21 April 2016

Mr Chris Pattas
General Manager
Australian Energy Regulator

By email: AERinquiry@aer.gov.au

Dear Mr Pattas

AER preliminary framework and approach for NSW / ACT / Tas

SA Power Networks welcomes the opportunity to comment on the Australian Energy Regulator's **(AER)** preliminary framework and approach **(F&A)** papers for electricity distribution network service providers **(distributors)** in New South Wales, the Australian Capital Territory and Tasmania. Our comments are not directed to any particular jurisdiction, being broadly applicable to all distributors. In our view:

- All of a distributor's responsibilities as an initial metering coordinator **(MC)** for type 5 and 6 meters must be classified as regulated distribution services, as intended by the metering competition reforms;[1]
- The AER should commence a transparent and collaborative review and consultation process with industry on its approach to using benchmarking to assess expenditure in upcoming regulatory determinations; and
- Clarify that there are no legal separation (ring–fencing) implications for unclassified / unregulated distribution services.

Service classification—type 5 and 6 metering

The AER's intended treatment of services pertaining to type 6 (accumulation) and type 5 (manually read interval) meters needs clarification. The AER suggests that type 5 and 6 metering services should be unclassified by virtue of the metering contestability reforms, but acknowledges that distributors should still be allowed to recover the remaining capital costs of their existing type 5 and 6 meter stock via the Alternative Control Service **(ACS)** classification.[2]

Distributor responsibilities with respect to type 5 and 6 meters will be altered by virtue of the metering competition reforms.[3] In particular, distributors will cease being responsible for both replacing meters (if a type 5 or 6 meter fails), and otherwise providing new meters. Distributors must continue to recover both the capital costs of existing type 5 and 6 meters and operating costs involved in exercising ongoing responsibilities (such as meter reading and testing of existing meters), as regulated ACS, noting that:

- Distributors must be appointed by retailers, as the initial MC for type 5 and 6 meter installations. Distributors remain in this role until such a time as their meter is replaced or the retailer provides reasonable notice of its intention to replace the distributor in its capacity as an initial MC;[4] and
- The expectation reflected in the metering competition reforms for distributors undertaking the initial MC role is largely one of a maintenance of the status quo, that is, a regulated distribution service.[5]

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1 Our comments on metering are applicable to all distributors outside of Victoria. Victoria is the only National Electricity Market jurisdiction in which the start of the metering competition reforms has been deferred.

2 See for example: AER, *Preliminary framework and approach—NSW*, p.22

3 Refers to rule changes made by the AEMC on 26 November 2015 – Expanding competition in metering and related services.

4 Clause 11.86.7 of the NER.

5 The AEMC's final determination on the metering competition rule changes set out an expectation for distributor initial MC functions to continue to be regulated distribution services. AEMC, *Rule determination— National Electricity Amendment (Expanding competition in metering and related services) Rule 2015*, 26 November 2015, p.230.

Unless retailers and distributors agree to other terms and conditions, the National Electricity Rules **(NER)** require that:[6]

- prices for type 5 and 6 metering services be in accordance with Chapter 6 of the NER—therefore, distributors should be allowed to continue to recover regulatory expenditures covering not only the remaining capital costs of their existing meter stock but also any reasonably incurred operating costs.
- the scope of work required of distributors as initial MCs be consistent with the NER—therefore, distributors acting as initial MCs would no longer replace meters but would still need to read and test meters according to established procedures, in addition to other responsibilities.[7]

Classifying a distributor's initial MC responsibilities as an ACS is in keeping with the intent of the metering competition rules, and avoids creating undue ring–fencing cost impacts on distributors in undertaking these responsibilities. Distributors should not be required to functionally ring–fence (i.e. separate staff and office locations, and branding restrictions) their initial MC service, noting that:

- this is a service that will diminish in importance over time as more type 5 and 6 meters are replaced or as retailers exercise their ability to otherwise replace distributors as the initial MC;
- this is a service that is intended to be governed under a status quo approach—as reflected in the drafting of the metering competition reforms and as appears to have been intended by the AER during the AEMC's development of these reforms;[8] and
- there will be no harm to broader competition in metering. Competition going forward will focus on type 4 meters, given that any new or replaced meter must now be a type 4 meter to comply with national requirements (i.e. the minimum services specification).[9] Broader competition in metering is also safeguarded by the ability of retailers to replace distributors in their role as the initial MC.

Benchmarking

The AER's F&A papers only briefly discuss its intended application of the Expenditure Forecast Assessment Guideline, including the use of benchmarking as one of many possible assessment tools. We support using benchmarking as one of the means of assessing the efficiency of proposed expenditure. However, the AER should commence an open and transparent consultation process with industry to review its approach to deriving and applying benchmarking for the upcoming round of regulatory determinations. This review and consultation process should cover the following (as a minimum):

- <u>General approach</u>—Any required modifications to its previous approach to benchmarking arising from the outcomes of the Federal Court decision on the NSW and ACT distribution determinations. This could include:
  - what any bottom–up review of opex would involve;

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6 Clause 11.86.7(d) of the NER.

7 As an initial MC, distributors would be required to undertake the following:
(1) provision, installation and maintenance of a meter installation in accordance with Part D of Chapter 7 of the NER—provision of new meters here is limited by the fact that any new or replacement meter needs to meet the national minimum services specification which requires that any such meter be a type 4 meter and therefore does not fall under a distributor's initial MC role;
(2) except as otherwise specified in clause 7.5.1(a) of the NER, collection of meter data with respect to the meter installation, processing of that data, retention of meter data in the meter data services database and delivery of the metering data to the metering database and to other persons in accordance with Part E of Chapter 7 of the NER; and
(3) managing access to and the security of the meter installation, services provided by the meter installation, energy data held in the meter installation and meter data from the meter installation in accordance with NER Part F—Chapter 7.

8 In a submission to the AEMC's draft decision, the AER expressed a view that initial MC responsibilities on distributors would not be subject to ring–fencing and should be treated under a status quo approach to avoid customer disruption. AER, *Rule changes—expanding competition in metering and related services, AER submission to Australian Energy Market Commission draft decision*, May 2015, p.4.

9 AEMC, *Rule determination— National Electricity Amendment (Expanding competition in metering and related services) Rule 2015*, 26 November 2015, p.68.

- what additional benchmarking techniques or models might be developed and how the results of these should be weighted; and
- the scope and application of international data that may be applied to benchmarking.

- Operating environment factors **(OEFs)**—Identifying and measuring the impact of OEFs[10] that should be taken into account in the AER's benchmarking, including:
  - identifying OEFs that materially impact on the expenditure of networks;
  - collecting, and making publicly available, data on material OEFs across all networks;
  - assessing the relative impact of material OEFs across all network businesses, rather than only for networks found to be below the AER's benchmark, and (again) making the calculations public; and
  - reviewing the appropriate method for adjusting the benchmarking data or models to account for the relative impact of material OEFs.
- Consistency in expenditure capitalisation—Identifying how greater comparability in benchmarking results across distributors might be achieved. In particular, the AER should consider:
  - Collaborating with distributors to improve consistency of data collected in Regulatory Information Notices **(RINs).** We note that Energy Networks Australia is initiating a work programme to improve the consistency and quality of RIN data reported by distributors. The quality of data input to benchmarking affects comparability. Currently, there is inconsistency in some RIN data, including for key data items used for benchmarking or which may be used in future.
  - The treatment of key material emerging changes in technologies that could temporarily distort opex benchmarking outcomes. For example, we observe that a trend with respect to Information Technology systems is to switch from hardware owned by businesses toward 'cloud' solutions using servers owned by other service providers. For distributors, this would entail a switch from a capex to an opex approach and could significantly increase required opex. Distributors might migrate to these systems in a staggered manner over time, potentially distorting benchmarking comparisons at any given point in time.

Ring–fencing and unregulated services

The AER should clarify the discussion in its F&A papers which suggests that unclassified / unregulated distribution services need to be provided through a separate affiliate to the distributor.[11] This conflicts with the AER's ring–fencing guideline which provides that distributors are allowed to undertake all distribution services without any of these needing to be provided by a separate legal entity.[12]

If you wish to discuss any of our comments further, please contact Bruno Coelho on 08 8404 5676.

Yours sincerely,

Richard Sibly
A/Head of Regulation

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10 These are the factors that the AER accounts for in order to provide greater comparability across different distributors operating in their own particular environments

11 AER, *Preliminary framework and approach—NSW*, p.10.

12 Clause 3.1(b) of the AER's ring-fencing guideline. AER, *Ring-fencing guideline—electricity distribution*, November 2016.