Energy Retailers Association of Australia
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8 August 2014

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson,

RE: Issues paper NSW electricity distribution regulatory proposals 2014-2015 to 2018-19

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments in response to the Australian Energy Regulator's (AER) issues paper on the NSW electricity distribution regulatory proposals 2014-2015 to 2018-2019 (the **Issues Paper**).

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

As our members are considered one of the primary parties involved in the roll out of smart meters under a market driven approach, the ERAA submission is focused on metering exit fees and we have also raised concerns with certain aspects of proposed operating expenditure contained in the Ausgrid, Endeavour Energy and Essential Energy (the Distributors) proposals as it impacts our member's customer base.

Metering exit fees

The ERAA supports the framework and approach that the AER will apply in assessing the regulatory proposals of the Distributors as outlined in the Issues Paper. The reclassification of metering types 5-6 as Alternative Control Services from Standard Control Services is an important change in the context of the AEMC's Rule Change process to support a market driven smart meter rollout.[1] The ERAA is also encouraged by recent statements made by the AER to facilitate an "…environment in which innovation may flourish. The purpose of regulation should be to establish a basis to the network to support competition of services in this exciting new world".[2]

The development of a competitive metering market in this exciting new world is predicated on two parties developing an internal business case to roll out smart meters to customers under an opt-out environment. The ERAA considers that the primary parties involved in the

[1] AER Issues paper NSW Electricity Distribution regulatory proposals, p.30
[2] Speech by Andrew Reeves, Acting Chairman AER, at the Networks Association's 2014 Regulation Seminar in Brisbane http://www.aer.gov.au/node/26828

initial investment decision for a smart meter roll out will be either the Meter Provider (MP) or the energy retailer. Yet for every business case there are various impediments that impact the investment decision and if either party considers that there is too much risk, uncertainty, or costs, then the business case for a smart meter roll out is unlikely to occur. Irrespective of whether the appropriate regulatory framework is developed to allow for innovation to flourish, no party will roll out meters if the business case is deemed to be negative, or provides limited shareholder value.

The internal business case for a roll out of smart meters in a contestable market assumes an opt-out environment – where a customer is simply informed of the benefits of a meter upgrade (as is the case today) assuming no change in meter cost or service, and customers have the option to opt-out of the upgrade therefore exercising choice. There are significant economies of scale and market efficiencies that can result from an opt-out regime, compared to an opt-in regime. In circumstances where there is a change in service, or consumers are exposed to additional costs, the ERAA supports the continued application of existing explicit informed consent provisions governing market contracts ensuring consumer protections are maintained (an opt-in environment). However the ERAA cautions that an opt-in environment for the mass roll out of smart meters under a market driven approach will increase transaction costs and impact the financials of the internal business case.

A significant impediment in the development of a viable business case are excessive upfront costs that may arise through high meter exit fees. This is because under an opt-out customer rollout the primary party involved in rolling out the meter will need to absorb these costs into their internal business case, unless a customer consents to pay for these fees (an opt-in environment) which will increase transaction costs.

The ERAA is therefore concerned that this impediment now exists with the metering exit fees proposed by the Distributors in their regulatory proposals. The ERAA understands that the fees will prevent or at best delay contestability in metering. This is in particular as the metering exit fees outlined in the Distributors proposals are economically inefficient, inconsistent, and will impede the development of competition in the metering market to the detriment of the long term interests of consumers.

Structure of the exit fees

The Distributors have proposed a single exit meter fee for their different metering configurations, presumably on the basis of simplicity and ease of administration. However, this leads to potential for over or under recovery of stranded asset costs. The economic efficiency of the meter exit fee will be maximised where it provides an accurate price signal for the meter exchange and the meters can be exchanged at least cost. The use of a single exit meter fee may be more problematic in Ausgrid's case, due to the installation of a large number of Type 5 meters compared to the Type 6 meters. Yet the ERAA would argue that Ausgrid must have assumed that there were benefits in installing Type 5 meters, rather than the regulatory requirement under the Rules to install Type 6 meters.

The development of a competitive metering market to support this exciting new world should not be impeded by Ausgrid's past investment decision. The ERAA would recommend that the AER investigate alternatives available to it under the Rules to account for this past decision.

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The proposed metering exit fees in the Endeavour Energy and Essential Energy proposals reduces year on year over the 2015-2019 regulatory period presumably on the assumption that metering competition is reducing their regulated asset base (RAB). However, Ausgrid's exit fees increase each year, with an underlying asset value that is between two to three times that of Essential Energy and up to 10 times that of Endeavour Energy. The ERAA assumes that the AER would seek clarification as to why this inconsistency exists.

Administration costs

There are general inconsistencies in the way the Distributors have accounted for administration fees. Whilst the ERAA recommends that the AER investigates whether the need for this administration fee is indeed at all warranted, it will need to be provided with reassurances that the administrative costs proposed by both Endeavour Energy and Essential Energy are in fact accurate, considering that they are approximately 140% to 150% of those proposed by Ausgrid. Inconsistencies can also be seen in the way the Distributors have allocated the proportion of employee time taken to facilitate a meter exchange. Ausgrid has proposed that it will take one of their full time equivalent employees (FTE's) approximately 24 minutes to complete the administration tasks associated with one meter exchange and Endeavour and Essential have indicated times of 20 minutes and 30 minutes, respectively. Assuming a hypothetical, yet conservative, churn rate of 10% of meters in the FY 2014/15 then in effect the Distributors collectively will require over 80 FTE's per annum to effect this transfer.[3] This seems to be quite excessive especially as the proposals provided by the Distributors don't seem to reflect a reduction in this operating cost over the regulatory period. The ERAA would at least have expected to see a reduction in time taken over the regulatory determination to account for such things as efficiency gains in labour productivity or semi-automation of business processes.

The ERAA estimates that should the AER approve the Distributors proposed administration charges, approximately $204 million in administration costs will be incurred during the regulatory period.[4] If this estimate is correct, this cost seems completely out of proportion to the tasks being completed, namely the updating and provisioning of information required for a simple meter exchange.

The ERAA also questions the allocation of corporate overheads that has been applied to these administration costs by each distributor. As example, Endeavour Energy has applied a corporate overhead factor of 205% to its labour cost. This seems to be excessive and warrants further investigation.

Irrespective as to how these meter exit fees are to be paid for, the ERAA recommends that the AER conducts some form of appropriate benchmarking to ensure that they are economically efficient.

Alternative approach to meter exit fees

The rollout out of Advanced Metering Infrastructure in Victoria allowed for the cost recovery of stranded meter assets displaced by AMI meters to remain in the regulatory asset base (RAB) and recovered through annual meter charges paid through Distributed Use of System (DUOS) charges. The ERAA understands that depreciation of non-compliant AMI meters

[3] Calculated using total NMI's provided by Ausgrid (1.63 million), Endeavour (1.35 million) and Essential (1.4 Million) and multiplying this by 10% and factoring in labour costs of 0.4 FTE/hour, 8 hour work day over 251 days.
[4] Based on the Distributors NMI count per FY multiplied by administration costs quoted in each year of their regulatory proposals. Also assumes that all meters are exchanged by a contestable party by the end of FY 2018/19.

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installed post 1 January 2006 was accelerated such that their life ended no later than 31 December 2013, which aligned with the end of the AMI rollout.[5] Whilst this may have been a reasonable approach under a mandated environment, the lesson learned from Victoria is that making customers pay for excessive costs upfront, prior to receiving or being educated about the benefits of the smart meters, is highly problematic.

In NSW it is proposed that metering is unbundled from Standard Control Services (and therefore DUOS charges) and reclassified as an Alternative Control Service. This is so to encourage competition in metering and the ERAA strongly supports this approach. The ERAA also considers that to further encourage competition in metering the AER should consider, if the Rules allow it, that once the Distributors meter is displaced by a competitive meter that the residual value of the Distributors meter asset is put back into their regulated asset base, and this residual value is included as part of Standard Control Services.

Whilst this may result in customers that have elected, or are yet to elect to move to a smart meter, subsidising the roll out of smart meters, the likely incremental increase in DUOS charges will be insignificant, especially if these assets are depreciated over their expected life, rather than what occurred in Victoria. Irrespective the ERAA is of the opinion that only a few customers, in the long term, will elect not to move to a smart meter. This is because the internal business case underpinning a party rolling out smart meters, in an opt-out environment, assumes a high penetration of smart meters and this will only be achieved through mass adoption of smart meters. The competitive market will do this by championing and selling the benefits of services enabled by the meters, and not the meter itself.

Furthermore the benefits from smart meters and associated technology are not only solely related to consumers that adopt them. Smart meters will have a positive impact across the whole energy value chain and will benefit all consumers. They will enable, as example:

- better network planning where the Distributors can work with retailers to develop energy products that reduce the burden on the network at peak times. Consequently, network augmentation can be delayed or reduced, minimising the impact of network charges on consumers' energy bills. A benefit to all consumers.
- better outage information and cost efficiencies. Even a small penetration of smart meters in a local network will allow the Distributors to identify whether the outage is isolated to just a single customer, or it relates to an outage that involves numerous customers. Being able to quickly identify the origin of the outage would result in network operating cost efficiencies as well as provide consumers with the benefits of quicker power restoration times. A benefit to all consumers.
- better administration of retailers' hardship policies by providing retailers with valuable comprehensive data on energy consumption. The availability of such data can only help retailers' processes to assist consumers in need allowing them to target more appropriate means of supporting these consumers. A benefit to all consumers in need.

Distributors proposed operating expenditure

The ERAA welcomes the stabilisation in distribution revenues and therefore prices forecast for the next five years following significant increases over the past 5-6 years.[6] The ERAA

[5] http://www.gazette.vic.gov.au/gazette/Gazettes2007/GG2007S200.pdf

[6] AER Issues paper NSW Electricity Distribution regulatory proposals, pgs.8-9

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whilst welcoming the stability in the future revenue paths of the Distributor's proposals, still has some concerns regarding the Distributors operating expenditure.

The ERAA questions the recovery of retail dis-synergy costs by the Distributors following the cessation of the Transitional Services Agreements (TSA). The ability of the Distributors to recover these costs must be assessed within the context of the opex criteria and the AER expenditure forecast assessment guideline.[7] The timeframe for elimination of the impact in FY 2016/17 by both Essential Energy and Ausgrid is too long as customers rather than shareholders are subsidising their inefficiency. Endeavour Energy's TSA finished in April 2013 and on the basis that Integral (its retail arm) was operating efficiently as a standalone business, Endeavour Energy should not be entitled to a revenue stream in the FY 2015-19 regulatory period.

The inspection costs for Essential Energy and Endeavour Energy are proposed to escalate substantially in the regulatory period. Essential Energy's costs are proposed to increase by $31 million and Endeavour Energy by $157 million. This is in stark contrast to the escalation in costs provided to the Victorian distributors. Therefore the AER should evaluate closely the justification for these escalated costs.

The Endeavour Energy vegetation management expenses will escalate by $130.6 million or around 60% in this next regulatory period. This will enable Endeavour Energy to increase conformance to their current internal standards. Whilst the ERAA understands that management of vegetation in bush fire prone areas is a cause of the escalation, the AER should ensure that Endeavour Energy justifies these costs.

On the basis of the issues outlined in this submission, the ERAA recommends that the AER exercise its full powers to seek further information from the Distributors to justify all aspects of their regulatory proposals, inclusive of matters raised by our members in their submissions. This is particularly important in the context of proposed meter exit fees as this determination will set a precedence for future regulatory determinations.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,

Cameron O'Reilly
Chief Executive Officer
Energy Retailers Association of Australia

[7] Ibid, pg.37

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