5 February 2010

Dr John Tamblyn
Chairman
AEMC
PO Box A2449
Sydney South NSW 1235

Dear Dr Tamblyn,

Draft statement of approach on request for advice on cost recovery for mandated smart metering infrastructure (EPR0018)

Integral Energy appreciates the opportunity to make a submission in relation to the Commission's draft statement of approach. The smart meter rollout represents an important opportunity for distribution businesses to further increase the cost effectiveness of their services as well as deliver a platform for more efficient and environmentally friendly energy usage by customers.

Integral Energy broadly agrees with the submissions on this matter made by the National Smart Metering Program (NSMP) Stakeholder Steering Committee (NSSC) and the Energy Networks Association (ENA). However, Integral Energy also has a number of additional comments outlined below.

Regulation under Chapter 6

As indicated in the Commission's draft statement of approach, the key challenge in regulating cost recovery for the pilots and trials and rollout of smart meters is the uncertainty associated with the technologies and business environment for delivering those services compared with existing regulated distribution services.

Integral Energy supports the Commission making a considered assessment of the implications of this uncertainty in determining whether there is a case for moving away from the existing Chapter 6 mechanism. However, as a starting point, there appears to be no prima facie reason why the current framework can't accommodate the task at hand. In addition, care should be taken when considering the application of different and/or multiple forms of regulation due to the associated administrative and cost burden involved in doing so. Moving to a different regulatory mechanism may also impact on the relevant regulatory incentives.

If the current framework is to be applied, Integral Energy considers that the appropriate starting point is to treat smart metering services as standard control services[1]. If a clear case can be established that one or more such services would be more appropriately regulated in a lighter handed manner, then this can also be accommodated within that Chapter.

The scope of smart metering services

It appears that there may be concern amongst some stakeholders about the fact that the final scope of what is to comprise smart metering services is currently unknown and that this should have a bearing upon how such services should be regulated.

Integral Energy notes that, under the Smart Meters Act, the relevant jurisdictional Minister will, at the time of making either a pilots and trials determination or a rollout determination, define what will comprise the smart metering services to be regulated. Integral Energy also understands that the NSSC is close to finalising its recommendations regarding the National Minimal Functional Specification and that this remains almost entirely consistent with the draft specification set out in the Ministerial Council on Energy's (MCE's) Phase 2 business case assessment released in mid-2008. These matters, combined with the experience gained through the pilots and trials program, will help manage against any risk the regulatory mechanism selected will turn out to be inappropriate

Regulatory reset or pass throughs

Integral Energy notes that the anticipated timing of both the pilots and trials and the rollout across the various jurisdictions makes it likely that cost recovery will need to be treated either as a pass through or as part of a regular revenue reset, depending on the jurisdiction. The Rules should therefore provide for both with, in particular, appropriate time periods allowed for lodging pass through applications.

Contestability and stranding

Integral Energy submits that, should distributor exclusivity for the provision of smart metering services cease and other parties (retailers) then wish to replace the meter, the appropriate regulatory approach is to have the other party compensate the distributor for the fair value of the asset at the time of disposal. To do otherwise would be to permit the uneconomic bypass of the replaced assets. Viewed another way, the compensation approach ensures that the costs of the first generation (exclusive period) assets are quarantined so that competition during later periods is as effective as possible.

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1 Integral Energy notes that, at present, it is not clear what Type (or Types) smart metering services for small customers will be classified as under the National Electricity Rules (Rules). Integral Energy's view is that these services are sufficiently different from Type 1 to 4 metering services that they should (at least for the foreseeable future) be treated as a new Type. If so, Integral Energy would reject classifying them as alternative control services simply because this is how Type 1 to 4 metering services are treated under the current Australian Energy Regulator (AER) regulated revenue determination applying to New South Wales distributors.

The timing of costs and benefits

Integral Energy cautions against adjusting depreciation schedules as a way to manage the likely differential between the up-front investment required to rollout smart meters and their longer-term benefits. Doing so introduces an additional regulatory risk in relation to business cash flows that could impact on their overall rate of return and, potentially, service level outcomes for customers. Given the technology risk and uncertainty over the timing of the benefits, it may well be difficult for the AER to justify the use of a depreciation profile other than the default one.

Regulatory incentive mechanisms

The rationale for incorporating incentive mechanisms such as the Efficiency Benefit Sharing Scheme (EBSS) in the regulatory framework is that it allows distributors to be rewarded for reducing their controllable costs. Such mechanisms are appropriate in situations where those costs are based on well understood, proven technology as well as reasonably stable business conditions. They are not appropriate either with respect to government mandates generally or, more specifically, for the upcoming period in relation to smart meters while there remains material uncertainty regarding the technologies as well as the broader market arrangements for smart metering services. This view is reinforced by the fact that, as the Commission itself notes, the terms of reference for the inquiry expressly exclude compensation for those risks through changes to the regulated rate of return.

Integral Energy submits that the more appropriate way to promote efficient outcomes is to ensure that the initial revenue allowances are as robust as practicable and to incorporate pass through mechanisms to manage any unexpected changes in the relevant circumstances.

Government mandates are uncontrollable.

Should you wish to discuss any aspect of this letter please contact Anthony Englund, Regulatory Policy Manager at anthony.englund@integral.com.au or (02) 9853 6511.

Yours sincerely,

Michael Martinson
Manager, Network Regulation