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Ref. MM/CP

2 August 2010

Australian Energy Market Commission
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SYDNEY SOUTH NSW 1235

Email: aemc@aemc.gov.au

Dear Sir/Madam

EPR0018 DRAFT REPORT REQUEST FOR ADVICE ON COST RECOVERY FOR MANDATED SMART METERING INFRASTRUCTURE

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd welcome the opportunity to provide comment on the draft advice of the Australian Energy Market Commission to the Ministerial Council of Energy on Cost Recovery for Mandated Smart Metering Infrastructure.

Ergon Energy has responded by addressing the questions raised in the Draft Report as well as providing general comment on the proposed changes to the National Electricity Rules.

Should you wish to discuss any aspect of this submission, please do not hesitate to contact me on (07) 41219545.

Yours sincerely

C.A. Price.

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Ergon Energy Corporation Limited
and
Ergon Energy Queensland Pty Ltd

Response to the Australian Energy Market Commission's Draft Report on Cost Recovery for Mandated Smart Metering Infrastructure

23 July 2010 (lodged 2Aug10)

AEMC Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure –

Draft Report

23 July 2010

This submission, which is available for publication, is made by:

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INTRODUCTION

Ergon Energy Corporation Limited (EECL) and Ergon Energy Queensland Pty Ltd (EEQ) welcome the opportunity to provide comment on the Australian Energy Market Commission's (AEMC) *Draft Report on Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure* (SMI) (Draft Report) to the Ministerial Council of Energy (MCE).

This submission is provided by:

- EECL, in its capacity as a distribution network service provider in Queensland; and
- EEQ, in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'. Ergon Energy has responded to the specific questions included for Stakeholder comment and provided general comment on the Draft Report's proposals.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

1. GENERAL COMMENT

Ergon Energy notes the findings that '*existing processes for cost recovery are adequate and have the potential to accommodate the recovery of the efficient costs of SMI mandated by Ministerial determination*'[1] Ergon Energy suggests that as far as possible, SMI should be treated in the same way as any other network asset infrastructure with minimal Rule changes.

2. COST RECOVERY DURING THE DISTRIBUTION DETERMINATION PROCESS

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?

Ergon Energy notes the arguments for extending the coverage of some of the proposed Rule changes beyond smart metering. However would suggest that this is beyond the scope of the MCE's Request for Advice. It is envisaged that consideration of the impact of broader application on other distribution investments would require further consultation.

The inclusion of smart meters in the RAB should be recognised in the opening asset base in accordance with the roll forward model assumptions, one of which is to apply economic depreciation. This applies a uniform methodology to the valuation of regulated assets.

[1] AEMC Draft Report -, Summary p. i

DNSPs' network assets currently include many examples of short life assets which are adequately dealt with under the existing depreciation profiles and SMI should be treated no differently.

When considered as part of the DNSP's network assets, it is to be expected that SMI will actually form quite a small proportion of the overall value so the full ramifications of the change to the roll forward model should be weighed up against the administrative cost burden.

The underlying issue of uncertainty regarding the efficient costs and expected benefits of SMI could be more appropriately addressed by the conduct of comprehensive smart meter pilots and trials prior to any Ministerial Determination. The main purpose of pilots and trials is to remove the uncertainty surrounding the implementation of new technology and the costs and benefits which can be gained.

1.2 Do you consider that a specific information provision 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?

Ergon Energy suggests that sufficient information gathering powers presently exist in the Rules. If the AER requires further information gathering in relation to smart metering roll-outs, pilots and trials, then clarification is needed as to the purpose and how the information is to be used. Many factors will cause cost differences as roll-outs, pilots and trials will occur across the various jurisdictions over differing timeframes, making it difficult to use the proposed annual reporting as a basis for comparison between or within jurisdictions.

Ergon Energy considers that, as the costs and benefits of any mandated smart meter roll-out should be established prior to the Ministerial Determination, further information gathering on an annual basis should be unnecessary and in any case, will prove difficult to present in a meaningful and accurate way due to:

- Difficulties in isolating and identifying costs for the annual reporting purposes. With SMI forming part of the much larger network technology, a mandated roll-out will necessitate integration with, and upgrading of, current network systems over the mandate period;

- Benefits will lag costs and it will prove difficult to isolate and quantify benefits of SMI from the rest of the distributor's metering and communications;

- Operational benefits from SMI will be incremental and will not be able to be fully realized or accurately measured until a mandated roll-out is complete throughout a network; and

- Operational benefits to the DNSP will not take into account benefits for retailers or customers which also need to be considered to present a complete picture.

3. MID PERIOD COST RECOVERY FOR MANDATED SMART METER ROLL-OUTS

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

Ergon Energy considers the need for a temporary interim price adjustment mechanism in instances where a DNSP experiences '*material cash flow difficulties*' after being required to undertake a mandated smart meter roll-out before the next distribution determination would be entirely dependent on the nature and scale of the Minister's decision. The need for an interim price adjustment is therefore a possibility.

Should a Ministerial Determination be made requiring the roll-out of smart meters mid-way through a regulatory control period, an interim price adjustment should be allowed to assist recovery of expenditure that was not previously forecast in the period. However careful consideration would be required to establish a threshold level and what items of expenditure would be included, i.e. all SMI costs, including network management system adaptation/upgrade costs, administrative costs, etc, or something less.

Ergon Energy suggests that any interim price adjustment is most appropriately based on the DNSP's own estimated forecasts of costs and benefits, rather than any other forecasts i.e. the cost benefit analysis which was the basis for the Ministerial determination is likely to be more high level and less accurate.

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

Ergon Energy is opposed to the concept of the ex-post review primarily on the basis that it is inconsistent with the current ex-ante approach that has been largely adopted as the preferred method in the current regulatory framework. However Ergon Energy is in agreement with a cost pass through arrangement that recognises that the SMI roll-out could occur over multiple regulatory years.

An ex-post review of the efficiency of smart metering costs as proposed in the paper would, by virtue of its very nature (i.e. being backward looking) have to be carried out separately from the ex-ante review of the rest of the regulatory proposal. As a consequence, no costs will be saved by undertaking the review at the same time as the distribution determination is made.

Ergon Energy considers that the ex-post review will add to uncertainty surrounding the cost recovery of a mid regulatory period smart metering mandated roll-out, may lead to an overly cautious approach to the SMI roll-out and will not necessarily achieve the aim of ensuring efficiency of costs which is better dealt with under the incentives provided by the Efficiency Benefit Sharing Scheme (EBSS).

4. MID PERIOD COST RECOVERY FOR MANDATED SMART METER PILOTS AND TRIALS ISSUE

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?

Ergon Energy considers that further consideration of the timeframes for the submission of a cost pass through for a mandated smart meter pilot/trial event, is required. The Draft Report states that *'Under clause 6.6.1(c) of the Rules, DNSPs would be required to submit a written statement to the AER within 90 business days of the making of a Ministerial determination. This 90 business day timeframe must be extended by the AER by written notice to the DNSP if it is satisfied that the difficulty of assessing or quantifying the effect of the relevant pass through event justifies the extension'*.[2]

Ergon Energy queries the interpretation of the timing for the submission of a cost pass through event and seeks clarification particularly in view of the wording of the smart meter amendments to the NEL. Clause 6.6.1(c) states that the DNSP must submit its written statement specifying the details of the event '*within 90 business days of the relevant positive change event occurring*',[3] and the Draft Report interprets the event as being the date of the making of the Ministerial Determination in relation to mandated smart meter pilots and trials. However the smart meter amendments allow the Ministerial Determination to '*specify the nature and timing of the smart meter trials*' which will undoubtedly be a much later date and possibly more than 90 days from the actual date of the Ministerial Determination.

In addition, a Ministerial Determination in relation to pilots and trials could prescribe more than one pilot/trial to more than one class of customer with different commencement dates therefore it is suggested that some aggregation mechanism be provided for the DNSP to submit its aggregated cost pass through application within 90 days of the relevant event or within 90 days of the end of the financial year in which the event occurred/commenced.

As the AER in its Final Decision Queensland Distribution Determination dated May 2010 classified a smart meter event as a specific cost pass through event in accordance with clause 6.12.1(14) of the Rules, the event has already been classified. Therefore, if the obligation of a trial is externally imposed and materially increases the cost of the DNSP providing direct control services Queensland DNSPs will be entitled to apply for an in-period adjustment during the 2010-15 regulatory control period.

[2] Draft Report, p. 52

[3] National Electricity Rules p. 53

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?**

Ergon Energy supports the proposal for a general amendment to the cost pass through provisions to allow DNSPs to seek cost recovery for pass through events in the following regulatory control period when an event occurs in the last 13 months, but the costs associated with the event are not incurred until the next regulatory control period. This 'dead zone' has long been recognized as an oversight in the rules and should be amended to apply for all pass through events.

If costs are incurred over more than one year of the event occurring then the assessment of whether the event materially increases the cost of the DNSP providing direct control services should relate to all expenditure incurred and forecast at the time of the application as envisaged by clauses 6.6.1((f)(3) and 6.6.1(j)(2) not assessed on each year in isolation.

5. COST RECOVERY FOR MANDATED SMART METERING SERVICES WHICH ARE CLASSIFIED AS ALTERNATIVE CONTROL SERVICES

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?**

Ergon Energy considers that should mandated smart metering services be classified as Alternative Control Services, greater prescription in the Rules is not required providing cost recovery treatment is guided by, and consistent with, the relevant Distribution Determination as provided for in the Rules.[4]

6. INCENTIVES UNDER THE CURRENT REGULATORY REGIME

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

Ergon Energy agrees with the Draft Report findings that the '*the current incentives under the Distribution Determination process are sufficient to maximise the competitive purchase of meters and metering services*'.[5] In addition, sufficient incentives in relation to operating expenditure are already in place under the provisions for an EBSS in the Rules.[6]

[4] Clause 6.2.6(b) of the Rules

[5] Draft Report Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, p.113.

[6] Clause 6.5.8 of the Rules

7. TARIFF ISSUES ASSOCIATED WITH MANDATED SMI

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?**

Ergon Energy suggests that any unbundling of smart metering services from DUOS charges should only be considered after the end of the mandate period and the allocation of costs for smart metering should be no different to any other network investment. There needs to be a clear assessment of the services which will be provided and paid for.

If metering costs were required to be unbundled within the classification of Standard Control Service, there would be significant administrative costs to Ergon Energy. These would include sourcing additional data from within the business and the AER to enable prices to be calculated, modifying IT systems including network pricing and network billing systems. It would also require Ergon Energy and Energex to request a change to the B2B Network Billing Specification. This requires a consultation process with retailers. It also may require retailers to undertake system changes to meet the B2B Specification. To do this prior to understanding and ensuring there are long term benefits to customers, distributors and retailers of the unbundling is not appropriate

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?**

No. Ergon Energy suggests at this stage it is premature to make rule changes relating to the unbundling of smart metering services until the nature and the feasibility of those smart metering services has been determined and the extent of contestability is known. There needs to be greater clarity around the services that could be provided in the future and what costs are associated with them, and to whom those costs should be allocated.

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?***

Ergon Energy does not favour the back end depreciation proposal because of the inconsistencies it creates.

Ergon Energy notes that providing the AER with the ability to require the depreciation of certain assets to be back ended, would be a reversal of the current treatment where the DNSP depreciates assets in accordance with Accounting Standards. .

Changing the depreciation profile of SMI assets may prove to have limited benefit when they already have a shorter economic life than other assets. Manipulating the depreciation profile to defer the opportunity for cost recovery until towards the end of the mandated roll-out will leave a higher deferred cost which, as the Draft Report suggests, may impact on future contestability by way of higher switching costs.