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ADVANCED METERING INFRASTRUCTURE REVIEW

CONSULTATION PAPER: REVISED FRAMEWORK
AND APPROACH

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In October 2005, the Essential Services Commission (the Commission) determined the price control applying to distribution use of system charges. In this Determination, the Commission established a separate price control for prescribed metering services. This followed the Commission's decision to mandate the rollout of manually read interval meters and to provide distributors with exclusive responsibility for metering services to customers who do not have a remotely read interval meter and consume less than 160 MWh of electricity per annum.

In 2006, the State Government announced a decision to rollout advanced interval meters to all Victorian electricity customers. Throughout 2006 and the first half of 2007, the State Government worked with distributors, retailers and consumer groups to establish the requirements of the advanced metering infrastructure (AMI) rollout. The regulatory arrangements relating to the rollout were initially set out in an August 2007 Order in Council made by the Governor in Council under section 15A and section 46D of the *Electricity Industry Act 2000* (referred to hereafter as 'the original Order').

Under the original Order the Commission was required to redetermine the distributors' metering services revenue requirement and establish a new price control to take effect from 1 January 2009. To facilitate this process the Commission released a consultation paper in August 2007 which set out the approach that the Commission intended to use to make a determination on the prices distributors can charge for the metering services specified in the original Order. Following the receipt of comments from the distributors and other stakeholders, the Commission released a final framework and approach paper in December 2007.

However, following discussions between the State Government, distributors and other stakeholders, arrangements relating to the rollout of advanced interval meters have now changed. Although consulted, the Commission was not involved in any of the decisions regarding the changed arrangements. Changes have been made in a number of areas, and are discussed in further detail below. The key amendments relate to:

- the timing for the rollout. The original schedule required the distributors to complete the rollout by 31 December 2012. The new schedule provides for the rollout to be complete by 31 December 2013
- regulatory arrangements for the rollout. Under the original Order the regulatory arrangements provided for charges to be set based on forecasts of expenditure and for the distributors to have incentives to outperform the expenditure forecasts. Under the new arrangements prices are based on a cost pass through model with the intention that both distributors and customers will benefit from prices being set with greater knowledge of the costs of the rollout

- regulatory responsibility for the rollout. It has now been confirmed that responsibility for regulatory oversight of the rollout will transfer from the Commission to the Australian Energy Regulator (AER) on 1 January 2009.

As a consequence of these new arrangements, it is necessary for the Commission to revisit the framework and approach to setting prices. This consultation paper represents the initial step in that process.

Although many aspects of the regulatory framework have changed, some aspects remain the same. In preparing this consultation paper the Commission has had regard to the positions established in its December 2007 framework and approach paper and the consultation that preceded this paper. Where relevant this consultation paper has also been informed by developments since December 2007, including the distributors' initial submissions to the Commission.

Given the proposed transfer of functions from the Commission to the AER, all references to 'the Commission' in this consultation paper (and the revised Order), unless explicitly stated or the context provides otherwise, are to be read as references to the AER from 1 January 2009.

It will accordingly be the responsibility of the AER to finalise the framework and approach, which is scheduled to be published in January 2009.

1.1 Timeframe for the rollout

Under the revised timeframes for the rollout the distributors are required to commence installing advanced interval meters by the middle of 2010, with the rollout to be completed by the end of 2013. The full schedule is shown in Table 1.

Table 1.1 **AMI rollout schedule**

<i>Timeline</i>	<i>Rollout percentage</i>
30 June 2010	5%
31 December 2010	10%
30 June 2011	25%
30 June 2012	60%
30 June 2013	95%
31 December 2013	100%

The Victorian AMI rollout is the first of a potentially more widespread planned rollout of similar meters across other States. The New South Wales Government has indicated that advanced interval meters (referred to as 'smart meters' in NSW) will be rolled out prior to 2017. Other jurisdictions are proceeding with pilot programs and business cases in order to determine whether to proceed with rollouts. The Ministerial Council on Energy (MCE) has committed to establishing a consistent national framework for AMI meters.

1.2 Legislative and regulatory framework

The primary regulatory instrument which will guide the determination of prices for metering services remains the Order in Council made by the Governor in Council in August 2007. However, this Order was altered by an amending Order made by the Governor in Council on 25 November 2008 and published in the Government Gazette No. S314. The amendments made to the original Order are substantial and the majority of the original Order has been deleted and replaced. For the purposes of this consultation paper the original Order, as amended, is referred to as the 'revised Order'.

The revised Order provides the framework for setting prices for the following services:

- regulated services comprising:
 - metering services supplied to first tier customers or second tier customers with annual electricity consumption of 160 MWh or less where the electricity consumption of that customer is (or is to be) measured using a revenue meter that is either an accumulation meter or a manually read interval meter
 - metering services supplied to first tier customers or second tier customers with annual electricity consumption of 160 MWh or less where the electricity consumption of that customer is (or is to be) measured using a revenue meter that is a remotely read interval meter
- other fees and charges:
 - exit fees where the retailer becomes the responsible person for a relevant customer's metering services
 - restoration fees where a retailer ceases to be the responsible person for a relevant customer's metering services and the distributor becomes the responsible person
 - prices for unmetered supplies
 - customer requested services - which are services provided to a retailer in respect of a customer that requests a services to a standard in excess of that normally provided.¹

While the services which are the subject of the revised Order are the same as for the original Order, the revised Order provides for a fundamentally different approach to establishing prices. In particular, the revised Order provides for a cost pass through model under which budgets for the rollout are established at the beginning of the period and then annual charges are determined based on actual expenditure. The focus of the regulatory framework is on the regulator ensuring that the expenditure is within scope and is otherwise prudent, in accordance with the tests established by the revised Order.

¹ It is also possible for a retailer to seek enhanced functionality or enhanced service levels from a distributor. The process for determining the price for such enhanced services is covered by the complementary Order in Council made by the Governor in Council under section 15A and 46D of the *Electricity Industry Act 2000* in November 2007 (referred to in the revised Order as the 'AMI Specifications Order').

The revised Order divides the regulatory process into two separate periods. The first is the first budget period, which applies from 1 January 2009 to 31 December 2011. The second budget period applies from 1 January 2012 to 31 December 2015. From 2016 onwards the determination of prices for metering services and other fees and charges will be undertaken by the AER in accordance with the process provided in chapter 6 of the National Electricity Rules (NER) to establish prices for standard control services and alternative control services.

The broad framework applying in respect of the two budget periods is similar. It requires distributors to provide an initial budget to the regulator which the regulator must approve unless it can establish that the expenditure is for activities that are out of scope or is not prudent. Expenditure is taken to be prudent unless:

- in the case where expenditure is a contract cost, the regulator establishes the contract was not let in accordance with a competitive tender process
- in the case of other expenditure, where the regulator establishes it is more likely than not that the expenditure will not be incurred or that incurring the expenditure involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

Prices are set on the basis of the budgets approved by the regulator, and are adjusted on an annual basis based on actual expenditure incurred. The revised Order provides for actual expenditure to be reflected in prices where it is within scope, certified in an audit report, and no more than 120% (in relation to the first budget period) or 110% (in relation to the second budget period) of the budget. Where actual expenditure is outside these ranges the regulator may only not permit it to be recovered where the regulator establishes that it is not prudent. The revised Order applies a generally similar definition of 'prudent' to that used in the consideration of a budget application.

The revised Order applies to prices for metering services and other fees and charges until 2015. After this time these prices will be regulated coincident with the regulation of general network services under the NER. Final 'true-ups' in relation to total AMI expenditure and revenue from 2009 to 2015 will be reflected in prices in 2016 and 2017.

The revised Order also contains a number of clauses relating to specific elements of the framework, including the cost of capital, an efficiency carryover mechanism relating to the rollout of manually read interval meters prior to 1 January 2009, and the treatment of tax.

More detail regarding provisions of the revised Order, and the way in which the regulator will implement them, is set out in chapters 2, 3 and 4 below.

The AMI Specifications Order, which sets out the detailed specifications for the AMI rollout, has also been amended, however the changes to this Order are mostly consequential in nature.

The timetable for establishing prices for regulated services under the revised Order is as follows:

Table 1.2 **Overview of AMI price setting timetable**

First budget period	
Initial prices take effect (based on the current price determination)	1 January 2009
Distributors submit initial budget submission (in respect of 2009 to 2011)	27 February 2009
Distributors to provide proposed 2010 and 2011 charges	1 June 2009
Determination on initial 2010 and 2011 budget and charges application	31 October 2009
Initial budget period charges take effect	1 January 2010
Second budget period	
Distributors submit initial budget submission and charges application (in respect of 2012 to 2015)	28 February 2011
Determination on initial 2012 to 2015 budget and charges application	29 October 2011
Subsequent budget period charges take effect	1 January 2012

1.2.1 Regulatory responsibility

Regulatory responsibility for the rollout will transfer from the Commission to the Australian Energy Regulator (AER) on 1 January 2009. Because the timeframes for the review set out in the revised Order require distributors to make a budget submission by 27 February 2009 it will not be possible for the AER to consult on and establish a framework and approach for the review prior to this date. Therefore the Commission and the AER have agreed that the consultation paper for the framework and approach for the review will be published by the Commission prior to the transfer of functions. From 1 January 2009, this means the AER will assume responsibility for finalising the revised framework and approach, including taking into account and addressing any submissions in response to this consultation paper. The AER will then also be responsible for implementing the framework. The statutory framework established to regulate the transition of responsibility for the AMI price review from the Commission to the AER provides that work done by the Commission (including the preparation and issue of a framework and approach paper) in relation to the AMI price review will be taken to be work done by the AER.

Given the proposed transfer of functions, although the revised Order (and this consultation paper) references 'the Commission' in all places, all such references, unless explicitly stated or the context provides otherwise, are to be read as references to the AER.

1.3 Purpose of this paper

The purpose of this paper is to discuss the proposed framework and approach likely to be applied in making a determination on the prices distributors can charge for the metering services specified in the revised Order. This paper focuses on the process that will be followed to determine prices for regulated services for the first budget period and in particular 2010 and 2011. It also sets out for stakeholders the proposed consultation process that will be followed by the Commission in formulating its draft decision on the prices.

This paper also sets out the information that will be required from distributors in their 27 February 2009 initial budget applications.

1.4 Consultation process

The Commission seeks comments on this proposed framework and approach and encourages all stakeholders to respond to the issues identified in this consultation paper.

Submissions are due on **29 December 2008** and can be sent to the Commission electronically at amireview@esc.vic.gov.au.

Alternatively, hard copy submissions can be mailed to:

Essential Services Commission
Level 2, 35 Spring Street
MELBOURNE VIC 3000

Submissions will be made available on the Commission's website and from 1 January 2009, available on the AER's website at www.aer.gov.au as well. Any confidential material should be clearly marked as such on the submission.

Generally, submissions received by the AER will be treated as public documents. Interested parties are referred to the ACCC/AER's information policy for further information regarding the AER's use and disclosure of information available at <http://www.accc.gov.au/content/index.phtml/itemId/846791>.

To facilitate communication between the Commission and stakeholders, the Commission has also established an area on its website that is dedicated to the AMI review. Similarly, from 1 January 2009, the AER will establish an equivalent area on its website as well. At these sites, stakeholders can find copies of all relevant documentation including consultation papers released, submissions received (subject to confidentiality requirements) and updates on the progress of the review.

Following the consideration of submissions the AER will publish the finalised framework and approach paper by **30 January 2009**.

1.5 Structure of this paper

Chapter two sets out the proposed broad approach to the review including the way in which the Commission will consider the distributors' budget applications, budget

variations and charges applications. Chapter three discusses some of the specific regulatory issues including the efficiency carryover mechanism, the cost of capital and the treatment of taxation. Chapter four discusses the establishment of individual prices, including 2009 prices and charges for the provision of metering services to unmetered connection points. Finally, chapter five discusses the information that will need to be provided by the distributors as part of the review process. It also sets out the proposed timeframes in respect of the initial AMI budget period.

2 | ANALYTICAL FRAMEWORK

This chapter sets out the Commission's framework and approach with respect to the analytical framework within which the Commission will determine the charges that distributors may set for the provision of the regulated services under the revised Order. In doing so it also identifies some of the information that the Commission will need to be provided with in order to undertake its analysis. Information requirements are also discussed in chapter five.

This chapter focuses on the first AMI budget period from 1 January 2009 to 31 December 2011. However much of the discussion is also relevant to the subsequent AMI budget period from 2012 to 2015.

2.1 Requirements of the revised Order

In order to discuss the analytical framework it is necessary to understand in detail the requirements of the revised Order.

As noted in chapter one, the revised Order provides for a cost pass through model under which budgets for regulated services are established at the beginning of the period and then annual charges are determined based on actual expenditure. The process is set out below.

Note that the process below only applies to regulated services. This means that revenue and expenditure on other AMI services and related fees and charges – notably exit and restoration fees, unmetered supplies and customer requested services - is excluded from the process described below.

2.1.1 Initial AMI period budget application and determination

Distributors are required to provide an initial AMI period budget application to the Commission by 27 February 2009. The application must contain a budget for expenditure on regulated services for the initial AMI budget period. It must clearly distinguish between capital expenditure and maintenance and operating expenditure and must set out, amongst other things:

- a forecast for capital and operating expenditure on regulated services in 2009, 2010 and 2011
- information required in the Commission's framework and approach paper
- information required in templates issued by the Commission
- the process that has been used or is proposed to be used for competitive tenders for contracts for regulated services

- a forecast of the number of metering installations that are proposed to be installed each year
- the information upon which the distributor relies.

The distributors must then, by 1 June 2009, make an application to the Commission which sets out their proposed initial charges for 2010 and 2011.

The Commission is required to review the budget application and initial charges application and make a determination on charges for 2010 and 2011 by 31 October 2009. Prior to making this determination:

- the Commission must release a draft determination
- the distributors may provide a revised budget application to the Commission by 31 August 2009 if there is a change in forecast expenditure by reason of a contract entered into by the distributor or a material change in a metering regulatory obligation or requirement.

Importantly, the Commission must approve the budget in the initial application unless the Commission can establish that the expenditure is:

- for activities that are outside scope at the time of commitment to that expenditure and the time of the budget determination or
- not prudent.

Under the revised Order budgeted expenditure is taken to be prudent:

- where that expenditure is a contract cost, unless the Commission establishes that the contract was not let in accordance with a competitive tender process, or
- where that expenditure
 - is not a contract cost or
 - is a contract cost and the Commission establishes that the contract was not let in accordance with a competitive tender process unless the Commission determines that:
 - it is more likely than not that the expenditure will not be incurred or
 - the expenditure will be incurred but doing so involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

A contract cost is expenditure incurred pursuant to a contract entered into before the relevant application is made, but excludes expenditure incurred pursuant to any variation to the contract made after that date.

In considering whether expenditure involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances the Commission is required to take into account the circumstances at the time of the distributor or other person incurring or managing the expenditure, including the state of technology, risks, market conditions and the available information relevant to the provision, installation, maintenance and operation of AMI.

The revised Order also allows for a distributor to seek the Commission's approval for a budget variation at any time after the budget has been determined. The

same criteria as set out above apply in relation to a determination by the Commission to approve or reject a variance in the budget.

Discussion in this paper in relation to budget applications is to be taken to include budget variance applications, except where otherwise indicated.

2.1.2 Exclusions from the initial AMI period budget

Clause 5B.2 of the revised Order provides that certain of the building blocks which relate to expenditure and events between 1 January 2006 and 31 December 2008 do not form part of the initial budget application, but will be considered separately under clause 5D.4. These are the following items:

- (a) net costs (or revenue) associated with providing prescribed metering services from 1 January 2006 to 31 December 2008
- (b) the amount by which DUoS taxation liability was reduced as a result of the Commission's consolidation of DUoS taxation and metering services in the current price determination
- (c) the value of any efficiency carryover arising from the current price determination
- (d) expenditure from 1 January 2006 to 31 December 2008 on trials conducted in accordance with the ISC or as directed or agreed by the Department of Primary Industries
- (e) expenditure from 1 January 2006 to 31 December 2008 on installing, commissioning and maintaining telecommunications and IT systems required to support the AMI infrastructure
- (f) other relevant expenditure incurred from 1 January 2006 to 31 December 2008 on project management and other preparation
- (g) expenditure from 1 January 2006 to 31 December 2008 attributable to interest rate hedging costs and exchange rate hedging costs.

A note at the foot of clause 5D.5 of the revised Order suggests that items (d) to (g) are not intended to be the subject of review at any time, except to the extent that the Commission can establish that any of this expenditure is not attributable to providing AMI services and systems from 1 January 2006 to 31 December 2008.

As clause 5D.1 of the revised Order makes clear, these building blocks must be included when determining the 2010 and 2011 initial charges. The Commission therefore requires distributors to provide this information, to the extent that it has not already been provided, by 1 June 2009 to enable it to be taken into account in that determination.

2.1.3 Charges for 2011

Once a budget and charges for 2010 have been determined by the Commission then these charges will apply in that year. In August 2010 distributors are then required to make a charges revision application in respect of charges to apply in 2011. The revised Order provides that the charges revision application must:

- set out actual expenditure and revenue in 2009
- contain an updated forecast of expenditure and revenue for 2010 and 2011

- be accompanied by an audit report that certifies that expenditure incurred is within scope and has been incurred in the amount claimed.

In determining the charges to apply in 2011 the Commission must include in the building blocks, amongst other things, expenditure in 2009 on items which are certified in the audit report and are within scope at the time of commitment to or incurring that expenditure, and which are within 120% of approved budget total operating expenditure and capital expenditure.² For the purpose of the 2011 charges determination, actual expenditure must be considered to be within scope if it is so certified by the auditor.

Where expenditure that is within scope exceeds the 120% threshold the Commission is required to include this above-threshold expenditure in the building blocks if either:

- the excess expenditure was incurred prior to the Commission's approval of the submitted budget (or alternatively, determination of the approved budget) in 2009
- the excess expenditure is prudent.

In determining whether the excess expenditure is prudent, the revised Order requires the Commission to adopt the same definition of prudent as when considering a budget application

In determining charges for 2011 (and indeed for any year from 2010 to 2015) the Commission must be satisfied that for the period from 1 January 2009 up to and including the year for which charges are being determined, the net present value of costs incurred is equal to the net present value of total revenue earned.

2.1.4 Budgets and charges for the subsequent AMI budget period - 2012 to 2015

The process and criteria for approving budgets and determining charges for 2012 to 2015 is similar to the process for 2010 and 2011. In February 2011 the distributors must provide a budget and proposed charges for 2012 to 2015 to the Commission for determination. In each of August 2012, 2013 and 2014 the distributors must provide charges revisions applications for 2013, 2014 and 2015 respectively. The key difference in this subsequent period compared to the initial period is that the actual expenditure approval threshold is 110% of total expenditure, rather than 120%.

There is a 'true-up' of revenue and actual expenditure in 2015 with the anticipated difference in revenue and actual expenditure from 2009 to 2015 to be calculated

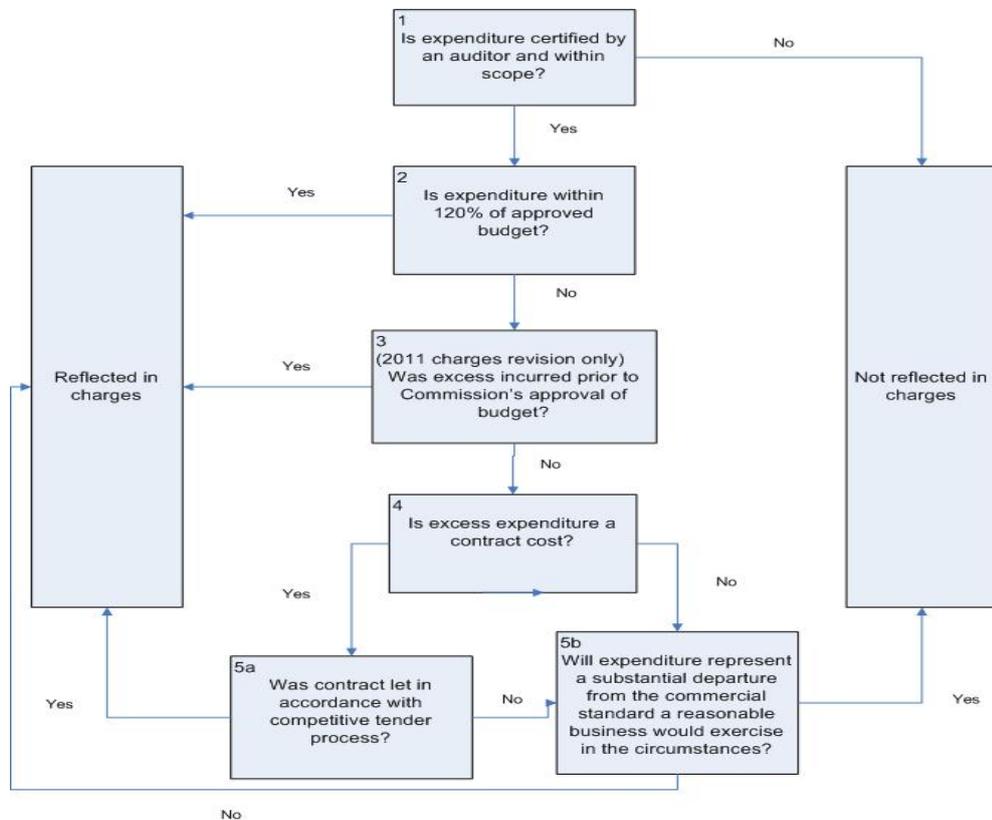
² Note that this requires the aggregate of operating and capital expenditure to be within 120% in aggregate, of the budget. It does not require operating expenditure to be within 120% of the operating expenditure budget and capital expenditure to be within 120% of the capital expenditure budget. Thus, for example, if the operating expenditure budget was \$100 and the capital expenditure budget was \$100, the Commission would be required to ensure charges reflected an aggregate amount of less than 120% x \$200 = \$240

and carried through to prices in 2016. A final adjustment, based on actual 2015 revenues and expenditure, will be made in prices in 2017.

2.2 Analytical framework

One of the key decisions the Commission must make revolves around whether actual and forecast expenditure can be included in revised charges. The Order is prescriptive as to the matters the Commission must consider when making this decision. These matters can be summarised in the flowchart below.

Figure 2.1 **Decision flowchart for assessing charges revisions applications in initial AMI budget period**



As can be seen from the flowchart the decision points include:

- determining whether expenditure is within scope
- determining whether expenditure is a 'contract cost'
- establishing whether a contract was let in accordance with a competitive tender process

- establishing whether expenditure will represent a substantial departure from the commercial standard a reasonable business will exercise in the circumstances.

In relation to establishing the original budget against which actual expenditure can be compared (step 2) the Commission is required to approve a budget proposed by a distributor unless the Commission can establish that the expenditure is

- for activities that are outside scope at the time of the commitment to that expenditure and at the time of the budget determination or
- is not prudent.

In determining whether expenditure is prudent or not the Commission is required to follow steps three to five in the above flowchart. The matters discussed below are therefore relevant both to the budget application and charges revision application process.

2.3 Is expenditure within scope ?

A key element of the revised Order is that the Commission is only required to determine charges that are based on expenditure that is 'within scope' at the time of commitment to or incurring that expenditure.

The scope of the AMI rollout is set out in Schedule 2 of the Order. The scope may be altered by agreement between the Minister and a distributor at any time. Schedule 2 consists of a list of activities that the distributor must undertake in order to give effect to the AMI rollout and also indicates certain activities which are outside scope. Schedule 2 is essentially a description of the activities that need to be undertaken and which are associated with the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems.

The revised Order contemplates that initial budget applications and charges revision applications may be accompanied by an audit report which certifies that expenditure incurred is within scope. However, where this is the case the Commission is bound to accept the certification in respect of initial budget applications and in respect of the charges revision application for 2011 charges. However this is not the case for charges revision applications in other years. For these other years the Commission will pay close regard to that certification when forming its view of whether expenditure is within scope however ultimately the decision on whether expenditure is within scope must be made by the Commission case by case. Further discussion of the audit certification is provided below.

In order to review whether expenditure is within scope it will be necessary for the Commission to receive information which relates the expenditure to the scope – i.e. a list of expenditure against each item of scope. Clause 5B.1 of the revised Order requires a budget application to provide this information but it is not explicitly required in an initial charges application or charges revision application. The Commission considers that it is essential that initial charges applications and charges revision applications include this information.

One of the ways in which the Commission may conduct an initial review of whether expenditure is within scope (particularly in respect of budget applications) is to

compare expenditure on a category-by-category basis across the distributors. Where expenditure in one area for a particular distributor is significantly different from the other distributors the Commission will seek information from that distributor in order that it can further investigate whether expenditure is within scope.

Another matter which relates to scope is the allocation of business overheads to the AMI project. The distributors will incur a substantial level of overheads and management costs associated with the AMI process. The distributors will also incur similar costs associated with the provision of general services and for which recompense has been provided through DUoS charges. It is important that the distributors are not able to 'double recover' these costs through both DUoS charges and AMI charges. The Commission will need to be provided with information that demonstrates that this double recovery has not occurred and will closely review overheads and management costs.

In considering the matter of scope it is also necessary to take into account the relevant specifications for providing the services. For performance in excess of the minimum Victorian specifications, distributors will need to provide a separate cost/benefit analysis quantifying benefits to the distributor, retailers and end customers, and demonstrating why regulated tariffs should provide the revenue required.

Finally, the Commission notes that expenditure and revenue in relation to exit and restoration fees, unmetered supplies and customer requested services is deemed to be outside scope by the revised Order.

2.3.1 Timing

When considering a budget application or charges revision application in order for the Commission to establish that activities are not within scope it must establish that those activities:

- were outside scope at the time of commitment to that expenditure and
- were outside scope at the time of the budget determination or incurring of that expenditure.

This implies that if expenditure was within scope at the time it was committed to, but outside scope at the time it was spent, the Commission must include it in the revised charges.

Stakeholders are invited to comment on matters relating to establishing whether expenditure is within scope.

2.3.2 Audit certification

The revised Order requires that actual expenditure information provided in a charges revision application shall be accompanied by an audit report prepared and signed by an external auditor. The revised Order also contemplates that an AMI

budget period application may be accompanied by an audit report. In each case, the report must certify that the expenditure incurred is within scope (in the case of an AMI budget application this must be at the time of the commitment and the time of the audit report), and has been incurred in the amount claimed.

The revised Order makes clear that in the case of a budget application and a charges revision application for 2011 charges, the auditor must be approved by the Commission or in default of approval, nominated or engaged by the Commission. The revised Order also specifies the qualifications that the auditor must hold. The Commission notes that similar provisions do not apply in the case of charges revision applications for years other than 2011. However, the Commission's view is that it is also desirable that the audit appointment process for charges revision applications in other years comply with the same requirements.

The revised Order also requires an auditor to have a formal duty to both the Commission and the distributor to conduct audits independently.

The Commission's preliminary view is also that, in order to minimise costs and ensure consistency, it would be not be inappropriate for the auditors appointed to audit the distributors' regulatory accounts to undertake this AMI audit. This is particularly the case for the audit certification which is required to be included with the charges revision application for 2011 charges, and which will need to provide certification on incurred expenditure from 2006 to 2009.

In all cases, prior to the audit process commencing, the Commission will provide the auditors with a briefing as to what matters they should consider and how they should ultimately form a view as to whether expenditure is within scope. Given that the revised Order binds the Commission to the auditor's view in respect of budget applications and in respect of the charges revision application for 2011 charges (but not charges revision applications for other years), this will enable the Commission to have the maximum confidence in the eventual audit report.

Stakeholders are invited to comment on form and nature of the proposed audit certification.

2.4 Is expenditure a 'contract cost'?

In considering the matter of whether expenditure is prudent, the Commission must also consider whether expenditure is a 'contract cost'. The Order provides a different threshold for approving expenditure incurred pursuant to a 'contract' compared to other expenditure. The Commission understands that this threshold ensures that as long as a distributor legitimately commits to expenditure pursuant to a major contract then it will be able to recover that expenditure.

The term 'contract cost' is defined in the context of an AMI budget application as:

expenditure incurred pursuant to a contract entered into by a distributor:

- (a) *prior to the day on which a distributor makes its initial AMI budget period budget application or subsequent AMI budget period budget application (as the case may be); or*
- (b) *if a revised initial budget application has been made by the distributor pursuant to clause 5B.3, prior to the day on which that application was made,*

but does not include expenditure incurred pursuant to a variation of that contract where that variation is entered into or takes effect after that day.

A similar definition applies to contract cost in the context of a charges revision application.

The Commission notes that the definition is silent on when expenditure is incurred, referring solely to when the contract is entered into.

A key issue for the Commission will be determining whether expenditure is in fact incurred pursuant to a contract and does not represent:

- expenditure that is not related to any contract
- expenditure that may be related to a contract but is not consistent with the terms of the contract

In relation to the latter point, while some contracts will be for fixed amounts, other contracts may provide for:

- payment to be based partly on the actual costs incurred by the contractor (eg for materials)
- variable payments e.g. based on the number of meters installed
- performance-based penalties or rewards
- other margins or contingencies.

For the Commission to establish whether expenditure has been incurred pursuant to a contract it will need to be provided with the following as part of each budget and charges application:

- an overview of each contract entered into, including the third party contractor and the nature of the services provided
- the total estimated value of the contract
- payment schedules
- details of the financial terms of the contract including:
 - fixed payments
 - variable payments
 - performance based penalties or rewards
 - other margins or contingencies
- payments made under the contract to date, separated into the four sub-points above.

Where expenditure is incurred pursuant to a variation to a contract, which is entered into or takes effect after the day the distributor made its budget application, the Commission is required to consider that expenditure alongside other non-contract expenditure.

Stakeholders are invited to comment on matters relating to establishing whether expenditure is a 'contract cost'.

2.5 A competitive tender process

Under the revised Order the Commission must consider whether a contract was let in accordance with a competitive tender process in the following circumstances:

- when reviewing initial budget applications under clause 5C.3
- making a determination of revised charges under clause 5I.7.

The revised Order provides that in assessing whether a contract was let pursuant to a competitive tender process the Commission is required to have regard to:

- the competitive tender process of the distributor
- whether there has been compliance with that process
- whether the request for tender unreasonably imposed conditions or requirements that prevented or discouraged the submission of any tender that is consistent with the tender process.

The consideration of whether a competitive tender process has taken place is relevant in the case of both:

- 'new' contracts awarded for AMI-related activities
- AMI work that is undertaken pursuant to existing contracts

Where the Commission has determined that a competitive tender process has not been followed, then the expenditure is assessed against different thresholds if it is to be reflected in charges. This is discussed in sections 2.6 and 2.7 of this consultation paper below.

2.5.1 General approach

In examining whether a competitive tender process has taken place the Commission will take into account, amongst other things, the actual tender process documented, the process carried out by the distributors and the tender outcomes. This is because although a distributor's documentation may suggest that an appropriate tender process has been carried out, the outcomes of the tender could represent a substantial departure from a competitive outcome (eg in relation to prices, risk sharing etc). The Commission's view is where a tender does not result in competitive outcomes, it may be inferred that the tender process that was followed was not a competitive one.

As part of the budget application, and if requested by the Commission to support a charges revision application, the distributor is to provide a probity auditor's report

prepared by a suitably qualified independent probity expert, who was not involved in designing, validating or operating the distributor's tender or probity processes. The report may consider past or future tender processes, dependent on the completeness of the processes at the time of the report.

2.5.2 Tender processes

In determining whether a competitive tender process has taken place (or will occur), considerations the Commission will take into account include whether the distributor has demonstrated:

- that the initial request for tender documentation is made widely available to all parties that might be interested in tendering
- that, if adopted, any multi-stage tendering process is appropriate given the nature of the services sought and the number and prospects of potential bidders
- that the issued tender documentation:
 - provides adequate information about the background to the AMI program and the distributor
 - details the tender process
 - provides a detailed specification of the services sought
 - adequately addresses matters such as risk sharing and contractual terms and conditions
 - where appropriate, sets out the tender evaluation criteria
- that adequate time has been allowed for bid preparation and between tender stages, taking into account the scope and complexity of information sought from tenderers
- that the request for tender does not unreasonably impose conditions that prevent or discourage the submission of any tender. For example, these might include the payment of high fees for receiving tender documentation, technical requirements that are unreasonably high given the nature of the tender, unreasonable liability requirements, or any other requirements that impose unduly high expenses on potential tenderers
- that detailed and appropriate tender evaluation criteria have been developed and applied. The design of the tender and the evaluation criteria need to ensure that, as far as possible, competing bids are easily comparable.
- that any 'bundling' of different services into a single contract is appropriate and that the advantages of doing so (economies of scale, reduced administration costs) outweigh the costs (less competition)
- that appropriate tender briefings have been conducted and tenderers have been provided with the opportunity to clarify aspects of the tender
- that the distributor has taken appropriate steps to verify the information provided in tender responses, including referee interviews, field trials, and other checks
- that any post-tender negotiations with the successful tenderer are consistent with the tender and do not call into question the original selection decision

- that the outcome of major tenders have been considered and approved by the distributors' boards of directors
- that for large contracts, a probity audit of the tendering process has been conducted.

The Commission may also have regard to whether the tender has been carried out in accordance with the relevant Australian Standards.

The probity auditor's report is to address the issues raised in subsection 2.5.2 above, and also set out the scope of the probity audit and state whether, if a probity plan was in place, it has been complied with.

In addition to the above, the Commission will also consider whether there is a clear business case demonstrating why contractual arrangements are likely to lead to better outcomes than internal provision of services. Relevantly, where it is evident that distributors have conducted tender processes simply because:

- contract costs have a different regulatory approval threshold under the revised Order, or
- it is likely that a related party will win the contract

The Commission notes this may be indicative of the tender process not being competitive.

The Commission will also consider the following matters and seek information from the distributors that confirms:

- that the tender process is consistent with the distributors' overall procurement program and risk management strategy
- that where a 'multi-vendor' approach to procurement has been selected, that this approach has clear benefits compared to a single-vendor approach
- where distributors seek to demonstrate synergies from undertaking joint tenders then standalone costs relating to each distributor need to be demonstrated by market testing standalone, individual distributor, projects
- where competing technologies are available for a certain application (e.g. metering solutions for suburban environments), distributors have considered seeking bids for each of these competing technologies from multiple vendors

Naturally the degree of complexity and detail surrounding the tender process will be related to the size of the contract. In relation to large contracts, the Commission acknowledges that the distributors may seek external assistance or advice regarding the design and implementation of the tendering process.

In respect of contracts with existing related parties, the Commission will also examine the circumstances in which the contract was entered into, for example, whether the contract was entered into on a stand alone basis or whether it was entered as part of a broader set of commercial arrangements or part of a broader transaction.

The Commission does not consider it appropriate to approve, before the fact, a specific tender process. The Commission will assess each tender process and

outcome case by case on its merits, taking into account any information provided on the process.

2.5.3 Tender outcomes

As noted above, in considering whether a competitive tender process has occurred the Commission proposes to have regard to the outcomes of the tender, including:

- the number of respondents to the tender
- the identity of the successful contractor, and specifically whether the successful contractor is a related party
- the final contractual agreement with the successful contractor.

The higher the number of responses to a tender in general the greater the degree of confidence the Commission will have that a tender process was competitive. At the same time the Commission accepts that a low number of responses does not automatically mean that a tender process has not been competitive. This is particularly the case with the AMI project where economies of scale and technical complexity may reduce the pool of potential respondents. However, the Commission expects that maximising the number of potential respondents will have been addressed by the distributors in designing their tender processes.

In relation to the identity of the successful tenderer, the Commission will place particular scrutiny on a tender process and its outcomes where the successful tenderer is a related party.³ There are several reasons for this, including:

- where the successful tenderer is a related party this may suggest that there was not a 'level playing field' for the tender process
- the possibility that related party contracts may include matters that are out of scope or prices that are not competitive.

The Commission will therefore review contractual outcomes in the case of all tenders, including contracts with related parties. One of the matters the Commission will examine is how the costs incurred under the winning contract compare with the cost of similar arrangements elsewhere (i.e. through benchmarking). Where the contract costs are not inconsistent with those benchmarks the Commission will be able to have more confidence that the tender process was competitive.

In the case of the AMI program, the tender arrangements might provide that final contractual details are subject to negotiation between the distributor and the successful contractor. The Commission will need to be satisfied that these negotiations are carried out on a competitive basis and that the outcomes are appropriate. It would not be consistent with a competitive tender process if the successful contractor was selected through an appropriate tender process but the negotiated outcomes bore little resemblance to the final tender submitted or

³ For the avoidance of doubt, in referring to a party being 'related' to a distributor the Commission is not referring to the definition of a related party in the Corporations Act 2001 or in any Australian accounting standard. Rather, it is referring to other parties to the contract, with whom the distributor may have a relationship.

introduced substantial variations to the original tender. This is particularly the case where the winning tenderer is a related party or where the tender outcomes result in a substantial amount of risk being allocated the distributor (and, by implication, its customers). The Commission will therefore review key elements of the final contractual arrangements entered into with the successful contractor and compare them with submitted bids. Amongst other things the Commission will review

- the incentive arrangements, if any, under the contract
- the manner in which legal, technical, financial and other risks are shared between the distributor and the successful contractor

The distributors should therefore bear the above matters in mind when providing information to support their applications under the revised Order. For example, the distributors should provide:

- information that demonstrates that the services provided under the contract are aligned with the services for which a distributor can seek cost recovery under the Order
- details of how the contract price compares with industry benchmarks or published list prices, including how the industry benchmarks have been calculated
- full details of the relationships between the parties

Where necessary, the Commission may require the provision of information directly from the business providing the outsourced services.

Stakeholders are invited to comment on matters relating to establishing whether a competitive tender process has taken place.

2.6 More likely than not that expenditure will not be incurred

When considering as part of a budget application within-scope expenditure that is not a contract cost or does not meet the contract cost threshold test, the Commission must consider whether:

it is more likely than not that the expenditure will not be incurred

The Commission acknowledges there may be many situations where it might consider that it is more likely than not that expenditure will not be incurred. For example:

- where the forecast expenditure on a particular cost item is so much greater than what the Commission considers a reasonable distributor should spend on that item.
- where expenditure on a specific cost item is not likely to be incurred to any extent. For example, this might include a contingency amount which the Commission considers is not likely to eventuate

In relation to specific costs items that may not be incurred to any extent, the Commission notes that it may be relevant to pay particular attention to expenditure items that are 'peripheral' to the provision of AMI infrastructure. These include such things as contingency amounts, reward and penalty payments, overheads and management costs.

Stakeholders are invited to comment on matters relating to establishing whether it is more likely than not that expenditure will not be incurred.

2.7 A substantial departure from the commercial standard a reasonable business would exercise

When considering within-scope expenditure that is not a contract cost or does not meet the contract cost threshold test as part of a budget application or charges revision application, the Commission must also consider whether incurring the expenditure:

involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances

In doing so the revised Order requires that the Commission shall take into account and give fundamental weight to the circumstances of the distributor or other person incurring or managing the expenditure at the time the commitment was made to incur or manage the expenditure or the expenditure excess (as applicable) including:

- information available to the business or other person
- the nature of the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems
- the nature of the roll out obligation
- state of the technology relevant to the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems
- risks inherent in a project of the type involving the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems
- market conditions relevant to the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems
- any metering regulatory obligation or requirement.

Having regard to these and any other relevant matters the Commission will assess each instance of expenditure that is not a contract cost or does not meet the contract cost threshold test as part of a budget application or charges revision application case by case on its merits in determining whether it involves a

substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

2.8 Existing contractual arrangements with related parties

The Commission is aware some distributors currently have existing contractual relationships with related parties. Some of these contracts are longstanding, while others have been entered into specifically in relation to the AMI rollout. The revised Order is clear in relation to how the Commission must consider a budget application which reflects expenditure to be incurred pursuant to these contracts:

- first the Commission must consider whether the expenditure is within scope. Any expenditure that is not certified by an audit report to be within scope must not be reflected in the budget
- second, the Commission must consider whether contracts have been entered into following a 'competitive tender process'. This will be undertaken on a case by case basis, and having regard to the matters set out in section 2.5 above. As noted, this will include the circumstances in which the contracts were entered into.

In the event that the Commission considers that the contracts did not follow from a competitive tender process it will need to consider whether the costs under the contract are likely to be incurred, and then whether the expenditure represents a substantial departure from the commercial standard a reasonable business would exercise in the circumstances. In doing so the Commission proposes to consider the following specific matters relevant to related party contracts:

- the structure of the contract, including whether:
 - the contract gives an incentive for the contractor to lower costs
 - these cost reductions are passed on to the distributor and
 - the contract gives the distributor control over expenditure
- the extent to which contract costs represent actual costs incurred in providing the services
- the extent to which contractual arrangements with the related party confer other benefits such as:
 - enabling economies of scope to be achieved
 - cost savings from not conducting a competitive tender process
 - other benefits such as retention of knowledge and avoiding the need for other contractors to 'come up to speed' with the distributor's working arrangements
- how the costs under the contract compare with benchmarks of efficient costs
- the extent and manner in which risks are allocated under the contract.

However, the Commission notes that where it determines that a competitive tender process has not been followed the revised Order does not mandate that the contract costs with related parties must be approved as part of a budget application.

Stakeholders are invited to comment on matters relating to establishing whether expenditure involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

In determining charges for regulated services clause 4(1)(b) of the revised Order requires the Commission to adopt a 'building blocks' approach under which the building blocks are:

- a return on capital (i.e. a weighted average cost of capital (WACC) multiplied by the regulatory asset base (RAB))
- depreciation (of the RAB)
- maintenance and operating expenditure
- a benchmark allowance for corporate income tax
- other building blocks relating to, where relevant:
 - net costs (or revenue) associated with providing metering services from 1 January 2006 to 31 December 2008
 - the amount by which DUoS taxation liability was reduced as a result of the Commission's consolidation of DUoS taxation and metering services in the current price determination
 - the value of any efficiency carryover arising from the current price determination
 - expenditure from 1 January 2006 to 31 December 2008 on trials conducted in accordance with the ISC or as directed or agreed by the Department of Primary Industries
 - expenditure from 1 January 2006 to 31 December 2008 on installing, commissioning and maintaining telecommunications and IT systems required to support the AMI infrastructure
 - other relevant expenditure incurred from 1 January 2006 to 31 December 2008 on project management and other preparation
 - expenditure from 1 January 2006 to 31 December 2008 attributable to interest rate hedging costs and exchange rate hedging costs.

As discussed in chapter 2, these 'other costs' do not form part of the initial budget application process and many of these costs are not subject to review by the Commission, except in respect of whether they are related to AMI services or not.

In most regulatory price determinations the building blocks are based on forecasts of operating expenditure, capital expenditure, taxation and volumes. However, under the cost-recovery approach established in the revised Order the building blocks are ultimately based on actual outcomes.

The broader issues associated with regulatory consideration of capital and operating expenditure budgets and charges applications were discussed in chapter

2. This chapter discusses some of the more specific issues associated with the building blocks calculation including:

- the WACC
- the efficiency carryover mechanism (ECM)
- calculation of taxation
- value of the RAB
- depreciation.

3.1 Net costs (or revenue) associated with providing metering services from 1 January 2006 to 31 December 2008

Clause 5D.4(a) of the revised Order requires that the Commission must determine additional expenditure relating to:

the building block costs incurred offset by the revenue earned by a distributor in respect of prescribed metering services (not being metering services to unmetered supply points to which clause 6 applies) under the Current Price Determination during the period from 1 January 2006 until the Start Date. For the purposes of this clause 5D.4(a), the weighted average cost of capital in the Current Price Determination shall be applied, adjusted for inflation

The Commission interprets this clause to refer to the net **actual** building block costs in respect of prescribed metering services under the Current Price Determination. Therefore the building block costs will be:

- a return on capital (using the actual regulatory asset base for prescribed metering services over the period)
- depreciation of the asset base, using the actual regulatory asset base and the asset lives established in the Current Price Determination
- actual maintenance and operating expenditure
- a benchmark calculation of tax in respect of prescribed metering services,

In relation to the WACC to be used to determine the return on capital the revised Order requires the WACC in the current price determination to be used, adjusted for inflation.

3.2 Weighted average cost of capital

The weighted average cost of capital is the financial return that investors seek when considering and assessing an investment decision. To provide sufficient remuneration for investors to invest, the rate of return should reflect the opportunity cost of their capital — that is, the return should be commensurate with the returns that an investor could expect to earn from other investment opportunities in the market, after adjusting for the different levels of risk that different investments entail.

The cost of capital for a particular investment is determined by the market. It is based on the aggregate demand and supply of investment funds and the riskiness of the potential cash flows generated by the investment in question relative to the riskiness of the cash flows generated by other investments.

However, the cost of capital cannot be observed in the same manner in which prices for other goods and services may be observed. Instead, the risk adjusted price for investment capital must be estimated from available capital market data and can be interpreted using models drawn from finance theory and practice.

The Commission and the AER have historically calculated the WACC, and the National Electricity Rules mandate that the WACC be calculated, as a 'nominal vanilla' WACC in accordance with the following formula:

$$WACC = k_e \frac{E}{V} + k_d \frac{D}{V}$$

where:

k_e = the expected rate of return on equity or cost of equity

k_d = the expected rate of return on debt or cost of debt

$\frac{E}{V}$ = the market value of equity as a proportion of the market value of equity and debt, which is $1 - D/V$

$\frac{D}{V}$ = the market value of debt as a proportion of the market value of equity and debt

The cost of equity is determined using the CAPM, calculated as follows:

$$k_e = r_f + \beta_e MRP$$

where:

r_f = the nominal risk free rate of return

β_e = the equity beta

MRP = the expected market risk premium

The expected cost of debt is calculated in accordance with the following formula

$$k_d = r_f + DRP$$

where:

r_f = the nominal risk-free rate of return

DRP = the debt risk premium

The Commission has traditionally allowed for the cost of raising debt to be included in the debt risk premium. The prescribed formula set out in the NER prevents debt (and equity) raising costs from being compensated through the WACC. However the NER do not prevent such costs from being compensated through other mechanisms such as the capital or operating expenditure allowances, provided they meet the requirements in the NER for these allowances.

3.2.1 Revised Order

The revised Order contains a number of specific provisions that dictate the way in which the WACC must be calculated. A key requirement is that a single WACC will apply for the period 1 January 2009 to 31 December 2013 (the initial AMI WACC period) and another WACC will apply for the period 1 January 2014 to 31 December 2015 (the subsequent AMI WACC period). (Note that the initial and subsequent AMI WACC periods do not coincide with the initial and subsequent AMI budget periods.)

The revised Order also provides that for the initial AMI WACC period:

- measurement of the market observable parameters (nominal risk free rate and DRP) will occur in the last 10 business days of November 2008 and the first 5 business days of December 2008 and will be determined in accordance with the AER's Statement of Regulatory Intent
- the WACC must be calculated using the non-market observable parameters from the current price determination
- a debt raising cost of 12.5 basis points for the initial AMI WACC period shall be adopted
- equity raising costs for the initial AMI WACC period will be recovered as a maintenance and operating expense.

3.2.2 Market observable parameters and the Statement of Regulatory Intent

The NER provide that the AER may review the WACC parameters to be adopted in determinations for electricity transmission and distribution network service providers. Reviews are to be conducted every five years with the first review concluded by 31 March 2009, at which time the AER will release a final Statement of Regulatory Intent and final decision.

The AER has already commenced the review and an Issues Paper was released in August 2008.⁴ Submissions on the Issues Paper closed on 17 September 2008.

⁴ See:

[http://www.aer.gov.au/content/item.phtml?itemId=722312&nodeId=d91f7605b58ef42b64dda8253f2d1b1c&fn=Issues%20paper%20\(6%20August%202008\).pdf](http://www.aer.gov.au/content/item.phtml?itemId=722312&nodeId=d91f7605b58ef42b64dda8253f2d1b1c&fn=Issues%20paper%20(6%20August%202008).pdf)

The AER is scheduled to release a draft decision on 9 December 2008 and to seek submissions on the draft decision until 23 January 2009.

The Issues Paper discusses a number of matters relevant to the market observable parameters. In respect of the nominal risk free rate the Issues Paper identifies the following matters:

- whether Commonwealth Government Securities are the best proxy for the nominal risk free rate
- the term of the proxy that should be used
- the averaging period over which the observations of the nominal risk free rate are undertaken (although, as noted above the revised Order requires a 15 business day averaging period for the initial AMI WACC period).

In relation to the DRP the Issues Paper notes that under the NER the maturity of the DRP must match the maturity of the risk free rate. The Issues Paper discusses the issues of:

- which benchmark credit rating should be used to calculate the DRP
- the sample of businesses that should be used to calculate the DRP.

As required by the revised Order the Commission will adopt the methodology set out in the AER's Statement of Regulatory Intent to determine the market observable parameters for the initial AMI WACC period. It will then apply this methodology to establishing the WACC for the initial AMI WACC period, using market data for the last 10 business days in November 2008 and the first 5 business days in December 2008.

At the time of the distributors' budget applications in February 2009, the AER will not have issued its final Statement of Regulatory Intent, and therefore the methodology to be adopted in determining the WACC will not be established. As such the Commission is prepared to initially accept a WACC calculated using the methodology for market observable parameters as set out in the AER's draft decision, which will be released in December 2008 as an indicative proxy for the WACC to be applied during the initial AMI WACC period. The Commission will subsequently revise the calculation of the market observable parameters in accordance with the AER's statement of regulatory intent (which will be published on 31 March 2009) in making its draft decision on the distributors' budget applications.

Stakeholders are invited to comment on the methodology the distributors should use to calculate the market observables for their February 2009 budget applications.

Debt raising costs

As noted above, the revised Order mandates that a debt raising cost of 12.5 basis points be adopted for the initial AMI WACC Period, This margin will be added to the DRP.

3.2.3 Non market observable parameters

The revised Order requires that non-market observable parameters from the current price determination be used in the calculation of WACC for the initial AMI WACC period. The relevant parameters are as follows:

Table 3.1 **Non market observable parameters – current price determination**

MRP ($R_m - R_f$)	6.00%
Equity beta β_e	1.00
Franking credit value (y)	0.50
Gearing (D/V)	60%
Inflation	2.56%

Equity raising costs

In the past the AER has considered whether a business should be compensated for equity raising costs on a case-by-case basis. The AER has undertaken its analysis using a cash flow analysis (based on the benchmark gearing ratio) and assuming that raising external equity is the last and least preferred option to funding capital expenditure

However, for the initial AMI WACC Period the Order requires equity raising costs be recovered as a maintenance and operating expense. Consistent with the nature of the revised Order, the Commission considers that the equity raising costs recovered should be the actual costs incurred (and not benchmark costs). Thus, if a distributor does not incur costs associated with raising equity to fund the AMI program, no cost recovery needs to occur.

Stakeholders are invited to comment on the methodology the distributors should use to determine equity raising costs.

3.2.4 Time value of money

The revised Order requires the time value of money to be taken into account by the Commission when determining expenditure for the 2006 to 2008 period. The revised Order requires this value to be calculated by reference to the WACC in the current price determination, adjusted for inflation. The WACC, in real after-tax 'vanilla' terms, is 5.90%.

3.3 Efficiency carryover mechanism

The revised Order requires that the charges in 2010 and 2011 reflect an efficiency carryover amount in respect of metering operating expenditure between 2006 and 2008. Clause 5D.4(c) requires charges to reflect:

the total value of benefit or burden which the distributors would have enjoyed or suffered from efficiency gains or losses arising from the Current Price Determination including those flowing from the efficiency carryover mechanism in the Current Price Determination limited to efficiency improvements (not volume changes) in operating expenditure for:

- (A) *metering data services (as described on pages 543, 544 and 545 of the Current Price Determination (Volume 1));*
- (B) *meter maintenance (as described on pages 539 and 540 of the Current Price Determination (Volume 1)); and*
- (C) *meter replacement costs (customer service costs) (as described on pages 542 and 543 of the Current Price Determination (Volume 1)).*

In the current price determination the Commission established an efficiency component on operating and expenditure on metering services which operated in the same manner as the efficiency carryover mechanism applying to DUoS charges. The purpose of the mechanism was to reward (penalise) the distributors for efficiency gains (losses) in relation to metering operating expenditure by carrying over the benefits (losses) into the next regulatory period.

In giving effect to the requirements of the revised Order, there are a number of matters that need to be taken into consideration. These include:

- The forecasts in the current price determination were based on the assumption that interval meters would be rolled out during 2006 to 2008. This did not occur and in some cases there is a need to ensure a 'like for like' comparison of costs
- how the 2006 to 2008 efficiency gains or losses will be reflected in charges
- whether there should be a 'no negative carryover' principle applied.

3.3.1 Ensuring a 'like for like' comparison

Adjusting the benchmarks

The revised Order requires the ECM to consider operating expenditure on metering data services, meter maintenance and meter replacement costs (customer service costs). To ensure a 'like for like' comparison, and hence ensure that volume changes are not reflected in the ECM as required by the revised Order, it is

necessary to make adjustments to the benchmarks set out in the current price determination.⁵

Each of the proposed adjustments is outlined below.

Meter replacement costs (customer service costs)

The current price determination set out a unit price for customer service costs associated with replacement meters. The costs were as follows:

Table 3.2 Unit costs for customer service, real \$2004

	<i>Alinta AE</i>	<i>CitiPower</i>	<i>Powercor</i>	<i>SP AusNet</i>	<i>United Energy Distribution</i>
Cost per meter	15.00	16.20	10.60	11.70	10.60

It is proposed that the adjusted benchmarks for customer service be calculated using the unit costs set out above.

Metering data services

The current price determination sets out the following total costs for metering data services:

Table 3.3 Total metering data service costs, real \$2004 millions

	<i>Alinta AE</i>	<i>CitiPower</i>	<i>Powercor</i>	<i>SP AusNet</i>	<i>United Energy Distribution</i>
Maintenance (IT)	2.1	2.1	2.1	2.1	2.1
Operating costs	14.9	13.9	50.1	44.1	31.6

The operating costs were established on a per unit basis with a separate cost per meter read and per customer for data management for accumulation and interval meters. These costs are shown in table 13.31 of volume 1 of the current price determination and are reproduced below.

Table 3.4 Unit cost for metering data services operating costs, real \$2004

	<i>Alinta AE, Citipower, United Energy</i>	<i>Powercor, SP AusNet</i>

⁵ There are two ways the 'like for like' comparison could be made – firstly by adjusting the benchmarks, or secondly by adjusting the actual outcomes. The Commission has historically taken the position that it is simplest to adjust the benchmarks.

Cost per read (accumulation meter)	0.75	1.50
Cost per read (interval meter)	1.50	2.50
Meter data management (per customer pa, accumulation meter)	4.50	4.50
Meter data management (per customer pa, interval meter)	6.20	6.20

With information on the number of accumulation and interval meters in place it is possible to adjust the operating costs benchmarks to allow a comparison with actual outcomes.

Maintenance (IT) amounts cover such things as hardware, software and labour for maintenance and support. These costs were determined on a lump sum basis (as distinct from a per unit basis) assuming a generic metering data system. This means that the manner in which the benchmarks should be adjusted to reflect actual outcomes is not immediately obvious. A solution is simply to assume that the requirement for maintenance IT spending is relatively fixed and unrelated to the number of customers.

Meter maintenance

Benchmarks for meter maintenance were set on a per meter basis in the current price determination, as follows:

Table 3.5 **Unit costs for meter maintenance, real \$2004**

	<i>Alinta AE</i>	<i>CitiPower</i>	<i>Powercor</i>	<i>SP AusNet</i>	<i>United Energy Distribution</i>
Cost per customer	2.11	1.95	1.52	1.64	0.81

It is proposed that the adjusted benchmarks for meter maintenance be calculated using the unit costs set out above.

Stakeholders are invited to comment on how the benchmarks costs should be adjusted for the purposes of the ECM, particularly in relation to metering data service IT costs.

Reported costs

Under the usual operation of the ECM the businesses can maximise their carryover amount by reducing their reported expenditure. However this incentive to minimise reported expenditure is offset by the fact that their future cost forecasts are based on the reported expenditure.

In this case the offsetting incentive does not exist. 2006 to 2008 operating expenditure is not being used as a benchmark to set future forecasts due to the

fundamentally different nature of operating expenditure under the AMI framework. Further, from 2009 expenditure is being recovered on an actual cost basis not an incentive basis.

It is therefore incumbent upon the Commission to scrutinise the distributors' reported actual expenditure from 2006 to 2008 on ECM items in order to ensure that the figures provided are accurate. Accordingly, the Commission will need to be provided with evidence from the distributors that all the direct expenditure on metering data services, meter maintenance and meter replacement costs have been reported.

Stakeholders are invited to comment on matters relating to ensuring that reported costs represent the true value of costs incurred.

3.3.2 Reflecting the efficiency gains or losses in charges

Under the ECM mechanism applied by the Commission efficiency gains or losses are retained for 5 years. Thus, in respect of a gain or loss in 2008 the relevant amount would be applied to the revenue requirement in each year from 2009 to 2013.

However, the revised Order requires the Commission to reflect the ECM amounts when determining the 2010-11 initial charges. The Commission proposes to meet this obligation by summing the efficiency carryover amounts for 2009 to 2013, adjusting to reflect the time value of money, and incorporating this amount in 2010 charges.

3.3.3 Negative carryovers

The matter of whether there should be a zero floor for the ECM amount, thus preventing penalties for inefficient performance being carried from one regulatory period to the next, has previously been considered both by the Commission and the AER. While regulated utilities have argued that this should be the case, both regulators have previously concluded that in general it is not possible for the ECM to achieve its objectives if it is not symmetrically applied both within and across regulatory periods.

In the current price determination the Commission did not set a zero floor approach and instead indicated that:

the efficiency carryover mechanism relating to the prescribed metering price control will ... apply to operating and maintenance expenditure and negative carryovers will be carried out into the next period.⁶

⁶ Current price determination, Volume 1, p. 577.

The revised Order appears to contemplate the potential net negative carryovers should be part of the mechanism. The Commission therefore considers that it would be both appropriate, and consistent with the current price determination, to apply negative carryovers where they occur.

Stakeholders are invited to comment on whether there should be the potential for a net negative carryover from the 2006 to 2008 period.

3.4 Taxation

Under the revised Order taxation needs to be considered in two separate areas. First, the Order requires that in determining charges for 2010 and 2011 the Commission must include the value of taxation liability from 2006 to 2010 in the current price determination which was reduced as a result of the consolidation of the DUoS and metering services taxation calculation.

Secondly, the revised Order requires that taxation is one element of the cost building blocks for determining charges.

3.4.1 Taxation adjustment for 2006 to 2010

In the current price determination the Commission forecast the distributors' tax liabilities in aggregate for DUoS services and prescribed metering services. The aggregate reflected a tax liability position in respect of DUoS services, which was partly offset by stand-alone tax losses forecast under the metering price control. However, because the IMRO rollout foreshadowed in the current price determination did not take place the tax losses for the metering price control were, in general, not realised. As a result the distributors have been liable for higher benchmark tax amounts than were calculated in the current price determination.

The aggregate benchmark taxation amounts (losses) for metering services included in the current price determination are as follows:

Table 3.6 **Benchmark taxation losses for metering services 2006 to 2010, \$million, real \$2004**

	2006	2007	2008	2009	2010
Alinta AE	0.67	2.54	2.98	3.06	2.29
CitiPower	0.0	2.50	4.61	4.25	2.88
Powercor	0.0	4.64	10.77	13.63	12.45
SP AusNet	1.98	2.48	6.58	9.98	9.72
United Energy Distribution	0.0	1.50	5.53	8.37	7.86

The revised Order requires the Commission to reflect these taxation amounts when determining the 2010-11 initial charges. The Commission proposes to meet this

obligation by summing the taxation amounts for 2006 to 2010, adjusting to reflect the time value of money, and incorporating this amount in 2010 charges.

3.4.2 Calculation of taxation in the building blocks

A forecast tax liability is normally included in the building blocks where a 'vanilla' WACC is adopted as it provides an after-tax return. Clause 4.1 (b) of the revised Order provides that a benchmark allowance for corporate income tax (as distinct from the actual tax incurred) be reflected in charges.

In calculating the taxation allowance regulators often apply benchmark assumptions for many of the inputs related to the taxation calculation. That is, rather than attempt to capture all of the detail of Australian taxation law, benchmark assumptions are made that reflect the major features and implications of the taxation law. The application of benchmarks when determining projected taxation liabilities provides distributors with the incentive to put in place efficient financing arrangements.

The revised Order requires the following matters to be benchmarked:

- the tax depreciation method and rate
- the value of debt as a proportion of equity and debt, and the return on debt, with both to be benchmarked consistently with the calculation of WACC for the relevant year
- the value of imputation (franking) credits.

The revised Order also provides that if there is an estimated tax loss in any particular year the allowance for tax must be set to zero with the loss to be carried forward to offset future taxable income.

Tax depreciation is usually benchmarked with assets allocated into broad taxation depreciation classes. This is primarily done because of the costs and difficulties associated with splitting a vast and existing asset base into detailed asset categories. However, in the case of the AMI project, all capital expenditure will be new. While some benchmark assumptions will still need to be made it may be possible to make a more detailed and accurate calculation of actual taxation than is normally the case.

In relation to the value of imputation or franking credits (γ), the Commission and the AER have previously adopted a value of 0.5. However, the value of γ is being reviewed by the AER as part of its review of the WACC. The Commission therefore proposes that the γ value adopted be that established by the AER in its most recent Statement of Regulatory Intent.

Stakeholders are invited to comment on matters relating to establishing the benchmark cost of tax in respect of the AMI rollout.

3.5 Value of the metering asset base

The revised Order provides that in determining the initial charges for 2010 and 2011 the opening value of the metering asset base at 31 December 2008 for each distributor must be calculated as follows:

$$\text{Opening Metering Asset Base}_{SD} = \text{Opening Metering Asset Base}_{2006} + \text{Capital Expenditure}_{2006-SD} - \text{Depreciation}_{2006-SD} - \text{Disposals}_{2006-SD}$$

Where:

Opening Metering Asset Base_{SD} is the closing value of the metering asset base at 31 December 2008

Opening Metering Asset Base₂₀₀₆ is the opening regulatory asset base set out in Table 13.35 of Volume 1 of the current price determination. (This table shows that the value of the opening metering asset base for each distributor for 2006 was zero)

Capital Expenditure_{2006-SD} is the actual capital expenditure between 1 January 2006 and 31 December 2008 inclusive

Depreciation_{2006-SD} is the actual depreciation between 1 January 2006 and 31 December 2008 inclusive

Disposals_{2006-SD} is actual disposals between 1 January 2006 and 31 December 2008 inclusive

Distributors' calculation of the opening value of the metering asset base as at 1 January 2009, as reflected in their 2010-11 initial charges application, should therefore apply the formula above.

In addition to the 'opening' metering asset base calculations, in determining revised charges for the next year of the initial and subsequent AMI budget periods (i.e. year t+1), the Commission will be required to make an estimate of the metering asset base at that time. The Commission's preliminary view is that the metering base should be calculated consistent with the approach for calculating the opening metering asset base. Thus, for example, when establishing revised charges for 2011 the metering asset base will reflect:

- actual capital expenditure to 2009 (to the extent that it is within scope and prudent).
- the most recent approved budget for capital expenditure in 2010 and 2011
- actual disposals in 2009 and the most recent approved budget for disposals in 2010 and 2011
- depreciation calculated consistently with the capital expenditure and disposal assumptions and the asset lives in clause 4.1(g) of the revised Order.

3.6 Regulatory depreciation

Regulatory depreciation is a component of the revenue requirement for regulated services and represents the annual rate at which accumulated capital is returned to investors. It is a function of the regulated asset base and the period over which the assets are depreciated.

As noted above, the revised Order stipulates that actual depreciation should be used for the period 1 January 2006 to 31 December 2008.

Clause 4.1(g) of the revised Order also stipulates the asset life for remotely read meters and measurement transformers shall be 15 years and for telecommunications and information technology assets shall be 7 years. For some assets it may not be clear as to whether they are 'meters and measurement transformers' or 'telecommunications assets'. Where this is the case the distributors should clearly outline the reason for the chosen classification.

The revised Order also provides that in respect of accumulation meters and manually read interval meters the depreciation period should end no later than 2013. This will require depreciation to be accelerated over the period 2010 to 2013 for some of these meters such that their value is zero at the end of 2013. Distributors will need to clearly set out in their submissions the number and regulatory asset value of these meters for which depreciation needs to be accelerated, and the profile of the depreciation.

3.6.1 Form of depreciation

While the revised Order specifies the asset lives to be used it does not specify the form of depreciation to be adopted. Most regulatory regimes adopt straight line depreciation on the basis that it is well understood and transparent. However, for assets in areas of rapid technological change, it may be more appropriate to adopt a form of depreciation that provides a greater level of return of capital in the early years of their life. This may better reflect the more rapid diminishment in value.

In responses to its August 2007 consultation paper there was no support identified for alternatives to straight line depreciation. While one respondent did acknowledge the likely accelerated depreciation for metering and telecommunications systems, the benefits of increased transparency and consistency with the current price determination were felt to be more important.

In its December 2007 framework and approach paper the Commission therefore proposed to use straight-line depreciation to determine regulatory depreciation in each year of the regulatory period. Nothing has been brought to the Commission's attention to date to suggest that this approach is no longer appropriate. The Commission's preliminary view is therefore that straight line depreciation remains its preferred approach under the new regulatory arrangements.

Stakeholders are invited to comment on the proposal to use straight line depreciation to determine the amount of regulatory depreciation.

The revised Order contains specific provisions relating to the calculation of individual charges, including charges for 2009. It also requires the Commission to determine maximum charges for exit fees, restoration fees and for the provision of metering services to unmetered connection points. Finally, it sets out certain requirements the Commission must have regard to in setting these charges.

4.1 Charges for 2009

The revised Order provides that charges for regulated services shall be determined as if the current price determination continued to apply for that year and the regulated services were prescribed metering services.

Pricing arrangements for prescribed metering services are set out in section 4 of volume 2 of the current price determination. Amongst other things the provisions provide for:

- a tariff basket mechanism (similar to the DUoS price control mechanism) that limits the annual increase in average metering service charges
- separate rebalancing controls for meter provision and metering data service charges
- a process whereby the distributors submit proposed tariffs to the Commission on an annual basis for approval prior to being implemented. Tariffs for 2009 were due to be submitted for approval on 3 November 2008.

4.2 Price controls

The original Order required that the Commission determine the maximum charges for metering services using a similar price regulation methodology as the methodology that was applied in the current price determination.

However, the revised Order does not contain an equivalent provision. The main requirement governing revenue to be recovered in a particular year is set out in clause 4.1(o) of the revised Order which provides that when determining charges for any year from 2010 to 2015 the Commission shall satisfy itself that the net present value of total costs up to that year (starting in 2009) is equal to the net present value of total revenue earned in that period.

In addition, the Order provides that the Commission may determine charges which differ in respect of:

- single phase single element meter
- single phase single element meter with contactor

- single phase two element meter with contactor
 - three phase direct connected meter
 - three phase direct connected meter with contactor
 - three phase current transformer connected meter and
 - any other customer or metering class proposed by the distributor and approved by the Commission
- but may not differ depending upon whether the meter is an accumulation meter, a manually read interval meter or remotely read meter.

Aside from the above and specific provisions relating to exit and restoration fees, the revised Order therefore does not provide any guidance in relation to matters including:

- the way in which individual charges should be calculated including the need for cost reflectivity
- the need for rebalancing constraints, and the level of any rebalancing constraints⁷

In its December 2007 framework and approach paper the Commission proposed to apply the following pricing principles:

- **Cost of service provision:** a distributor's charge and terms and conditions for a prescribed metering service must be based on the costs incurred by the distributor in providing the prescribed metering service.
- **Cost allocation:** in respect of the costs incurred by a distributor in providing a prescribed metering service:
 - those costs must not include costs in respect of which the distributor is remunerated under the distributor's distribution tariff or excluded service charges or charges for metering services to unmetered supply points, and
 - those costs must only include an appropriate allocation of any shared or common costs incurred by the distributor in providing the prescribed metering service and in providing any other goods or services, whether in the conduct of a distributor's business as a distributor or any other business.
- **Cost differentials:** a distributor's charge and terms and conditions for a prescribed metering service must be the same for all customers, regardless of whether an accumulation meter or an interval meter is installed, unless there is a material difference in the costs of providing the prescribed metering service to different customers or classes of customers. Different charges and terms and conditions for different customers or classes of customers must only be attributable for differences in:
 - the volume or quantity of the prescribed metering service provided

⁷ Rebalancing constraints limit the annual change in the average price of a tariff and aim to limit sharp changes in tariffs where a distributor is moving a tariff to a more cost-reflective level.

- the places to or from which the prescribed metering service is provided
 - the time of day at which the prescribed metering service is provided, unless the costs for providing the service at a different time of day to that class of customer have been included in the revenue requirement
 - the performance characteristics at which the prescribed metering service is provided, or
 - any other legitimate differences in the costs of providing the prescribed metering service.
- **Simplicity:** charges and terms and conditions for prescribed metering services should be simple and easily comprehensible.

The Commission’s preliminary view is that these principles are not inconsistent with the terms of the revised Order, as long as the application of these principles does not effectively result in charges differing according to the type of meter.

Under an alternative approach, in considering proposed charges it would possible for the Commission to consider the relevant distribution pricing rules in section 6.18 of the NER, to the extent that these are not inconsistent with the revised Order. Section 6.18 of the NER includes rules relating to:

- revenue from each tariff class, which should lie between stand alone cost and avoidable cost
- rebalancing controls (‘side constraints’).

In applying any rebalancing constraints the Commission notes clause 4.1(o) of the revised Order provides that charges must be designed so that the net present value of building block costs incurred to date must equal the net present value of revenue incurred to date. Therefore any rebalancing constraint must operate subject to this provision. The Commission also notes that clause 4.1(p) enables distributors to propose to recover revenue which is less than building block costs, and recover any under-recovered amount in later years. The Commission considers that it is desirable for distributors to make use of this provision to provide customers with a smooth price path where possible.

Stakeholders are invited to comment on the additional pricing principles, if any, to which regard should be given when considering distributors’ charging proposals.

4.3 Exit and restoration fees

An exit fee is to be paid by a retailer to a distributor where:

- that retailer becomes the responsible person in respect of a metering installation for a customer with annual electricity consumption of 160 MWh or less which, immediately prior to that time, included a revenue meter that is a remotely read interval meter that has been previously installed by a distributor which complies with the Specifications and

- the responsible person in respect of that metering installation immediately prior to that time was the distributor.

A restoration fee is to be paid by the retailer to the distributor where:

- that retailer ceases to be the responsible person in respect of a metering installation for a customer with annual electricity consumption of 160MWh or less which, immediately prior to that time, included a revenue meter that is a remotely read interval meter that has been previously installed by a distributor; and
- the distributor becomes the responsible person in respect of that metering installation.

The Commission notes that the Australian Energy Market Commission (AEMC) has issued a draft rule determination pursuant to which it proposes to accept the rule change proposal put forward by the Victorian Government seeking a jurisdictional derogation to implement the AMI rollout. The derogation would establish the distributors as exclusive responsible persons for small customers for the purposes of the rollout. The AEMC has invited submissions on the draft determination by 7 November 2008, and is then required to make a final determination within 6 weeks from that date.

The derogation would grant exclusivity to the distributors until 31 December 2013 (unless there are further amendments to the NER prior to this date which provide for an AMI rollout in other jurisdictions).

The Commission considers that, if the derogation is ultimately approved in its current form, exit fees and restoration fees would not be payable during the initial AMI budget period. Accordingly, it would be unnecessary for a determination on those fees to be made during this period.

4.4 Unmetered supplies

As with exit and restoration fees, costs and revenues associated with unmetered supplies are excluded from the cost recovery process. Clause 6 of the revised Order specifies the methodology for determining the maximum charges that each distributor may make for the provision of metering services to unmetered connection points.

The revised Order defines an unmetered connection point to mean:

...a connection point at which it is determined that a meter is not necessary in accordance with schedule 7.2 of the National Electricity Rules.

An example of an unmetered connection point is public lighting (for example, traffic lights and street lights). The metering services to an unmetered connection point would essentially be the processing and storage of metering data.

The provision of metering services to unmetered connection points will remain a prescribed metering service under the revised Order.

Clause 6 of the revised Order specifies the formula that the Commission must use to determine the revised prescribed metering service charges.

For the period from 1 January 2009 to the commencement of the first subsequent price determination (1 January 2011), the revised Order states that the prescribed metering service charge is:

$$p_t = p_{t-1} \times \left(\frac{CPI_{t-1Q3}}{CPI_{t-2Q3}} \right)$$

where:

- p_t is the price for provision of metering services to unmetered connection points
- p_{t-1} is the price for provision of metering services to unmetered connection points determined under this Order applying on 31 December of the previous year
- CPI_{t-1Q3} is the Consumer Price Index – All Groups Index for the eight state capitals as published by the Australian Bureau of Statistics for the September quarter of the previous year
- CPI_{t-2Q3} is the Consumer Price Index – All Groups Index for the eight state capitals as published by the Australian Bureau of Statistics for the September quarter of the year preceding the previous year.

The Commission will require distributors to ensure that their charges for the provision of metering services to unmetered connection points are consistent with the formula set out above. It is proposed that this be achieved via the distributors providing their proposed unmetered supply charges to the Commission at the same time as their DUoS tariff proposals.

Stakeholders are invited to comment matters relating to establishing that charges for unmetered supplies are consistent with the revised Order.

4.5 Customer requested service fee

Clause 9 of the revised Order enables distributors to seek approval from the Commission for the establishment of a customer requested service fee. This is a fee which is paid by a retailer to a distributor where:

- a retailer's customer requests a regulated service to a standard in excess of that normally provided
- the costs of providing that regulated service can be reasonably attributed to that customer.

To the extent that distributors propose to charge such a fee, they will be required to provide information on:

- the level of extra service that is proposed to be provided
- the extra costs of the extra service, and the manner in which the extra costs have been calculated.

Given that the additional service level required by the customer in such circumstances is likely to be 'above scope' the Commission notes that the costs of serving the customer cannot be included in a budget application or a charges

application. They therefore need to be included in a separate fees application. Under the Order these may be made at any time.

5 | INFORMATION REQUIREMENTS

The regulatory framework set out in the revised Order provides for a relatively intensive exchange of information between the distributors and the regulator. Under a standard incentive-based framework, once an initial price determination has been made, information provision may be limited to the distributors providing the regulator with a list of proposed tariffs on an annual basis which need to be checked against the pre-determined formulae.

However, under the cost recovery based approach of the revised Order several submissions, each containing a large amount of information, will need to be provided to the regulator.

In order to ensure that the regulatory arrangements operate in a smooth and efficient manner, it is important that the regulator and the distributors have a common and well defined view regarding the nature of the information that needs to be provided.

This is particularly the case given that the revised Order generally provides that the onus of proof is on the Commission to establish that expenditure should not be included in a budget or charges determination. In such circumstances it is important for the Commission to take a pro active approach to obtaining information so that it can form a view as to whether it can establish or not establish certain matters.

Initial AMI budget period information needs to be provided by the distributors associated with the following:

- an initial AMI budget period budget application by 27 February 2009
- an initial charges application by 1 June 2009 including actual expenditure for 2008
- charges revision application by 31 August 2010
- budget variance applications, which may be made at any time.

The revised Order sets out the specific information that must be provided with each of the above submissions. In addition, the Order provides that budget and charges applications must include the information specified by:

- any framework and approach paper (as amended from time to time)
- information templates (as amended from time to time).

The revised Order also provides that the Commission may from time to time require provision of further information or documents in order to determine an application.

In chapter 2 the Commission set out some of the information it proposes to seek from distributors on specific issues. This chapter 5 discusses the information that the distributors will need to provide, including in their initial AMI budget period budget applications. It also sets out the proposed timeframes for the initial AMI budget period.

5.1 General principles for information provision

This section sets out the Commission's general expectations regarding information provision. It generally reflects the position set out in the December 2007 framework and approach document.

As the Commission is committed to an open and transparent process, as a general rule, distributors' budget and charges applications and revisions are to be made public. However, it recognises that some of the documentation will naturally contain confidential information, including information that may harm the commercial interests of the distributor if it were to be released publicly. Any confidential material which forms part of a submission should be clearly identified and justified..

Submissions will be made available on the Commission's website. From 1 January 2009, these submissions will also be available on the AER's website at www.aer.gov.au. Generally, information received by the AER will be treated as public documents. Interested parties are referred to the ACCC/AER's information policy for further information regarding the AER's use and disclosure of information available at <http://www.accc.gov.au/content/index.phtml/itemId/846791>.

5.1.1 Verification of information

In order to ensure the integrity of the review process and that the requirements of the Order are met, it is important that information provided by the distributors must be probative – that is, it must be rationally supported by underlying evidence. Where information is provided by the distributor the information should be:

- relevant
- true and correct, and not misleading or deceptive
- based on internal business records and be capable of corroboration from internal business records
- verified by the distributor.

In relation to verification, an appropriate verification statement in respect of historical information (where that historic information is not addressed by any required audit certification) could be to the effect that the officer has reviewed the information provided, made all relevant and appropriate enquiries in relation to the information provided, and is satisfied it is true and correct and drawn from the internal business records of the distributor. Specifically, budget applications, budget variation applications, charges applications and charges revision applications should include a verification statement signed by the distributor's chief executive officer or equivalent officer.

In relation to forecast and estimated information, including budget applications, an appropriate statement would set out that the officer has reviewed the basis on

which the forecast or estimate is made and is satisfied that the forecast or estimate is a genuine forecast or estimate made on a reasonable basis.

While a verification statement of this nature will be of assistance, ultimately it is a matter for the Commission to decide whether the information provided is sufficient, and whether additional information is required.

The Commission may also require provision of internal corroborating business records. In relation to business/expenditure plans, forecasts and estimates, the corroboration may include:

- a copy of the business planning/expenditure approval processes on which such plans, forecasts or estimates have been made
- a copy of the internal business planning/expenditure approval documentation in relation to a particular expenditure or forecast/estimate
- evidence that such plans, forecasts or estimates have been adopted by the board of the distributor as appropriate
- a statement from an authorised officer verifying that planned or forecast expenditure meets the internal business planning approval/expenditure approval requirements, has been approved and is reasonably anticipated to be incurred, and
- a copy of the internal procedures for ensuring that projects are undertaken prudently and efficiently.

Naturally the scope and detail of additional material required to support information provided by the distributors will vary on a case by case basis. For example, an item that is of greater importance and/or materiality is likely to require greater substantiation.

5.1.2 Expert reports

Expert reports provided by distributors to support their applications should include the following:

- a statement as to the particular matter or issue the report is intended to address
- the basis of the qualification of the third party to provide the supporting submission or report
- details as to the factual matters and assumptions on which the report is based and the source of such facts and assumptions, and
- the reasoning and the process of reasoning on which the conclusions and the opinions set out in the report are based.

5.1.3 Timely provision of information

The Commission expects information to be provided in a timely manner. It is unhelpful for material to be submitted late or outside a consultation period because it undermines the ability of the Commission and other relevant stakeholders to properly review and assess the information provided.

The Commission expects that the distributors will voluntarily provide information in accordance with their obligations under the revised Order and as set out in the final framework and approach paper.

Attention is also drawn to the Commission's powers under section 37 of the *Essential Services Commission Act 2001* to require provision of information and/or production of documents.⁸ This section permits the Commission to require a person, who the Commission has reason to believe has information or a document that may assist in the performance of any of its functions, to give that information or a copy of that document to the Commission.

5.2 Initial AMI budget period budget application

The initial AMI budget period budget application will need to include both written information as well as a set of data templates. The written information is generally discussed in chapters one to four.

5.2.1 Data Templates

It is important that the form and nature of information provided is consistent across the distributors, but also across budget applications, initial charges applications and charges revision applications.

To assist with this process, the Commission has prepared a draft set of data templates (and associated guidance document) for the distributors to complete and submit with their initial AMI budget period budget applications. The templates are based on the requirements of the revised Order and draw from the Commission's experience with data templates previously issued to the distributors under the original Order. The templates and guidance paper form Appendix 1 to this consultation paper.

The Commission will release templates for the submission of information in initial charges applications and charges revision applications. These templates will be consistent with the templates issued for the initial budget applications, but may be amended in light of the experience with the budget applications. The Commission will consult with the distributors before finalising these templates.

Stakeholders are invited to comment on the draft data templates.

⁸ Note that under the transitional framework established by the *National Electricity (Victoria) Amendment Act 2007* the Commission's information gathering powers under the *Essential Services Commission Act 2001* for the purposes of implementing the revised Order are transferred to the AER. The information gathering powers of the AER under the National Electricity Law do not apply to the review.

5.3 Timeframes for initial AMI budget period

The Commission's proposed timetable for the initial AMI budget period is shown below. Dates prescribed in the Order are in normal text and milestones proposed by the Commission are shown in italics.

Table 5.1 **Revised Order - milestones for the initial AMI budget period**

Milestone	Date
Initial prices take effect	1 January 2009
Distributors submit initial AMI period budget submission and initial charges application (in respect of 2010 and 2011)	27 February 2009
Distributors provide proposed 2010 and 2011 charges	1 June 2009
<i>Draft determination on initial 2010 and 2011 budget and charges application</i>	<i>31 July 2009</i>
Distributors may revise budget application to reflect material changes in costs as a result of contracts entered into or new regulatory obligations	31 August 2009
<i>Submissions on draft determination close</i>	<i>11 September 2009</i>
Final determination on initial 2010 and 2011 budget and charges application	31 October 2009
Initial budget period charges take effect	1 January 2010
Charges revision application to be submitted	31 August 2010
<i>Submissions on charges revision application close</i>	<i>30 September 2010</i>
Determination of revised charges for 2011	31 October 2010
2011 charges take effect	1 January 2011

As evidenced by the table above, the revised Order is relatively prescriptive regarding the timeframes to be followed. However, it does not specify dates for draft determinations or the periods during which submissions on draft determinations will be sought.

The Commission's proposes to release a draft determination on the distributors' 2010 and 2011 budget and charges application by 31 July 2009. While it may be desirable to release the draft decision slightly earlier than this, distributors' proposed 2010 and 2011 charges and 2008 actual outcomes will not be provided until 1 June 2009. Consistent with the minimum period specified in the revised Order of 30 business days, based on this draft decision date, submissions will be received until 11 September 2009.

As noted the revised Order does not specify the timeframes by which the building blocks related to 2006 to 2008 expenditure should be provided. The Commission proposes that this information be provided to the Commission at the same time as the initial budget application – i.e. 1 June 2009. This will ensure that actual 2008 outcomes are known at the time of the submission.

The timetable set by the revised Order allows revised budget applications (which must be submitted by 31 August 2009) to be made after the date proposed for the draft determination (31 July 2009). It is proposed that the distributors' proposals be released and submissions sought on the proposals until 11 September 2009, consistent with the submissions to the draft decision.

In relation to the determination of revised charges for 2011, there is a two month period from 31 August 2010 to 31 October 2010 for the Commission to consider distributors' submissions. This is insufficient time for a draft decision to be released. However, it is proposed that the distributors' proposals be released and submissions sought on the proposals until 30 September 2010. This will allow for consideration of submissions prior to the Commission's determination on 31 October.

Stakeholders are invited to comment on the proposed regulatory timeframes.