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Friday 30 January 2015

Mr Sebastian Roberts
General Manager – Network Regulation Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

MACQUARIE

Dear Mr Roberts,

**SUBMISSION TO THE AUSTRALIAN ENERGY REGULATOR – SA POWER NETWORKS REGULATORY PROPOSAL**

In November 2014, the Australian Energy Regulator ("AER") requested submissions regarding SA Power Networks' ("SAPN") Regulatory Proposal for regulatory control period of 1 July 2015 to 30 June 2020. This submission contains the views of Macquarie's Corporate and Asset Finance Group ("CAF") only. CAF is one of six operating groups within the Macquarie Group ("Macquarie").

Macquarie is a global provider of banking, financial, advisory, investment and funds management services. CAF specialises in lending and asset finance, engaging Macquarie Bank Limited's balance sheet to provide tailored finance and asset management solutions.

### Executive Summary

CAF values the opportunity to comment on SAPN's proposal for the next regulatory period.

Based on CAF's experience in the UK competitive metering market we believe that establishing a market framework which encourages and promotes competition is integral to the development of the South Australian smart meter market. Market competition promotes innovation, drives down prices and ultimately delivers greater benefit to consumers.

An important part of this is setting the correct annual metering charges and treating exit fees appropriately.

Some aspects of SAPN's proposed determination remain unclear and subject to further enquiry. CAF welcomes the opportunity to discuss the contents of this letter with the AER.

### CAF Background and Credentials

CAF has been involved in the competitive metering market in the UK since its inception in 2002, as both an adviser and an investor. CAF currently own a portfolio of over seven million traditional and smart, gas and electricity meters, and has invested and arranged over GBP700 million of equity and debt financing into various UK metering portfolios. Through our close relationships with retail and commercial energy suppliers, CAF has also built and owns the largest portfolio of smart meters in the UK, with over 1 million installed industrial & commercial and residential smart meters. In addition CAF has played an active role in the various smart metering consultation processes over the last 7 years arranged by the UK regulator ("Ofgem") and the Department of Energy & Climate Change.

In the UK, Macquarie is viewed as an independent third party meter owner and funder with a demonstrated history of working with a range of stakeholders including "in-house" energy supplier service companies, the majority of independent participants in the smart metering market, manufacturers, smart meter service providers and installers.

**Detailed Submission**

CAF's understanding of SAPN's determination proposal with respect to meters includes:

- Deployment of 65,000 'smart ready' meters ("Interval Meters") per annum, with the ability to retrofit communication hubs;
- Deployment of 10,000 smart meters per annum (i.e. with two way communications) ("Exceptional Meters");
- Interval Meters and Exceptional Meters will be captured under SAPN's regulated Meter Asset Base ("MAB") and earn a regulated rate of return;
- Interval Meters and Exceptional Meters may be subject to a "meter transfer fee" payable to SAPN should a third party meter provider be selected. In such case, ownership of the meter may pass to the third party and SAPN would no longer charge the regulated metering charge for that customer;
- SAPN propose an exit fee of $212 for existing 'type 5' and 'type 6' meters; and
- Significant investment is required for SAPN to build and commission backroom systems and functionality with the ability to support a full smart meter platform.

Based on CAF's extensive experience operating under a contestable market framework in the UK, we would like to make the following points:

<u>Non ring-fenced smart meter business platform</u>

The Power of Choice Review supports competition as an essential element for the efficient long term deployment of smart meters.

SAPN's determination proposal includes some elements of a smart meter business, including development of IT infrastructure. In this regard we note that SAPN propose to install 75,000 smart ready meters a year and to equip 10,000 of these meters[1] each year with communications, making them a 'type 4' meter.

Under the regulatory proposal SAPN will always have the protection of an exit/ transfer fee for the recovery of their capital investment or the ability to recover such amounts under a regulated MAB.

In effect SAPN is proposing to build the foundations of a smart metering business while being permitted to recover such investment via regulatory protections. This provides SAPN with a significant "risk free cost/ investment" advantage in servicing a future smart meter market, leading to a disincentive for other contestable participants to engage the segment. That is, SAPN is subject to a significantly lessened risk profile than others seeking to engage the smart metering market.

The absence of competition is likely to lead to increased inefficiencies and increased costs to consumers.

<u>Inefficient market pricing</u>

Based on CAF's experience in the UK and through conversations with various market participants, the notion of retrofitting 'smart ready' meters is both technically and financially flawed.

While CAF won't comment at length on the technical limitations of retrofitting communication devices onto meters, it is understood that this is impractical and in many cases not possible in a retailer energy supplier led model. Such technical limitations will

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[1] SA Power Networks Regulatory Proposal 2015-20, Attachment 14.3 SA Power Networks: Tariff and Metering Business Case, September 2014, pg 52

inhibit an efficient smart meter deployment and the delivery of benefits to the State of South Australia and its energy consumers.

The high cost of the proposed Exceptional Meter transfer fee plus additional costs associated with retrofitting communications is likely to be prohibitive in terms of developing a business case for efficient meter suppliers in a competitive market. Ultimately, as with the case in Victoria, higher costs will be borne by the consumer. In essence the currently proposed smart ready deployment model coupled with SAPN's incumbent monopoly position may create an environment which discourages competition, with high barriers to entry for contestable meter providers. The inability for a third party meter services provider to achieve critical mass in a market will almost certainly act as a disincentive for competition.

Exit Fees

SAPN's regulatory proposal includes a scale of exit/ transfer fees where dumb meters are replaced, Interval Meters are retrofitted to full smart functionality or a third party metering provider is nominated. CAF agrees with the AER's position that "*any exit or transfer fees proposed by SAPN are likely to inhibit development of effective competition in the provision of metering services...[as] they will be a disincentive for consumers to switch to smart meters. In turn, the potential benefits of using smart meters will be less likely to emerge*".[2]

In CAF's view, any existing MAB should be recovered via the network tariff as a Standard Control Service in order to best facilitate a contestable market environment. We refer to the outcome in NSW as a precedent for this approach.

**Conclusion**

Based on CAF's experience in the UK competitive metering market, we believe that:

- Rolling out smart ready meters under any regulated business poses a significant risk to the development of a contestable market. Any DSNP led smart meter, or smart-ready meter rollouts, should be deployed by a ring fenced business to facilitate the optimal environment for the development of competition which will drive the most cost effective outcome for consumers.
- Only a truly contestable market will deliver maximum benefit in terms of costs and services to consumers.
- SAPN should be able to recover the value invested in the existing MAB through the Standard Asset Service charge and not through a direct charge to the consumer, in-line with AER's NSW DNSP Draft Determinations.

We would be pleased to share our experiences from the UK contestable metering markets with the Australian Energy Regulator. If you have any questions or comments, please do not hesitate to contact Mr John Wilson on (02) 8232 4502 or via email john.wilson@macquarie.com

Yours sincerely
**Macquarie Corporate and Asset Finance Limited**

**John Wilson**
Executive Director
Corporate and Asset Finance

**Bruce Mellor**
Division Director
Corporate and Asset Finance

[2] AER Issues Paper, SA Power Networks Electricity Distribution Regulatory Proposal 2015-20. December 2014, pg 31