7 March 2014

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

Dear Mr Pierce, JOHN

RE: Supplementary Paper – Framework for Open Access and Common Communication Standards Review (Reference EMO0028)

The NSW Distribution Network Service Providers, Ausgrid, Endeavour Energy and Essential Energy (the NSW DNSPs) are pleased to provide comments in response to the AEMC's Supplementary Paper - Framework for Open Access and Common Communication Standards Review.

The NSW DNSPs note that the supplementary paper outlines the AEMC's draft findings in regards to: 1) whether access to smart meter functionality and access charges should be regulated; and 2) whether persons providing services to manage access to smart meter functionality should be subject to accreditation under the National Electricity Rules (NER) by Australian Energy Market Operator (AEMO). The NSW DNSPs views in relation to the AEMC's draft findings are summarised below:

- the NSW DNSPs do not support the AEMC's draft finding that access to and charging for basic smart meter functionality should be unregulated, rather we contend that such functionality should be subject to light handed regulation, whereas new and advanced smart meter functionality should be unregulated;
- the NSW DNSPs support the AEMC's draft finding regarding accreditation of parties responsible for managing access to smart meter functions; and
- the NSW DNSPs support a competition review of metering contestability arrangements.

Our submission is largely focused on demonstrating that light handed regulation is appropriate for basic smart meter functionality and is likely to better contribute to the achievement of the National Electricity Objective (NEO) than if these services were unregulated. Our submission also discusses implementation of recommendations from this review. In particular, we suggest that there is merit in any recommendations regarding access and accreditation arrangements being considered as part of the Standing Council on Energy and Resources (SCER's) metering contestability Rule change rather than through a separate Rule change process, given the interdependencies of these topics with other aspects of the SCER metering contestability Rule change.

If you have any further queries or would like to arrange a meeting to discuss our submission please contact Mr Murray Chandler, Group Manager Network Technology & Innovation at Networks NSW on (02) 9269 7210 or murray.chandler@ausgrid.com.au

Yours sincerely

Vince Graham
Chief Executive Officer
Ausgrid, Endeavour and Essential Energy

NSW DNSP RESPONSE TO AEMC SUPPLEMENTARY PAPER

1.0 INTRODUCTION

The NSW DNSPs are broadly supportive of most of the AEMC's draft findings in its supplementary paper. For instance, we support the AEMC's draft finding that:

- persons responsible for managing access to smart meter functions should be required under the National Electricity Rules (NER) to be accredited by the Australian Energy Market Operator (AEMO); and
- the need to undertake a competition review of the metering contestability framework after an appropriate period of time to determine whether it has been operating effectively.

As we agree with the AEMC's views on these issues, we have not discussed these points further in our submission. Rather, our submission is focused on:

1) access and charging arrangements for smart meter functionality- our submission is aimed at demonstrating that basic[1] smart meter functionality should be subject to light handed regulation, whereas it would be appropriate for advanced and new smart meter functions to be unregulated; and
2) implementation of recommendations from this review - our submission discusses the merits of implementing the AEMC's recommendations from this review regarding access and accreditation arrangements as part of the Standing Council on Energy and Resources (SCER) Rule change rather than as a separate Rule change.

These issues are discussed in further detail below.

2.0 ACCESS AND CHARGING ARRANGEMENTS FOR SMART METER FUNCTIONALITY

Whilst the NSW DNSPs agree with the AEMC's analysis that a case for heavy handed regulation in relation to access arrangements for smart meter functionality has not been established, we disagree that access arrangements for basic smart metering functionality should be unregulated. In our view, access to advanced and new smart meter functionality should not be subject to regulation; however, basic smart meter functionality should be subject to light handed regulation.

The NSW DNSPs consider that there is a need for light handed regulation of basic smart meter functionality due to:

- the potential for market power imbalances to develop under the proposed meter contestability framework;
- uncertainty regarding DNSPs ability to negotiate access on competitive terms; and
- the need for DNSPs to retain existing network functions.

2.1 Potential market power imbalances under meter contestability

In our response to the AEMC's Draft Report on the Framework for Open Access and Common Communication Standards (the review) we noted the potential for the SCER metering contestability Rule change to give rise to market power imbalances.

[1] Basic smart meter functionality refers to both metrology and core network services

Under the proposed SCER metering contestability Rule change DNSPs do not have guaranteed access to metering functionality outside of metrology functions unless they are engaged in the role of metering coordinator (MC). If a DNSP is not the MC for a metering installation and wishes to access network services enabled by the MC's smart meter, it will need to enter into contractual arrangements with the MC. However, it is important to note that under the proposed metering contestability framework, DNSPs do not choose the MC for a metering installation. Rather, it is the customer or the Retailer as the Financially Responsible Market Participant (FRMP) who selects the MC for a metering installation.

Consequently, our previous submission noted that as DNSPs are the only party seeking access to network services, and there is one MC per metering installation. MC's in effect have a monopoly over the provision of these services. As a natural monopoly provider of a service, MC's are likely to have weak incentives to provide access to network services at cost reflective prices given the lack of competitive forces for providing these services. Subsequently, our previous submission sought to highlight the potential for market failure to arise under the open access and metering contestability framework without regulation to correct this power imbalance.

Further, because some network services (such as direct load control and power quality monitoring) which are currently provided through existing metering installations are likely to be categorised as "basic" smart meter functionality under the AEMC's open access framework, we noted the potential for DNSPs to become "price takers" if they wanted to retain existing network services, when a network meter is churned.

The NSW DNSPs note that the potential for DNSPs to become "price takers" for network services in part arises from the fact that the benefits that flow through to customers from network services do not always accrue at an individual customer level but can be spread across a DNSPs customer base. For example, DNSPs use meter enabled functions such as direct load control to more effectively and efficiently manage their networks. The benefits from this flow back to customers through the deferral of network investment, better utilisation of network assets, and in the case of customers on controlled load, cheaper tariffs. However, as not all customers accrue direct benefits from network services they may have limited knowledge or place little value on network services enabled by smart metering.

As it is unlikely that customers or other parties aside from the DNSP place value on metering enabled network services, the ability of the MC to provide cost effective prices for these services is unlikely to be a factor in selecting a MC. Rather MC's are likely to be selected based on their ability to provide efficient retail services. This is because in most cases it will be the Retailer who assigns the MC. If a MC is able to provide cost efficient retail services that may enable the Retailer to offer more attractive product offerings to customers and obtain greater customer shares in the market, the Retailer is likely to select this MC regardless of whether the MC offers cost efficient network services.

Consequently, without appropriate regulation there is the potential for MC's to extract monopoly rents by offering access to network services at a significantly higher price than the cost to provide the service, in order to increase its profit margins or to cross subsidise the provision of retail services. DNSP's are likely to become "price takers" for network services if they seek to retain the existing network services and the MC sets the access price significantly higher than the cost of providing the network service but below the marginal cost of the DNSP installing new infrastructure to retain the benefit.

If DNSPs have limited market power to negotiate an efficient price for the provision of network services it is effectively faced with two options: 1) pay the higher price to retain the service; or 2) choose not to retain the service. The NSW DNSPs consider that either option leads to undesirable outcomes for customers over the longer term. Under option 1)

customers are paying more to receive the same level of benefits which were previously provided; whereas option 2) may result in the need for DNSPs to invest more to manage peak demand or power quality resulting in an under utilisation of network assets and higher prices to customers.

2.2 DNSP negotiating power

The NSW DNSPs note that whilst the AEMC has identified the potential for market power imbalances to occur in the provision of basic smart meter functionality, it has determined that regulation is not required as DNSPs should have sufficient market power to negotiate a reasonable price. The AEMC has formed this based on the following[2]:

- if MC's set access prices too high they risk losing a revenue stream that may help them compete in the market;
- DNSPs have the option to bypass smart meters; and
- DNSPs could continue to operate their networks based on the limited information currently available through type 5-6 meters.

2.2.1 Consequences from access prices being too high

Whilst it is true that if a MC sets access prices too high they risk losing a revenue stream, it is important to recall that MC's are likely to primarily compete for market share based on their ability to offer competitive prices for access to retail services, as opposed to the provision of network services.[3] Consequently, we do not agree with the AEMC that the risk of losing revenue provides a sufficient incentive for MC's to set cost efficient prices for network services, as their primary revenue stream is derived from retail services.

2.2.2 Credibility of DNSP by-pass option

The NSW DNSPs acknowledge that it is possible for DNSPs to have some counter-veiling market power if they are able to by-pass the meter to obtain access to the network service. However, we note that this is only likely to be a credible option where the DNSP is seeking to retain existing network services, and there is the ability for the DNSP to retain the asset rather than paying the new provider for the service. Therefore, in order to provide DNSPs with any counter-veiling market power to negotiate terms of access to network services with what is in effective a monopoly provider, the AEMC will need to ensure that DNSPs' assets cannot be removed without either the DNSP's consent or first negotiating access arrangements with the DNSP.

Further, it should be noted that this option may not always be possible for practical reasons such as when there is insufficient space on the customer's meter board to accommodate both the DNSP's metering installation and the MC's smart meter.

Consequently, when seeking to negotiate with MC's to retain access to existing network services, DNSPs may not always have the threat of utilising a by-pass option. Where this is not the case, the DNSP will have little counter veiling market power to negotiate an efficient price for the retention of existing network services.

Refer also to the NSW DNSPs comments in section 2.1 regarding the feasibility of installing new assets to retain existing network services where a network meter is churned.

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[2] AEMC 2014, Framework for open access and common communication standards, Supplementary paper – regulatory framework, 24 February 2014, Sydney, p 23.

[3] As noted in section 2.1, Retailers and customers are likely to select MC's based on their ability to offer competitive prices for access to retail services, as opposed to network services, as customers derive direct benefits from these services and are hence likely to value these more highly.

2.2.3 Maintaining networks based on metrology enabled services only

In reaching its view that basic smart meter functionality should be unregulated the AEMC has overlooked the fact that in some jurisdictions existing metering installations (such as type 5 interval metering) currently enable cost reflective pricing and network services such as direct load control. For instance, in Ausgrid's network alone 508,777 customers are on controlled load or approximately 31 per cent of Ausgrid's total customer base.

Consequently, where these meters are churned under the proposed metering contestability framework, and the previous network services enabled by the meter are not retained (because it is not cost efficient to do so), the ability for networks to defer network investment by effectively managing peak demand will be significantly diminished, which would also affect DNSPs ability to offer cheaper tariff rates to controlled load customers. As noted in section 2.1 this may lead to the need for increased investment, resulting in an under utilisation of network assets and increased prices to customers.

2.3 The case for light handed regulation

Our analysis in sections 2.1 and 2.2 has sought to demonstrate that there is a need for some form of regulation over the provision of basic smart meter functionality. The need for regulation for basic smart meter functionality arises due to the need to retain customer benefits that arise over the longer term from networks being able to better utilise their infrastructure through existing meter enabled network services.

Our analysis in the above sections has shown that DNSPs may have difficulty in retaining existing network services at cost efficient prices under the proposed metering contestability framework due to market power imbalances. Our submission has shown that there are weak incentives for MC's to provide network services on a cost reflective basis due to a lack of competitive forces in the market for providing these services. Further, we have also demonstrated that there is uncertainty regarding whether DNSPs will have sufficient counter veiling market power to negotiate cost efficient prices for the provision of network services, particularly where the MC sets the price just below the marginal cost of the DNSP installing a new asset to retain the same level of functionality at the customer's premise.

Based on our analysis, the NSW DNSPs contend that there is a demonstrated need for regulation of smart meter functionality. However, we consider that regulation should be limited to basic smart meter functionality as opposed to new and advanced smart meter functionality. This is because regulation of basic smart meter functionality is aimed at ensuring that customers are able to retain the same level of benefits derived from existing network services at cost efficient prices.

The NSW DNSPs accept the AEMC's comments that it is difficult to determine the level of regulation that is appropriate for access to smart meter functionality. We note that the AEMC has identified a number of scenarios which have the potential to give rise to power imbalances and market failure. However the AEMC has noted that at this stage it is difficult to determine the likely degree of market failure or if market failure will occur at all, and has consequently determined that regulation should not be imposed at this point in time but may be appropriate depending on how efficiently the market has been operating.

The NSW DNSPs disagree with this position. Rather we contend that for basic smart meter functionality there is a strong case for light handed regulation in order to ensure that customers are able to retain the same level of benefits currently derived from network metering infrastructure at efficient prices. In our view, access and charging for basic smart metering functionality should done on a commercial basis subject to high level negotiating principles enshrined in the NER. This may be as minimal as requiring the MC to negotiate

terms and conditions of access “in good faith” and on “fair and reasonable terms.” The NSW DNSPs note that provisions such as this currently exist under clause 7.2.3 (e) –(g) of the NER with respect to the terms and conditions upon which a Local Network Service Provider (LNSP) agrees to act as the Responsible Person with respect to Type 5-7 meters.

Given the AEMC’s view that AER enforcement of compliance with negotiating principles is likely to be undesirable in the context of delivering access arrangements[4], the NSW DNSPs suggest that Chapter 8 of the NER could offer a more appropriate dispute resolution for disputes that arise between the MC and any authorised party seeking access to smart meter functions.

Consequently, whilst we recognise that regulation imposes costs, we consider that enshrining high level negotiating principles in the NER for the provision of basic smart meter functionality is appropriate and likely to better contribute to the achievement of the National Electricity Objective (NEO) than if these services were unregulated. This is because this form of regulation is likely to impose minimal costs upon parties; and provides an important safeguard for ensuring that customers benefits derived from existing network metering installations are not diminished under the proposed metering contestability framework.

Given the potential for market failure to arise in providing access to network enabled services and the consequential flow on impacts to customers, the NSW DNSPs consider that it is appropriate to impose light handed regulation initially on access to basic smart meter functionality to preserve existing customer benefits derived from network services.

The NSW DNSPs note that as part of the AEMC’s intended review of competition under meter contestability, it will have the ability to assess the effectiveness of light handed regulation in delivering efficient outcomes for customers. As part of its review of competition the AEMC will have the ability to maintain the current level of regulation; wind back and remove regulation or impose further regulation depending on its assessment of the efficiency of the market.

3.0 IMPLEMENTATION OF RECOMMENDATIONS

The NSW DNSPs consider that any recommendations regarding accreditation or access arrangements should be implemented as part of the SCER metering contestability Rule change rather than through a separate Rule change process. We consider that it would be more appropriate to consider these changes as part of the broader SCER metering Rule change request given the inter-linkages and interdependencies of these topics with other aspects of the SCER metering contestability Rule change such as parties’ roles and responsibilities under the metering contestability framework.

Further, the NSW DNSPs note that considering these changes as part of the SCER metering contestability Rule change would also allow for issues and impacts that arise from these inter-related topics to be considered holistically.

[4] AEMC 2014, Framework for open access and common communication standards, Supplementary paper – regulatory framework, 24 February 2014, Sydney, p 17.