November 2023

Legacy metering services – Guidance note

Draft decisions

In our draft decision:

- we considered the AEMC's final report on the review of the regulatory framework for legacy metering services (AEMC review)[1] is a material change in circumstances that allows for the departure of the service classification and/or the form of control from our Framework and Approach Papers;[2]
- however, due to the timing of the AEMC's final report and the need for additional time to work through the implications of a reclassification to standard control services, we chose to maintain legacy metering services as alternative control services. We also proposed to mitigate the inequitable price increases to individual customers by recovering costs across a wider customer base of all low voltage customers who have or have had a legacy meter;
- we considered that it would be more appropriate to reclassify legacy metering services as standard control services in the revised proposals as this would result in the most equitable solution by recovering legacy metering costs across all customers. We considered cost recovery for the metering transition across all customers appropriate as all customers will receive the whole-of-system benefits the smart meters will provide;
- we stated that we had engaged with distributors on the reclassification, and that they were supportive of the proposal to reclassify legacy metering services as standard control services. We also encouraged distributors to consider the reclassification for their revised proposals, and that we would work with the distributors to establish guidance on a common approach to reclassification as standard control services.

Revised proposals

This paper provides guidance on the information that needs to be provided in a revised proposal in reclassifying legacy metering services as standard control services.

Where the revised proposal for legacy metering services interacts with standard control services building blocks, and the AER has accepted those building blocks in our draft decision, those building block amounts accepted by the AER should not change unless required in response to the AEMC review. To the extent they need to be amended to account for the AEMC review, this should be done through the metering portion of standard control services if proposing a reclassification, or through the existing service classification if proposing to maintain as alternative control services (i.e. if costs are currently treated as alternative control services they should remain as alternative control services and the same for standard control service costs).

Our final decision will consider the price impacts for consumers which is a concern raised by stakeholders. As such, the revised proposals should include supporting information on why it has

1 https://www.aemc.gov.au/market-reviews-advice/review-regulatory-framework-metering-services

2 See clauses 6.12.3(b) and (c) of the *National Electricity Rules*.

proposed to reclassify legacy metering services to standard control services or maintaining as an alternative control service with regard to stakeholder feedback, bill impact analysis, and any likely impacts into the 2029–34 regulatory control period.

Control mechanisms

We consider it may be optimal to operate legacy metering services under a revenue cap due to the volume uncertainty and that uncertainty being generally outside of distributors' control.

As such, we would be supportive of distributors proposing a revenue cap form of control in their revised proposal (noting that standard control services are already a revenue cap by default).

We have provided the price control formulae we consider may apply where legacy metering services are reclassified to standard control services (see page 5).

Modelling

Where legacy metering services become standard control services, we intend to treat metering services expenditures separately as a sub-component of the total standard control services expenditures. This will maintain the transparency of the costs and assist with any 'true-ups' or adjustments (such as cost pass throughs) that may need to occur during the regulatory period.

For clarity, we expect distributors to submit two separate sets of models (roll forward model or RFM, post-tax revenue model or PTRM, and depreciation tracking module where applicable) in the revised proposals: one for the main standard control service assets; and another for legacy metering assets. To avoid doubt, distributors are to use the AER's developed PTRM and RFM currently applicable to distributors in the NEM for both the main standard control services and for legacy metering services.[3] Where appropriate, distributors would sum the outcomes of the models. For example, distributors would sum the outcomes of the main standard control services PTRM and the legacy metering services PTRM to derive their proposed annual revenue requirement for the regulatory control period.

We consider the standardised metering expenditure model is fit for purpose under these changes. The general treatment of operating expenditure (opex) remains the same, and then feeds into the AER's legacy metering services PTRM. We consider the RFM and PTRM are appropriate for use, and the PTRM can be used for pricing under a revenue cap or price cap due to the removal of the special treatment of capital/non-capital charging components.

We no longer consider the standardised metering pricing model is necessary, and pricing should occur through the metering PTRM as per our draft decisions.

We note that the opex trend approach applies logarithmic functions which distributors may not consider appropriate considering the magnitude of change in volumes. As such, we would support the removal of these logarithmic functions in revised proposals.

Annual revenue requirement

Where reclassifying legacy metering services as a standard control service, the annual revenue requirement outputs from the main and legacy metering services PTRMs should be consolidated at the total level for the purpose of the proposal and the AER's constituent decisions. To clarify, there

[3] For the PTRM, see https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-post-tax-revenue-models-transmission-and-distribution-april-2021-amendment.
For the RFM, see https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-roll-forward-models-transmission-and-distribution-2020-amendment.

will be two sets of annual revenue requirement outputs, one from the main standard control services PTRM and one from the legacy metering services PTRM. This also means that there will be two separate smoothing processes to accommodate the different priorities in smoothing across main standard control services and legacy metering services.

For all other purposes they should be considered separately, with the NER requirements applying to each.

Regulatory asset base

The main standard control services regulatory asset base and the legacy metering services regulatory asset base should be considered separately for all purposes, and in separate models as identified above.

Capex

Our default position is that there should be no proposed capital expenditure (capex) for legacy metering services in the NEM going forward.

Where we have approved metering non-network capex and the distributor proposes to reclassify this as a standard control service, main standard control services capex and approved legacy metering services non-network capex should be consolidated at the total forecast capex level for the purpose of the proposal and the AER's constituent decisions. For all other purposes they should be considered separately, with the NER requirements applying to each.

Opex

In reclassifying legacy metering services as standard control services, the distributor should propose a total standard control services opex amount that is the aggregate of both the main standard control services opex as well as the legacy metering services opex. These amounts are to be consolidated at the total forecast level (that is the combination of the amounts entered into each of the metering and the main PTRMs) for the proposed total forecast opex amount and the AER's constituent decisions. For all other purposes they should be considered separately, with the NER requirements applying to each.

Base (legacy metering services only)

Where 2022–23 has been used as a base year, we expect this to be updated to reflect actual opex for that year because that should now be known.

We do not consider it appropriate for adjustments to be made to the base opex to reflect the smart meter rollout as these will be transitional expenses, or dependent on the rate of change.

Trend (legacy metering services only)

We expect distributors to provide the best estimate of volume trends in line with the AEMC review. Where appropriate, we may seek an update to these volumes before our final decision to reflect any updates or early progress on legacy meter retirement plans.

While we have set the volumes to reach the 100% target by the end of 2029–30, we note the AEMC review has provided for several exemptions to this target. We consider it appropriate for distributors to forecast volumes that appropriately reflects their expectations of meters requiring operation by the distributors, including meters that may be exempt from the 100% target.

We have applied weightings to volume trends of 65% where otherwise not used, to reflect the portion of costs that are variable, and to remove fixed opex from this trend component. We consider

it appropriate for distributors to consider this weighting and propose a better alternative where applicable.

Step (legacy metering services only)

We expect distributors to provide their best estimate of opex considering the additional requirements stemming from the AEMC review. This includes, but is not limited to, any remediation works on the distributor side which fit into this service classification, and transitional opex resulting from the development and application of the rollout and relevant legacy metering retirement plans that will be incurred in the forthcoming regulatory period.

The AEMC noted the cost pass-through mechanism to be sufficient for managing costs incurred in the current regulatory period.[4]

True-up mechanism

We consider it appropriate to allow for a true-up of operating expenditure relating to variations in forecast metering volumes. This is due to the volume uncertainty and that uncertainty generally being outside of distributors' control.

This true-up will operate by annually updating the forecast volumes of meters in the expenditure model as a part of the annual pricing process. The variation in total operating expenditure resulting from the changes in volumes will be applied through the A-factor in the control mechanism, with relevant time value of money adjustments using the regulated weighted average cost of capital.

In updating the expenditure models, only the forecast metering volumes are to be revised, with all other components and data in the model to be maintained as per the AER's final decision.

Incentive Schemes

Incentive schemes will only relate to the main component of standard control services and be applied to the main standard control services revenue where relevant. The legacy metering component of standard control services will be excluded from all incentive scheme considerations.

Pricing

Upon reflection of our draft decision and engagement with the distributors, we consider it optimal to recover these costs over all LV customers where appropriate. This would be facilitated by reclassifying these services as standard control services.

We consider there is uncertainty that recovering these costs from HV customers is within the NER pricing principles.

Where reclassified as standard control services, we consider legacy metering services charges are best applied as a fixed charge component and separate to other fixed charges. This is to maintain the transparency of these charges throughout the transition and better accommodate any true-ups or pass-throughs that may be required. This approach would require the introduction of a new fixed charging component to the TSS for metering services.

4 AEMC, *Final report – Review of the regulatory framework for metering services*, August 2023, p. 46.

Price control formulae for metering as SCS

We consider the following mechanism most appropriate for combining the main SCS and metering revenues for the purpose of annual pricing. This mechanism seeks to balance pragmatism and transparency, noting that some components will be zero values for metering (such as incentive schemes I-factor).

	Equation	where
1.	$TAR_t \geq \sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij}\, q_t^{ij}$	$i = 1, \ldots, n$ $j = 1, \ldots, m$ $t = 1, 2, 3, 4, 5$
2.	$TAR_t = TAR_t^{SCS} + TAR_t^{M}$	$t = 1, 2, 3, 4, 5$
3.	$\mathrm{TAR}_t^{SCS} = AAR_t^{SCS} + I_t^{SCS} + B_t^{SCS} + C_t^{SCS}$	$t = 1, 2, 3, 4, 5$
4.	$AAR_t^{SCS} = AR_t^{SCS}$	$t = 1$
5.	$AAR_t^{SCS} = AAR_{t-1}^{SCS} \times (1 + \Delta CPI_t) \times (1 - X_t^{SCS})$	$t = 2, 3, 4, 5$
6.	$\mathrm{TAR}_t^{M} = AAR_t^{M} + I_t^{M} + B_t^{M} + C_t^{M}$	$t = 1, 2, 3, 4, 5$
7.	$AAR_t^{M} = AR_t^{M}$	$t = 1$
8.	$AAR_t^{M} = AAR_{t-1}^{M} \times (1 + \Delta CPI_t) \times (1 - X_t^{M})$	$t = 2, 3, 4, 5$
9.	$\mathrm{B_t} = \mathrm{b_t} + \mathrm{A_t}$	$\mathrm{t} = 1, 2, 3, 4, 5$
10.	$\mathrm{b_t} = -\mathrm{O_t} \times (1 + \mathrm{WACC_t})^{0.5}$	$\mathrm{t} = 1, 2, 3, 4, 5$
11.	$\mathrm{A_t} = \mathrm{a_{t-2}^1} \times (1 + \mathrm{WACC_{t-1}}) \times (1 + \mathrm{WACC_t}) + \mathrm{a_{t-1}^2} \times (1 + \mathrm{WACC_t}) + \mathrm{a_t^3}$	$\mathrm{t} = 1, 2, 3, 4, 5$
12.	$\mathrm{WACC_t} = (1 + \mathrm{rvWACC_t}) \times (1 + \mathrm{CPI_t}) - 1$	$\mathrm{t} = 1, 2, 3, 4, 5$

Where:

Variable	Represents
t	the regulatory year with t = 1 being the 2024–25 financial year.
$\mathrm{TAR_t}$	the total annual revenue for year t, calculated as per formula 2 above.
$\mathrm{TAR_t^{SCS}}$	the total annual revenue for main SCS for year t, calculated as per formula 3 above.
$\mathrm{TAR_t^{M}}$	the total annual revenue for metering for year t, calculated as per formula 6 above.
$\mathrm{p_t^{ij}}$	the price of component 'j' of tariff 'i' for year t.
$\mathrm{q_t^{ij}}$	the forecast quantity of component 'j' of tariff 'i' for year t.
$\mathrm{AR_t^{SCS}}$	the annual smoothed revenue requirement in the main SCS Post Tax Revenue Model (PTRM) for year t.
$\mathrm{AR_t^{M}}$	the annual smoothed revenue requirement in the metering PTRM for year t.
$\mathrm{AAR_t^{SCS}}$	the adjusted annual smoothed revenue requirement for main SCS for year t., calculated as per formulae 4 and 5 above.
$\mathrm{AAR_t^{M}}$	the adjusted annual smoothed revenue requirement for metering for year t, calculated as per formulae 7 and 8 above.
$\mathrm{I_t^{SCS}}$	the sum of incentive scheme adjustments for year t. Where applicable, incorporates revenue adjustments relating to the outcomes of: • the service target performance incentive scheme (STPIS) (S-factor) in relation to regulatory year t-2 • the demand management incentive scheme (DMIS) in relation to regulatory year t-2

Variable	Represents
	• the demand management innovation allowance mechanism (DMIAM) relating to the 2019–24 regulatory control period to be applied in regulatory year t=2 only • the customer service incentive scheme (CSIS) (H-factor) in relation to regulatory year t-2 • the export service incentive scheme (ESIS) (E-factor) in relation to the regulatory year t-2 • any other related incentive schemes as applicable that are to be applied in year t.
B_t^{SCS}	the sum of annual adjustment factors to balance the unders and overs account for year t, calculated as per formula 9 above. It includes: • the true-up of any under or over recovery of actual revenue (b-factor) collected through distribution use of system (DUoS) charges calculated using the method outlined in formula 7. • Any other bespoke adjustments the AER deems necessary (A-factor). These include but are not limited to: residuals of jurisdictional scheme amounts upon cessation, applicable licence fee payments, or other true-ups not provided for elsewhere. These adjustments will apply the time value of money where appropriate, calculated as per formula 11 above.
C_t^{SCS}	the approved pass-through amounts (positive or negative) for year t, as determined by the AER. It will also include any annual or end of period adjustments for year t.
I_t^M	the sum of incentive scheme adjustments for metering services for year t. Currently no incentive schemes apply.
B_t^M	the sum of annual adjustment factors to balance the unders and overs account for year t, calculated as per formula 9 above. It includes: • the true-up of any under or over recovery of actual revenue (b-factor) collected through metering services charges calculated using the method outlined in formula 7. • Any other bespoke adjustments the AER deems necessary (A-factor). These include but are not limited to the true-up of operating expenditure explicitly related to variances from forecast metering volumes, or other true-ups not provided for elsewhere. These adjustments will apply the time value of money where appropriate, calculated as per formula 11 above.
C_t^M	the approved pass-through amounts (positive or negative) for metering services for year t, as determined by the AER. It will also include any annual or end of period adjustments for metering services for year t.
ΔCPI_t	the annual percentage change in the Australian Bureau of Statistics' (ABS) Consumer Price Index All Groups, Weighted Average of Eight Capital Cities[5] from December in year t–2 to December in year t–1. For example, for the 2024–25 year, t–2 is December 2022 and t–1 is December 2023.
X_t^{SCS}	the X-factor in year t, incorporating annual adjustments to the main SCS PTRM for the trailing cost of debt.
X_t^M	the X-factor in year t, incorporating annual adjustments to the metering PTRM for the trailing cost of debt.
b_t	the true-up for the balance of the respective unders and overs account in year t, calculated as per formula 10 above.
O_t	the opening balance of the respective unders and overs account in year t as calculated by the method in Appendix A of the control mechanisms draft decision.
$WACC_t$	the approved weighted average cost of capital (WACC) used in regulatory year t in the DUoS unders and overs account in Appendix A. The WACC is updated annually to apply actual inflation, calculated as per formula 12 above. It also applied to true-up mechanisms to adjust for the time value of money.
A_t	the sum of bespoke adjustments, including the application of the time value of money where appropriate, calculated as per formula 11 above.
a_t^1	the bespoke adjustment '1' for year t. Formula 11 above demonstrates the application of the time value of money for different bespoke adjustments relating to different regulatory years.
$rvWACC_t$	the real vanilla WACC provided in the annually updated PTRM for year t.

5 If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.