



Department of Environment, Land, Water & Planning

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Ms Paula Conboy
Chair
Australian Energy Regulator
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MELBOURNE VIC 3001

Dear Ms Conboy

ADVANCED METERING INFRASTRUCTURE TRANSITION CHARGES APPLICATIONS 2017

The Victorian Government welcomes the opportunity to provide its comments in relation to the Victorian distributors' Advanced Metering Infrastructure (AMI) transition charges applications for 2017 (the applications).

The applications mark the end of the regulation of costs associated with the roll out of smart meters through the Cost Recovery Order in Council (CROIC), with the roll out of smart meters now complete. As such, where metering services charges are regulated, they are regulated through the five yearly revenue determination process.

The Victorian Government is pleased that metering service charges will decrease for electricity customers of four of the five electricity distributors as a result of the transition charges applications. Notwithstanding this, there are a number of areas of concern within the applications and the Victorian Government expects the Australian Energy Regulator (AER) to rigorously assess these applications.

In June 2015, important amendments were made to the CROIC that governs the AMI transition charges. In particular, clause 51.7AA of the CROIC states that:

For the purposes of clause 51.7 and in any case where an application pursuant to clause 5L is made, the expenditure excess is prudent where the expenditure of the distributor over the entirety of the initial regulatory period reasonably reflects the efficient costs of a business providing the Regulated Services over the entirety of that period.

The Victorian Government expects that the AER will have regard to this clause and assess the efficiency of the distributors' expenditure over the entire 2009-15 period.

A comparison of the expenditure per meter by each electricity distributor and the electricity distributors' metering service charges would indicate that the AER should have particular regard to the expenditure incurred by AusNet Services, Jemena and United Energy, while noting the analysis submitted by Jemena which indicates that the higher costs incurred by it may be largely due to recovering fixed IT and communications costs over a smaller customer base.

In addition, the Victorian Government would like to draw the AER's attention to issues related to:

- capital expenditure for communications modules, meter installation, new connections and IT expenditure; and

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- operating expenditure for the project management office and corporate overheads.

These are discussed in further detail in the attachment to this letter (Attachment 1).

The Victorian Government believes that these are important matters for the AER's consideration, due to the potential impacts that may result for Victorian consumers.

If you require further information please contact me on (03) 8392 7607.

Yours sincerely



Mark Feather
Executive Director
Energy Policy & Programs

30 / 8 / 16

Attachment 1: Victorian electricity distributors' Advanced Metering Infrastructure Transition Charges applications for 2017

Communications modules

AusNet Services has applied for an expenditure excess of \$20.8 million in 2014 for 122,579 3G communications modules - \$9.0 million due to a volume difference and \$11.8 million due to a unit price difference. While the approved budget included \$73.60 for each communications module, the cost incurred by AusNet Services for each 3G communications module was \$170.

It is expected that some meters will be located in areas that require a 3G communications module. The issue for the Australian Energy Regulator (AER) to consider is whether the number of 3G communications modules required is higher than it would have been had AusNet Services converted to a mesh radio communications technology during its Advanced Metering Infrastructure (AMI) rollout when there was information showing that it was a less costly, market proven solution.

If the AER is of the view that the number of 3G communications modules required with a mesh radio communications technology is lower than with a WiMax communications solution, then some of the expenditure on 3G communications modules is inefficient.

Meter installation

The average unit cost for AusNet Services to install meters is summarised in the following table.

Period	Number of meters / communication modules	Expenditure	Unit cost
2009-12	411,914 ¹	\$43.0 million	\$104 ²
2013	243,084 ³	\$36.2 million	\$149 ⁴
2014	110,944	\$13.3 million	\$120
2015	12,152 (3,319 meters)	\$4.3 million (\$1.2 million on meters)	\$354

AusNet Services has presented the installation cost in 2014 and 2015 as the average cost over the 2009-15 period (\$138.15 per meter), which is below the benchmark established by Energeia in its review of the 2013 costs (\$151). On this basis, it concludes that the meter installation cost of \$1.2 million for the installation of 3,319 meters is efficient.

However, the installation of 3,319 meters at a unit cost of \$138.15 is actually \$0.46 million, rather than \$1.2 million as per the application. Alternatively, if the average cost over the 2009-14 period is applied (\$132.66 per meter), then the efficient cost for the installation of 3,319 meters is \$0.44 million.

¹ AusNet Electricity Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application*, 29 August 2014, page 20.

² Calculated based on tables 10 and 13 in AusNet Services' Transition Charges application.

³ AusNet Electricity Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application*, 29 August 2014, page 20.

⁴ Energeia, *Review of Victorian Distribution Network Service Provider's Advanced Metering Infrastructure 2015 Charges Revision Applications*, December 2014, page 25.

AusNet Services has also sought approval of \$8.4 million in 2014 for the installation of stand-alone communications modules. The communication modules were installed separately to the meters due to a delay in the delivery of the 3G communications modules in 2013. While page 29 of the application attributes this delay to the impact of policy changes, page 24 of the application attributes this change to the 3G communications modules being:

a brand new product, and as such had to undergo proof of concept and prototype testing.

The Victorian Government considers the installation of meters without communications modules to be an inefficient practice – this practice required two site visits rather than one.

The Victorian Government concurs with the statement in Jemena's application that the requirement to rollout meters by 31 December 2013 on a best endeavours basis:

... is neither an unqualified obligation to achieve the outcome prescribed in the AMI OIC, nor a warranty that it will be achieved—for example, a best endeavours obligation does not require JEN to select the option that best mitigates the risk of delay, in isolation of the costs associated with implementing that option.⁵

Accordingly, the Victorian Government does not consider that the expenditure incurred by AusNet Services to install stand alone communications modules is efficient.

New connections

United Energy has sought approval of \$2.09 million and Jemena has sought approval of \$3.642 million in 2014 for meter purchases for new connections.

It is unclear why United Energy and Jemena are seeking approval of meter purchases for new connections through the metering service charges. It is expected that these costs would be recovered through ancillary service charges. As noted in the AER's draft revenue determination for the 2011-15 regulatory control period:

In the current regulatory control period, the Victorian DNSPs have differing charges for new connections depending on whether or not they are the responsible person, due to the potential for customers to have meters supplied by other parties.⁶

As part of the 2011-15 revenue determination, the AER approved two sets of new connection charges for United Energy – one set of charges that applied where United Energy was the responsible person for metering, and one set of charges that applied where United Energy was not the responsible person. The charges where United Energy was the responsible person were higher than the charges where United Energy was not the responsible person, presumably because they included the costs associated with the meter.

For example, the cost of a single phase, single element new connection during business hours was \$87.51 in 2011 where United Energy was not the responsible person and \$201.38 where United Energy was the responsible person.⁷

⁵ Jemena Electricity Networks (Vic) Ltd, *Advanced Metering Infrastructure, Transition application, Public*, 31 May 2016, page 6.

⁶ Australian Energy Regulator, *Victorian electricity network service providers, Distribution determination 2011-2015, Draft decision*, June 2010, page 865.

⁷ Australian Energy Regulator, *Victorian electricity network service providers, Distribution determination 2011-2015, Final decision – appendices*, October 2010, page 780.

Jemena only provided new connection charges on the basis that it was responsible for metering.

It is unclear from the other transition applications that have been made as to whether other electricity distributors have also sought to recover costs associated with new connections through the metering service charges.

The Victorian Government expects the AER to assess whether costs have been recovered twice – once from the distributors' metering customers through the metering service charge and once from the connecting customer through the new connections charge - over the entirety of the initial regulatory period, by each of the electricity distributors.

IT expenditure

During the life of the CROIC, the allocation of expenditure has been problematic with two parallel regulatory regimes – an incentive-based regulatory regime for standard control services and a cost recovery regulatory regime for metering services. There has been an incentive for the electricity distributors to recover as much expenditure as possible through the cost recovery regulatory regime for metering services. Where the expenditure had been included in the forecast revenue for standard control services, the electricity distributors were then able to recover the expenditure from their customers twice – once through metering services and once through standard control services.

This was particularly the case with IT expenditure. While the principle applied was that any expenditure on IT systems required for all customers was to be recovered through standard control services and any expenditure on IT systems required only by customers with the distributor's meter was to be recovered through metering services, the reallocation of expenditure from metering services to standard control services as part of the 2016-20 revenue determination indicates that the application of this principle to the smart meter rollout should be reviewed.

The Victorian Government accepts that the electricity distributors have, in some cases and as specified in the agreed scope of services for the smart meter rollout, recovered IT expenditure that was incurred as a direct result of the smart meter rollout through the metering services charges, despite the IT systems being required for all customers.

However, AusNet Services appears to be seeking approval of IT expenditure for a system required for all customers and which would reasonably be expected to have been recovered through standard control services charges. It has sought to recover costs associated with its Network Management System to:

- implement High Availability and Disaster Recovery
- design and validate existing market services applications
- enhance security protocols, firewalls and processes.

From the limited information provided in AusNet Services' transition charges application, it is unclear why expenditure on the Network Management System should be recovered through metering service charges when AusNet Services' customers paid for \$143.0 million (\$2010) for non network capital expenditure (largely IT) during the 2011-15 regulatory control period.⁸

⁸ Australian Energy Regulator, *Victorian electricity network service providers, Distribution determination 2011-2015, Final decision*, October 2010, page 438.

The AER needs to rigorously assess the IT expenditure sought by the electricity distributors to be satisfied that it is not expenditure that has already been paid for by customers through standard control services charges.

Customer service and project management office

AusNet Services is seeking approval of an expenditure excess of \$5.3 million in 2014 for customer service and its project management office, in addition to the approved budget of \$0.6 million, and Jemena is seeking approval of an expenditure excess of \$2.274 million (relative to a budget of \$0).

It does not appear that the other three electricity distributors are seeking an expenditure excess for customer service and project management office. The AER will therefore need to assess whether an efficient electricity distributor that had installed a mesh radio communications network should reasonably be expected to incur the level of expenditure sought by AusNet Services and Jemena for customer service and project management office in 2014.

Corporate overheads

AusNet Services is seeking approval of \$2.8 million of corporate overheads in 2014, \$1.0 million more than the approved budget, and \$2.3 million of corporate overheads in 2015, \$0.5 million more than the approved budget.

The AER must assess whether it is reasonable for AusNet Services' customers to pay more for AusNet Services' corporate overheads, or whether they have already paid for these corporate overheads through standard control services.

The corporate overheads incurred by an electricity distributor are largely fixed in aggregate. At the time of a revenue determination, the electricity distributor forecasts the proportion of these corporate overheads that may be recovered through standard control services' operating expenditure, standard control services' capital expenditure, metering services' operating expenditure and metering services' capital expenditure. For example, AusNet Services' forecast capital expenditure for the 2011-15 regulatory control period included \$189.3 million (\$2010) of corporate overheads.⁹

If all the electricity distributor's expenditure is recovered through an incentive based regulatory regime, it is largely irrelevant how the corporate overheads are actually allocated during the regulatory control period, noting that the cost allocation methodology is highly subjective and often contentious. However, where the electricity distributor is regulated under two different regulatory regimes, as occurred in 2009-15, the allocation of the corporate overhead costs is highly relevant.

The electricity distributor has an incentive to allocate as much of the corporate overheads to a cost recovery regulatory regime (the metering service cost recovery regime) as possible.

It is not sufficient for the AER to approve a higher allocation of costs to metering services on the basis that this is consistent with the approved cost allocation methodology. The AER must be satisfied that:

- the total quantum of corporate overheads incurred by the electricity distributor is efficient
- the total quantum of corporate overheads has increased relative to the forecast for the total period as a direct consequence of the AMI Program

⁹ Australian Energy Regulator, *Victorian electricity network service providers, Distribution determination 2011-2015, Final decision*, October 2010, page XXIX

- the amount of corporate overheads to be recovered through the metering services is in addition to the amount that has been paid for by the electricity distributor's customers through the standard control services.

For example, assume that the total corporate overheads incurred by AusNet Services in 2014 were \$40 million, with \$1.8 million recovered through metering service charges and \$38.2 million recovered through standard control services. If AusNet Services' total corporate overheads remain at \$40 million, but it now seeks to recover \$2.8 million through metering service charges, then it will recover \$41 million for corporate overheads - \$2.8 million through metering service charges and \$38.2 million (as forecast) through the standard control services charges. It will therefore earn additional profit of \$1.0 million. This is not a fair and reasonable outcome for AusNet Services' customers.