For example, the Draft Report refers in various places to 'smart metering services' and in other places to 'mandated smart metering services'. Do both terms refer to smart metering services required to be provided by a DNSP pursuant to a Ministerial smart meter rollout determination made pursuant to section 118 D of the NEL (in this submission referred to as 'mandated smart metering services')? The NSSC assumes that, consistent with the MCE's Request for Advice, the Draft Report applies only to 'mandated smart metering services' and not smart metering services that may be provided by a DNSP or a retailer on a commercial basis.
- If it is the case that the Draft Report applies only to mandated smart metering services, the report does not consider the implications (if any) on cost recovery under chapter 6 of the Rules if smart metering infrastructure, installed in accordance with a Ministerial smart meter rollout determination to enable the provision of mandated smart metering services, is used for the provision of non-mandated smart metering services for example where access to smart metering infrastructure is available to a third party for the provision of services to customers (that is, where there is a disconnect between the service delivery party and the regulated infrastructure provider). As noted in section 3 of this submission, the benefits of smart metering also include the use of smart metering infrastructure by parties other than DNSPs.
- In its submission to the Commission on the Draft Statement of Approach, the NSSC questioned whether some (mandated) smart metering services should (and could) be classified as alternative control services while others remain standard control services and others be unregulated. In its Draft Report the Commission notes that mandated SMI has the potential to facilitate a range of services³ and the NSSC agrees with this statement. Nevertheless, in its discussion on page 64, the Commission seems to equate smart metering services (a range of services) with metering services (a

² See NSSC submission on Draft Statement of Approach dated 5 February 2010.

³ Draft Report, Summary at page 64

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narrower metrology service) in discussing alternative control services. Also, it seems that in concluding that “in principle, [the Commission considers] that the costs of a mandated roll-out should be separated from DUOS charges”⁴, the Commission may again be thinking of metrology charges, as there are likely to be some ‘costs of a mandated roll-out’ which relate to the provision of standard control services and DUOS charges. The statement that “metering services, including smart metering services, should be unbundled from DUOS charges” is perhaps a reference to metrology services, including those provided by smart metering infrastructure. Clarity on which of the range of services that might be facilitated by mandated SMI that the Commission feels may, in principle, be appropriate for classification as alternative control services and thus tariff unbundling would help in understanding the Commission’s views in this area.⁵

2 Recommended changes should be limited to mandated smart metering services

The Commission recommends in its Draft Report that a number of proposed Rules changes have more general application than smart metering. The NSSC acknowledges that there is merit in some of these Rules changes extending beyond smart metering (for example, the proposal to remove the ‘dead zone’ in the cost pass through arrangements). However, the NSSC is strongly of the view that any Rules changes arising from this Draft Report should be limited to smart metering; any proposed changes to chapter 6 to support smart metering should preserve the integrity of that chapter in relation to network investments and extension of proposed Rules changes beyond smart metering may delay implementation of those changes. Further, by recommending Rules changes to be applied more generally to chapter 6, the Commission is acting beyond the scope of the MCE’s Request for Advice.

3 Reporting of smart metering benefits by DNSPs may not provide a complete picture

The Commission proposes a Rules change to ‘require DNSPs in all jurisdictions to provide annual information to the AER on the costs and network operational benefits of any mandated smart meter roll-out, pilot or trial they are undertaking. The AER should be required to publish a guideline, following stakeholder consultation, which sets out the nature and format of information that DNSPs must provide.’⁶

The NSSC is concerned that the network operational benefits a DNSP will be required to report on under this proposed Rule change will not be a ‘true and complete’ report of the costs and benefits associated with smart metering. A DNSP will never be able to provide a ‘true and complete’ report of these costs and benefits but will only be able to report on measurable and quantifiable benefits accruing to their own operations.

For example, as noted by the NSSC in its submission to the Commission on the Draft Statement of Approach,⁷ in relation to network operational benefits (amongst other matters):

⁴ Ibid, page 90.

⁵ Ibid, page 91

⁶ Draft Report, at page 12

⁷ See NSSC submission on Draft Statement of Approach dated 5 February 2010.



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- some of the benefits of smart metering are likely to be unquantifiable, such as more accurate settlement of bills, customer satisfaction, and product and service innovation;
- realisation of some of the benefits of smart metering depend not just on DNSP action but on that of retailers and customers, and also upon national processes and procedures for smart metering services being put in place;
- some of the benefits may flow directly to customers without delivering a benefit to the DNSPs, yet achieving those benefits may require costs to be incurred by the DNSP (for example, through systems augmentation).

In addition, a DNSP should only be required to report on (and could only report on) measurable and quantifiable benefits accruing to the DNSP's own operations in respect of the reporting period, as a result of investment already made and implemented.

Accordingly, the Commission (and the AER) should be clear in the purpose and scope of this additional reporting requirement to be placed on the DNSP – to assist the AER in making a distribution determination, so that any such report is not seen as an overall/all encompassing report on the costs and benefits of smart metering.

In addition, in the NSSC's view, the Commission should also consider further whether the likely benefits of imposing this additional reporting obligation on DNSPs outweigh the likely costs of such obligation.

4 AER discretion to determine 'substantive degree of uncertainty regarding efficient costs and expected benefits' too broad; AER should not have a discretion to roll forward the RAB on the basis of forecast depreciation

The Commission is proposing that, 'where there is a substantive degree of uncertainty regarding the efficient costs and expected benefits of SMI at the time the AER makes a distribution determination, the AER should be provided with the discretion to apply one of the following mechanisms in making a distribution determination:

- Rolling forward the RAB on the basis of forecast depreciation for assets with economic lives of 15 years or less; or
- A cost sharing mechanism, which would allow the AER to vary the proportion of any underspend or overspend which is retained by DNSPs and shared with customers, according to the extent of uncertainty the AER considers remains in relation to the costs and benefits of SMI. This mechanism would only apply to expenditure which is specifically required or mandated SMI.

The AER would be required to indicate in its Framework and Approach Paper for a distribution determination whether it considers there is a possible need to apply one of these mechanisms in the forthcoming regulatory control period.⁸

The NSSC has some concern with this proposed approach.

⁸ Ibid, page 12.



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- Firstly, guidance should be given to the AER in determining whether or not there is a 'substantive degree of uncertainty regarding the efficient costs and expected benefits at the time the AER makes a distribution determination'.
- Secondly, and as a related issue, the Commission elsewhere notes in the Draft Report that uncertainty regarding the efficient costs that need to be incurred by DNSPs 'is likely to vary in relation to the different types of expenditure (e.g. the unit costs of smart meters may be more certain than the costs of installing smart meters). There may be some difficulty in identifying the scope of the efficient costs for some items (e.g. IT systems required to support a roll-out could be also be expanded to allow the DNSP to develop 'smart grid' functionalities)'.⁹ How does the AER make its assessment regarding the 'substantive degree of uncertainty regarding the efficient costs and expected benefits' giving there may be varying layers of uncertainty in smart metering costs and benefits?
- Thirdly, requiring division of the RAB to allow the roll forward of assets with economic lives of 15 years or less on the basis of forecast depreciation, adds unnecessary administrative complexity to the roll forward model.
 - Short asset life is not a contributing factor to uncertainty in the costs of a mandated rollout of smart metering. A good deal of other business as usual network investment has a short economic life and involves new technology.
 - The proposal is a significant change to the roll forward model for assets which comprise a relatively small proportion of the total value of network assets.
 - The proposal adds 'another layer' to the roll forward model, which already imposes on DNSP obligations additional to general statutory and accounting obligations.
 - The roll forward model was the subject of wide consultation, which consultation included consideration of rolling forward the RAB on the basis of forecast depreciation. This option was not adopted for reasons including that rolling forward the RAB on the basis of forecast depreciation, never provides benefit to DNSPs even where there is good reason for 'actual spend' differing to forecast spend.
 - There are other, less complex, incentives available to ensure that DNSP forecasts of network investment are reasonable.
- Fourthly, as noted above, any mechanism proposed to address uncertainty regarding efficient costs and expected benefits for smart metering, should be limited to smart metering and not extend to other network assets, as proposed by the Commission.¹⁰

The Commission proposes a mechanism such that the AER be able to decide to roll forward the RAB on the basis of forecast depreciation for assets with economic lives of 15 years. The

⁹ Draft Report, at page 19.

¹⁰ See Draft Report at pages 29 and 30.



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result would be that the amount of underspend permitted to be kept by the DNSP in the first period is reduced compared with longer life assets.

However, that will not remove the prospect of an increased allowance for contingencies and “if significant uncertainty remains when the AER makes its distribution determination, then it is likely that this uncertainty could result in the AER approving a higher level of forecast expenditure”¹¹, as a result of which consumers will still end up funding some part of the contingency allowance.

The NSSC notes also that the alternative cost sharing mechanism proposed by the Commission would still impose administrative burden on a DNSP. Of the two options the NSSC's preference is this mechanism given that it results in less additional complexity than the alternative.

Accordingly, the NSSC's preferred approach would be:

- requires the AER to make an assessment of the degree of uncertainty regarding the efficient costs and expected benefits of smart metering at the time the AER makes a distribution determination, and allows the AER to apply the 'required mechanism' only where the degree of uncertainty regarding the overall efficient costs and expected benefits of smart metering is materially greater than that in relation to other network assets;
- the only 'required mechanism' which the AER may apply is the cost sharing mechanism (mechanism two, described above).

5 No ex-post review should be introduced to the Rules

The Commission is proposing that, 'where a Ministerial rollout determination is made subsequent to a distribution determination process and has triggered expenditure which has not been incorporated in a relevant distribution determination, the AER's decision on the allowed level of expenditure would be deferred until the next distribution determination process. At this time, the AER would perform an ex-post review on the efficiency of the incurred expenditure.¹² The Commission argues that this is necessary because the timeframes under the chapter 6 cost pass through process are not adequate to accommodate the recovery of efficient costs given the potential scope and complexity of smart meter rollouts. Moreover the cost pass through process could only apply if the relevant smart metering service had been classified in a distribution determination as a standard control service or had been classified as an alternative control service with provision for a pass through.

The NSSC does not support deferral of consideration of the roll-out expenditure until the making of the next distribution determination, and does not support amending the Rules to allow an ex-post review of incurred expenditure.

¹¹ Draft Report, page 20 – 21.

¹² Draft Report at pages 33 to 34.



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Issues with ex-post reviews

The introduction of ex-post reviews would be a significant shift away from the current regulatory framework which is based on ex-ante incentive arrangements. Introducing inconsistency in regulatory methods creates complexity and additional costs.

Ex-post reviews:

- Create considerable uncertainty and regulatory risk (with no proposed compensation).
- Provide less incentive to drive efficiency (as the ex ante incentive mechanisms wouldn't apply). Reducing the incentive on DNSPs to reveal efficient costs could increase costs to consumers in the longer term.
- Would incentivise investment by DNSPs to maximise the likelihood of cost recovery rather than investment to maximise benefits to consumers (for example a DNSP may not pursue a more costly investment that would offer benefits to consumers if there is a risk that this additional cost may not be recoverable). Ex-post reviews would remove some of the flexibility in the current ex-ante framework to allow DNSPs to make the best investment choices.
- If based on the “no hindsight” rule, then an ex-post determination would be based on the same information as an ex ante determination and thus wouldn't be any less complex.

As an ex-post review of a mandated smart meter rollout would be a unique process and hence undertaken independently to the ex-ante review of expenditure for the next regulatory control period (that would be using a different mechanism), there would be no cost efficiencies in undertaking the review ex-post rather than ex-ante. Essentially a similar review of a mandated smart meter rollout should be undertaken whether this is undertaken at the time of the distribution determination (ex-post) or mid period (ex-ante).

Proposed alternatives

As noted above, the NSSC strongly supports the Commission's recommendation that, where possible, the timing of a Ministerial determination should be aligned with the distribution determination process.

If it is not possible to align the timing of a Ministerial determination with the distribution determination process, then it would be preferable to:

- fix the practical difficulties with the cost pass through arrangements; and/or
- provide for a limited re-opening of a distribution determination,¹³

to allow for an efficient mid-period cost recovery decision. The NSSC suggests that the Rules could provide for both alternatives, with the issue of the alternative to apply being determined by the point at which, a Ministerial roll-out determination is made during the

¹³ An option similar to Option 11 (Adjustment to existing cost allowances) considered by the Commission. The NSSC considers that the Commission's objection to this approach (that the option may overlap with activities required for the next distribution determination) are of lesser concern than the introduction of an ex-post review.



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regulatory period, with the former to apply later in the period and the latter to apply earlier in the period. It is the view of the NSSC that these alternatives address the Commission's concerns but do not present such a fundamental change to the Rules as the Commission's proposed 'ex-post review'.

Revised cost pass through arrangements

The main impediment to an efficient decision identified by the Commission is the lack of time allowed for the AER to make a decision under the existing Rules. The AER should be allowed to extend this period to a maximum of 6-months to allow sufficient time for the AER to ascertain efficient costs and benefits (as is proposed by the Commission for cost pass through determination for mandated smart meter pilots and trials). Six months should be sufficient time because considerable information on the costs and benefits of a smart meter rollout would have been established as part of the decision to mandate a rollout (and accordingly, the 8 month time frame allowed to the AER to assess the Victorian AMI rollout is, in the NSSC's view, too much time)¹⁴.

Allowing an extension to the period for the AER to make a cost pass through determination extends the period of investment uncertainty for the DNSP, however this is preferable to an ex-post determination where the period of uncertainty extends to the end of the regulatory control period.

If the Commission considers that six months may not be sufficient time for the AER to ascertain efficient cost and benefits, a 2-step cost pass through process could be considered. Under such a process the AER could make an interim decision for cost recovery for the next 12 months. This decision could be made within the current 60-day timeframe. The AER would then have 12 months to undertake a thorough assessment of costs and benefits, and make a determination to apply for the remainder of the regulatory control period.

The Rules would also need to be amended to allow a cost pass through to apply to any smart metering service which had been classified as an alternative control service but for which a pass through process had not been provided.

Limited re-opener

Alternatively, to address the Commission's concerns that the cost pass through provisions of the Rules do not provide sufficient guidance to the AER for the recovery of efficient costs in the context of a smart meter roll-out determination, the NSSC suggests that the Rules be amended so that, where such a determination is made during a regulatory period, the AER may revise the existing distribution determination:

- only to accommodate the costs and benefits of smart metering services for the remainder of the regulatory period; and
- by following the same process as for making a distribution determination, but with (prescribed) reduced timeframes (reflecting the timeframes proposed above).

¹⁴ Draft Report, page 40. The NSSC notes too, the different arrangements for cost recovery applying in respect of the Victorian AMI rollout.



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6 Difference in forecast profile of installation and actual timing of rollout

The NSSC understands the Commission's objective in proposing amendment to the Rules to provide for explicit revenue adjustment which makes the DNSP neutral to the difference between the forecast profile of installation and the actual timing of the rollout. The NSSC considers, however, that the most likely cause of any difference between the forecast profile of installation and the actual timing of the rollout will be technical difficulties arising, despite the best efforts of a DNSP, because of the scale and nature of an accelerated rollout. The Commission's description of how the proposed mechanism might work may simplify the application of that mechanism in practice – there may be a number of factors that should be taken into account and the AER should at least be required to consider submissions in this regard.

7 Principles for recovery of costs of alternative control services should be same as for standard control services

Again, the NSSC is of the view that the AER's discretion in determining the control mechanism for smart metering services that are alternative control services, should be limited so that the AER is required to apply the principles of Part C of chapter 6. The Commission notes that "there is little guidance in the Rules as to how alternative control services are to be regulated and the AER discretion in designing the control mechanism for such services"¹⁵ and concludes that the NEL Revenue and Pricing Principles and NEO are sufficient in the circumstances. Alternative control services are, in broad terms, those which are fee based or quoted, and make up a relatively small component of the costs of direct control services. In those circumstances the current regulatory model is appropriate. In the case of a mandated smart metering roll-out, however, we might be speaking of the allocation of tens, if not millions, of dollars to an alternative control services RAB and a similarly comparatively high opex component. The Commission's Table 5.1 does not even refer to the detailed RAB roll forward rules in Schedule S6.2.1 of the Rules. In those circumstances the very high level guidance in the NEL is clearly inappropriate.

8 Investment uncertainty remains

This Commission's proposals discussed in sections 4 to 7 above highlight the issue of 'investment certainty'. The NSSC's February submission raised the issue of cost certainty in the context of the operation of chapter 6 of the Rules but also noted that need for the regulatory framework to provide investment certainty for boards of directors of distributors when committing to new expenditure to comply with a legal mandate. While there is considerable discussion in the Draft Report of timing and cost uncertainty and the sufficiency or otherwise of chapter 6 of the Rules in those circumstances, the Draft Report says little regarding the issue of investment certainty. This discretion given to the AER to assess, on a case by case basis, the level of 'cost uncertainty' and determine the appropriate mechanism to deal with such uncertainty may create greater issues for 'investment certainty'. A regime that provides the AER with greater discretion is likely to create less certainty, especially if the distributors are required to commit funding before the AER makes its decision.

Further, the potential stranding of existing meters as a result of a mandate as well as the possibility of future smart metering contestability creates a substantial risk of asset stranding

¹⁵ Ibid, page 63



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for existing and future meters. The NSSC's commitment to supporting a policy of mandated smart meter roll outs depends on the Rules ensuring reasonable cost recovery for the required efficient investment and stranded assets resulting from the smart meter rollout during the post mandate period. The NSSC suggests that the Commission's proposed treatment of existing meters stranded as a result of a mandated rollout (continued depreciation under approved asset lives) also apply to stranded smart meters.

The Commission should look at whether the current regulatory framework can support features that will preserve investment certainty when and if contestability occurs in whatever form.

9 Smart metering charges should be levied prior to installation

The Commission also states that it considers that 'it would be inappropriate for individual smart metering charges to be levied on customers before a customer has an installed and functioning smart meter.'¹⁶

The NSSC strongly disagrees with this view. Once a Minister has mandated the provision of smart metering services (and the efficient costs of providing those services determined by the AER) customers should commence paying for those services, notwithstanding that installation of required SMI may occur at a later date. This position is consistent with the current regulatory framework, which is predicated on the principle that customers pay upfront for infrastructure costs, and that such costs are smeared across all customers, in advance of any immediate benefits. Customers are better protected through a robust determination process and the Commission's proposal to amend the Rules so that the DNSP is neutral to the difference between the forecast profile of installation and the actual timing of the rollout.

10 Recovery of retailer pilots and trial costs not adequately addressed

The Commission concludes that 'DNSPs have an ability to recover efficient third party costs under the distribution determination process that may be incurred in undertaking a mandated smart meter pilot or trial.'

Nevertheless, under the distribution determination process, the DNSPs ability to recover retailer costs for mandated pilots and trials is not certain (nor is it for a retailer); recovery of these costs is left to the discretion of the AER. This uncertainty may compromise the scope and timing of mandated smart meter pilots and trials. There may be practical difficulties with establishing the contract and risks for both the distributors and retailer under a regulatory framework that has the AER potentially disallowing a distributor cost as not prudent and efficient when that cost is required for retailer participation in a mandated pilot or trial.

The NSSC recommends that criteria be considered for application by the AER in relation to retailer cost recovery for pilots and trials and that the AER commit ex ante to the cost pass through amounts, allowing third party service providers (retailers) in pilots and trials to gauge the risk of participation appropriately. Not allowing an ex ante assessment will significantly impact on retailer participation in mandated pilots and trials.

¹⁶ Draft Report Summary at page v.



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Thank you again for the opportunity to provide comments on the Draft Report. If you have any questions on our submission please do not hesitate to contact me via Harry Koller, NSMP Program Director via email on Harry.Koller@au.pwc.com.

Kind regards

A handwritten signature in black ink, appearing to read "David Miles". The signature is fluid and cursive, with a large loop at the beginning and a long tail extending to the right.

David Miles
Chairman

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Annexure

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?

As noted in section 2 of this submission, the NSSC is strongly of the view that any Rules changes recommended by the Commission in its Draft Report should not extend beyond smart metering.

1.2 Do you consider that a specific information 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?

As noted in section 3 of this submission, the NSSC is concerned that such report will not fully capture all benefits arising as a result of the introduction of SMI.

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?

As noted in section 5 of this submission, the NSSC is proposing application of the cost pass through or limited re-opener mechanism, to allow for recovery of costs and benefits, including adjustment in prices, where a mandated roll-out occurs prior to the next distribution determination.

In the event the Commission's 'ex-post review model' is adopted, an interim adjustment in prices would be required prior to the next distribution determination, to allow for funding of expenditure incurred pending that review.

If so, should this adjustment be based on the forecast costs and benefits outlined in the relevant Ministerial roll-out determination or on the DNSP's own forecasts?

Any interim adjustment in prices should be made on the basis of the DNSP's own forecasts, given that the costs and benefits outlined in the relevant Ministerial roll-out determination are unlikely to be at the required level of detail.

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

As noted in section 5 of this submission, the NSSC is strongly of the view that ex-post review should not be introduced to the Rules.

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?



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The NSSC generally supports recovery of smart meter pilot and trial costs through application of the cost pass through provisions, but consider that the proposed maximum period of 6 months for making a cost pass through determination for a smart meter pilot or trial is too long. As noted above, the NSSC considers that 6 months is sufficient time for assessment of the costs and benefits of a rollout determination. Assessment of costs of mandated smart meter pilots and trials will not be as complex. The NSSC suggests that the maximum period be 3 months.

The NSSC also refers to its comments in section 10 of this submission, in relation to the recovery of retailer costs associated with a smart meter pilot or trial.

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?

As noted in section 2 of this submission, the NSSC is strongly of the view that any Rules changes recommended by the Commission in its Draft Report should not extend beyond smart metering.

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?

As noted in section 7 above, the principles Part C of chapter 6 of the Rules should apply in the event smart metering services are classified as alternative control services.

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

As noted in the NSSC's February submission a relevant consideration in determining how benefits should be promptly passed through to customers is what action is required for the benefit to accrue:

- some of the benefits may flow directly to customers without delivering a benefit to the DNSPs yet achieving those benefits may require costs to be incurred by the DNSP (for example, through systems augmentation) In those circumstances the imperative is to encourage DNSPs to undertake the additional investment to use these functions as soon as possible, which in turn depends on the capacity of the regulatory regime to permit the DNSPs to recover the additional costs;
- the efficient response in the presence of the smart metering capabilities may be to raise the levels of service rather than to reduce cost, or a combination of both¹⁷.

Thus a proper analysis of the network operational benefits needs to consider the levels of service being provided in combination with the costs that DNSPs may incur, and

¹⁷ While it is common for cost-benefit analyses to derive estimates of the costs that may be avoided if new technologies are deployed (assuming a constant standard of service), this is done to make the cost benefit analysis more tractable.



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recognise that (absent service incentive mechanisms) the benefits of service improvements flow directly to customers; and

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 NSSC considers that the principles for allocation of costs for smart metering, and for unbundling smart metering services, should be the same as those currently applying for other network investment.

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?

The NSSC believes that is premature to make Rules regarding the unbundling of smart metering services.

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?

The NSSC believes that it is asymmetrical to include a prescriptive Rule that prohibits accelerated depreciation and one which provides the AER with the ability to back end depreciation. The Commission has proposed a regime based upon regulatory discretion constrained by high level principles. The Commission should be consistent in its approach. Relevant principles for back ending depreciation would include that the outcomes must be compatible with any contestability after the mandate and a balancing of ameliorating immediate price impacts with the consequences for later prices if assets are replaced leaving the remaining capital value and the capital value of the new assets both in the RAB and to be recovered at the same time. Once again, any amendment to clause 6.5.9 to expressly authorise the use of the x factor to smooth tariffs within the regulatory period should be limited to smart metering, in accordance with the general principle that the Commission's Terms of Reference are so limited.