Exit fees from regulated metering

AER workshop,
11 September 2014

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Chris Pattas – General Manager
Agenda

Part 1:
1. Context – policy & market developments
2. Setting regulated metering charges
3. Proposed regulated metering costs & charges
4. Stakeholder concerns
5. Regulatory decisions & objectives
6. Questions & discussion

Break

Part 2:
1. Alternative options for exit fees
2. Questions & discussion
Context – policy & market developments

- AER determination during policy reform phase (draft Nov, final 30 Apr)
  - Metering contestability rule changes – AEMC draft Dec.
  - New & replacement policies – nationally consistent or by jurisdiction

- Reforms & market response/investment likely toward end of reg period?

- Market investment most likely (not all) in advanced metering:
  - Greater potential to unlock various efficiencies for consumers, retailers, networks, energy services companies.

- For most – unlocking greater efficiencies dependent on switching.
  - Who will exercise this choice? Opt-out, opt-in?
  - What signal should regulated cost recovery send?
Setting regulated metering charges

- AER framework & approach > unbundle metering:
  - Metering costs removed from Standard Control Services & placed into Alternative Control Services
  - Direct cost allocation, transparency > not inhibit emergence of contestability
  - Exit fees not explicitly considered
    - now principal stakeholder concern re contestability
Proposed regulated meter costs

Types of meter costs to be recovered

- **Capex - Meter assets**
  - **Three types**
  - **Existing** (installed as at 1 July 2014)
  - **Replacement** (replaced during 2015-19)
  - **New** (customer initiated: new/upgrade/additional)

- **Capex - Supporting assets**
  - Buildings, IT systems, motor vehicles etc

- **Opex**
  - Meter reading & maintenance etc
Proposed regulated meter charges

Ausgrid/Essential/Endeavour

Upfront
- Metering assets (new)
- Metering assets (existing/replacement)

Annual charge
- Opex
- Supporting assets
- Residual metering assets

Exit fee
- Residual supporting assets
- Opex (admin fee)
### Setting regulated metering charges (cont.)

<table>
<thead>
<tr>
<th></th>
<th>Meter assets</th>
<th>Supporting assets</th>
<th>Opex</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Existing</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Essential</td>
<td>Annual charges with residual in exit fee <em>(for existing customers only)</em></td>
<td>Annual charges with residual in exit fee <em>(for existing customers only)</em></td>
<td>Upfront charges</td>
</tr>
<tr>
<td>Ausgrid</td>
<td>Annual charges with residual in exit fee for <em>(new &amp; existing customers)</em></td>
<td>Annual charges with residual in exit fee <em>(for new &amp; existing customers)</em></td>
<td>Annual charges with costs of customer transfers in exit fee</td>
</tr>
<tr>
<td>Endeavour</td>
<td></td>
<td>Annual charges</td>
<td></td>
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<tr>
<td>ActewAGL</td>
<td>Annual charges</td>
<td>Annual charges</td>
<td>Annual charges</td>
</tr>
</tbody>
</table>

**Source:** NSW & ACT DNSP regulatory proposals 2014-19, including attachments/models provided with proposals
Proposed exit fees

<table>
<thead>
<tr>
<th>Company</th>
<th>Average exit fee ($, nominal)</th>
<th>Stranded asset</th>
<th>Admin fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ausgrid</td>
<td>$199</td>
<td>$160</td>
<td>$39</td>
</tr>
<tr>
<td>Essential</td>
<td>$117</td>
<td>$61</td>
<td>$56</td>
</tr>
<tr>
<td>Endeavour</td>
<td>$64</td>
<td>$11</td>
<td>$53</td>
</tr>
</tbody>
</table>

Opening metering RAB:
- Ausgrid: $253m
- Essential: $118m
- Endeavour: $23m
Stakeholder concerns

- 8 formal submissions received + informal feedback
  > retailers, consumer reps, specialist metering companies, financiers.

- Concerns expressed with exit fees:
  1. Level is too high
  2. Presence of exit fee = disincentive for competition
     - For consumers > disincentive to switch
     - For investors > disincentive for first movers (esp. under opt-out model)
  3. Not useful signal for consumers (esp. under opt-out model)
  4. Not efficient signal for consumers/investors

Regulatory objectives

- AER decisions =
  - how to classify metering services
  - setting ACS charges to be price capped (inc. cost build up)
- Decisions to be linked to existing regulatory framework:
  - Provide for efficient outcomes in long term interests of consumers (NEO).
  - Ensure cost recovery for distributors (revenue & pricing principles).
  - Limit cross subsidies, improve transparency where can better inform efficient choices (efficient pricing under NEO).
  - Charges that send efficient signals for use of network (distribution pricing principles in NER).
  - Administrative simplicity.
Questions & discussion

- Additional stakeholder concerns not mentioned?
- Views on regulatory objectives?
- Linking stakeholder concerns to regulatory objectives?
Part 2

1. Alternative options for exit fees
2. Questions & discussion
Alternative options for exit fees

What to signal for future decisions?

- Directly signal only avoidable/future costs?
- How to recover sunk costs?
  - Direct signal – with exit fee
  - Partial signal in smaller exit fee
  - No signal – no exit fee

- Annual charges in ACS
- More cost reflective exit fees
- Accelerated depreciation
- Re-bundle a portion of assets & recover via DUOS
- Re-bundle all assets & recover via DUOS
Option 1 (with exit fee): More cost reflective exit fees

**Implementation:**
- Split by meter type (e.g. type 5 or 6).
- Try & better reflect age of meters.

**Impact:**
- Not all customers pay the same exit fee when depart:
  - Type 6 metering customer could face lower exit fee than type 5 customer.
  - Customers with newer meters could face higher exit fee.

**Issues:**
- Administratively complex to have more than one exit fee
- Price signal for customers/investors:
  - *Single exit fee* - type 5 & 6 meters both as likely to be replaced with smart meter
  - *Separate exit fees* - type 6 meter more likely to be replaced before type 5 meter
  - KEY ISSUE: Are sunk costs of regulated businesses an efficient signal for future choices of investors/consumers?

- Other considerations:
  - Single exit fee - Should type 6 meter customers ‘subsidise’ residual meter assets of more expensive type 5 meter customers?
  - Separate exit fee - Should type 5 meter customers pay much higher exit fees even though they did not ask for a type 5 meter?
Option 2 (with exit fee): Accelerated depreciation

- Rather than remaining life depreciation, Endeavour & Essential have proposed accelerated depreciation (of 5 and 7 years respectively)

**Impact:**
- Annual charges will increase.
- Eliminate exit fees sooner.
- Quantum of the impact varies by business:
  - Ausgrid: large metering RAB → large impact on annual charges
  - Endeavour & Essential: smaller metering RAB → smaller impact on annual charges

**Issues:**
- Eliminating exit fee sooner worth the trade-off of having a higher annual charge?
- Does preparing for contestability warrant departing from conventional regulatory approach to depreciation?
  - This would be ex-ante depreciation (before assets have become stranded), typically depreciate ex-post
Option 3 (smaller or no exit fee): Partial or full re-bundle & recover through DUOS

Implementation:

- Determine right costs to signal directly in ACS for future investment choices (& re-bundle others):
  - Directly signal avoidable/future costs only?
  - Smear or directly signal some portion of metering assets (sunk costs)?
    - New service classification (departing from unbundling decision in F&A), or pass through.

Impact:

- Re-bundled assets - paid by all network customers via network charges, rather than individuals paying residual at exit.
- The impact of any re-bundling on annual metering charges varies depending on how re-bundling occurs, what gets re-bundled & when.

Issues:

- Better signal for future investment created by only directly signalling avoidable/future costs & smearing sunk costs - rather than single or quasi cost reflective exit fee?
- Sunk investments = existing or/ & replaced meters?
## Option 3 (No exit fee)- Re-bundle & recover through DUOS

<table>
<thead>
<tr>
<th>Options</th>
<th>ACS</th>
<th>SCS (DUOS)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual charges</td>
<td>Exit fees</td>
</tr>
<tr>
<td><strong>Option 1 – Re-bundle residual sunk costs</strong></td>
<td>• Meter assets of existing &amp; replacement</td>
<td>Removed</td>
</tr>
<tr>
<td></td>
<td>• Opex for all meters</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Supporting assets for all meters</td>
<td></td>
</tr>
<tr>
<td><strong>Option 2</strong></td>
<td>Opex &amp; supporting assets relating to new meters</td>
<td>Removed</td>
</tr>
<tr>
<td>Re-bundle all costs of sunk &amp; soon to be sunk investments</td>
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<td><strong>Option 3</strong></td>
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<td>Re-bundle of meter assets of sunk &amp; soon to be sunk investments</td>
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</table>
Option 3 (No exit fee) - Re-bundle & recover through DUOS

Ausgrid - Annual charges

<table>
<thead>
<tr>
<th>Option 1 Residual sunk costs</th>
<th>Option 2 All costs sunk &amp; soon to be sunk investments</th>
<th>Option 3 Re-bundle meter assets sunk &amp; soon to be sunk investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annual charge ($, nominal)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential Inclining Block</td>
<td>Residential Time of Use</td>
<td></td>
</tr>
<tr>
<td>Option 1</td>
<td>Option 2</td>
<td>Option 3</td>
</tr>
<tr>
<td>$37</td>
<td>$12</td>
<td>$12</td>
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</table>
Option 3 (No exit fee) - Re-bundle & recover through DUOS

Option 1 Re-bundle residual sunk costs

Option 2 Re-bundle all costs of sunk & soon to be sunk investments

Option 3 Re-bundle of meter assets of sunk & soon to be sunk investments

Ausgrid metering revenue - SCS vs ACS

Revenue over the regulatory period ($millions, nominal)

<table>
<thead>
<tr>
<th>Option</th>
<th>SCS revenue</th>
<th>ACS revenue</th>
<th>SCS revenue</th>
<th>ACS revenue</th>
<th>SCS revenue</th>
<th>ACS revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option 1</td>
<td>$39</td>
<td>$336</td>
<td>$351</td>
<td>$8</td>
<td>$236</td>
<td>$122</td>
</tr>
</tbody>
</table>

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Australian Energy Regulator
Option 3 – Other variants

Partial re-bundle – smaller exit fee:

- Re-bundle only some meter assets (e.g. existing meters only)
- Maintains exit fees but at lower level than proposed
- Directly signals avoidable/future + soon to be sunk meter assets
- Smears recovery of sunk meter assets

Others?
Questions & discussion

- Issues with greater cost-reflectivity?
- Views on options seeking to define which costs are best signalled to investors/consumers for future decisions
  - Sunk assets (existing meters) & soon to be sunk assets (replacement)?
  - Signal only avoidable/future costs (new meters, opex, admin?)
- Further administrative or other implementation concerns with re-bundling options?
- Appropriateness of sunk costs of regulated business as evaluation signal for switching decision?