

# AMI Budget Application 2012 – 2015

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**UNITED ENERGY**  
***Distribution***

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## Executive summary

United Energy Distribution (UED) is committed to implementing the Victorian Government's Advanced Meter Infrastructure (AMI) policy. UED supports the policy decision to replace existing accumulation meters at each customer site with a new AMI meter.

The average age of the existing meters is more than 20 years. Bringing forward the early replacement of these meters with smart meter technology will deliver tangible benefits to our customers. For example, the process of checking the wiring at the meter board has identified potentially life-threatening safety issues. Once installed, the new technology will provide better information to distributors and customers. As a result, customers will enjoy better fault detection and response times from distributors, while also having an opportunity to use Victoria's energy resources more efficiently. UED firmly believes that the benefits from the AMI roll-out will substantially outweigh the costs.

UED has established a joint program with Jemena Electricity Networks (JEN) under the management of Jemena Asset Management (JAM). The joint program involves cost sharing arrangements that deliver benefits to UED and our customers in the form of lower costs and risks. UED could not achieve these benefits under a stand-alone program and therefore UED pays a commercial margin to JAM to obtain these benefits.

The joint program has achieved the key project milestones to date. In particular, UED and JEN are the first, and presently the only distribution businesses in Victoria, operating AMI meters in the market as remotely read interval meters with daily delivery to market of the meter data. By 7 November 2010, 8 weeks ahead of schedule, UED had successfully installed 10% of AMI meters in its distribution area without a safety incident. UED regards these achievements as practical confirmation that the joint program is delivering tangible benefits to UED's customers.

Arrangements for recovering the costs of the AMI project are prescribed by the Victorian Government in the AMI Cost Recovery Order in Council (the CROIC). The CROIC requires UED to submit budget and pricing information to the Australian Energy Regulator (AER). This submission is UED's second budget application and covers the period from 1 January 2012 to 31 December 2015. It is supported by Appendix A, *Substantiation of Base Costs to Provide Regulated Services*, which has been prepared by JAM.

This budget application, together with the supporting paper prepared by JAM, reiterates and updates many of the matters addressed in UED's first budget application, dated 27 February 2009. In particular, the vast majority of UED's AMI costs are subject to the discipline of competitive tenders managed by the joint program. This competitive process, together with the economies of scale achieved through the joint program, will continue to deliver significant benefits to UED's customers during the 2012-2015 budget period. In accordance with the CROIC, this budget application only includes expenditure that falls within the scope defined by the Victorian Government and is targeted to deliver the AMI functionality and service levels specifications applying to the AMI roll-out.

Alongside this budget application, UED is also submitting a charges application, which sets out UED's initial charges for the years 2012–2015 based on actual expenditure and

revenues known to 2010, the revised forecasts for 2011 and the proposed budget for 2012–2015.

UED is confident that this budget application and the accompanying charges application comply fully with the requirements of the CROIC and should be approved by the AER.

## 1 Introduction

This section is structured as follows:

- section 1.1 provides background information on the AIMRO program;
- section 1.2 summarises UED's AIMRO obligations; and
- section 1.3 introduces the joint AIMRO program employed by UED for delivery of AMI roll-out.

### 1.1 Background

In early 2006, the Victorian Government concluded that Victorian residential and small business electricity customers would obtain substantial benefits from the roll out of advanced metering infrastructure (AMI) or 'smart meters'. UED supports this policy decision because it recognises that benefits of moving to smarter technology rather than continuing to replace out-dated accumulation meters. Smart meter technology offers many improvements, including:

- faster and more reliable meter reading;
- increased customer information, when teamed with an in-home display or web portal;
- fast and more convenient connection and reconnection;
- Automatic fault detection and faster response; and
- The prospect of more flexible electricity tariffs or pricing structures to reward customers for better managing Victoria's resources.

The AMI roll-out also provides a unique opportunity to inspect the domestic wiring at the meter board. Across Victoria approximately 3,500 homes have been found to have defective wiring that may have led to loss of life. The identification of these problems by Victorian Government-accredited installers is a tangible benefit to all Victorians from the AMI roll-out. UED believes that the benefits from replacing accumulation meters, which currently have an average age of 20 years, will substantially outweigh the costs.

The Government's Order in Council<sup>1</sup> sets out the distributors' AMI roll-out obligations. The Functionality and Service Levels Specifications Order in Council further defines a range of

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<sup>1</sup> Victorian Government Gazette (2007), Electricity Industry Act 2000 – Order under section 15A and section 46D, 28 August 2007.

requirements for the deployment of AMI, including minimum AMI functionality, performance and service levels and phasing timelines for these meters.<sup>2</sup>

The AMI roll-out requires UED to invest in new, leading-edge technology which will affect 658,000 customer sites<sup>3</sup>. The changes will affect virtually all aspects of UED's business in a compressed timeframe, including UED's communications infrastructure, information systems and business processes, roles and responsibilities. The complexity and extensive nature of these changes necessarily create risks for UED and our customers. It is essential, therefore, that UED's AMI roll out program identifies and manages risk so that UED's customers obtain the greatest benefit from the new technology now and into the future.

In 2008, the Victorian Government made a number of important changes to the regulatory and cost recovery arrangements. In particular, the amended Order in Council sets out its purpose in the following terms<sup>4</sup>:

- to provide for the setting and regulation of the prices, fees and charges that a distribution company may charge for or in connection with the costs of, or in relation to, the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems;
- to empower the recovery of those prices, fees and charges from a retailer who is a relevant licensee or a class or classes of retailers who are relevant licensees supplied electricity by the distribution company; and
- to confer powers and functions on, and leave matters to be decided by, the Essential Services Commission<sup>5</sup>.

The Victorian Government also amended the form of regulation from an incentive based approach<sup>6</sup> to a cost recovery mechanism. In particular, the following regulatory principles are now included in the Cost Recovery Order in Council (CROIC):

- There shall be no incentive based control mechanism applied. Instead there shall be a pass through of the costs of a distributor for Regulated Services.
- The regulatory economic methodology to be used by the Commission for determining those costs shall be a building block approach.

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<sup>2</sup> Department of Primary Industries (2007a) "Minimum AMI Functionality Specification – Release 1.0", October 2007, and Department of Primary Industries (2007b) "Minimum AMI Service Levels Specification – Release 1.0", October 2007.

<sup>3</sup> This is the number of customer sites - actual AMI meters required by 31 Dec 2013 will be greater than this number.

<sup>4</sup> Victorian Government Gazette (2008), Electricity Industry Act 2000 –Advanced Metering Infrastructure Order In Council, 25 November 2008, clause 1A.

<sup>5</sup> Responsibility for regulatory oversight of Victorian DNSPs generally and the AMI roll-out in particular transferred from the Essential Services Commission of Victoria (ESCV) to the AER on 1 January 2009.

<sup>6</sup> Cost recovery order under sections 15A and 46D of the Act and published in the Government Gazette on 28 August 2007, clause 4.2(a).

As explained in further detail in section 2 of this submission, the CROIC requires UED to submit a budget application which sets out UED's expenditure requirements for the period from 1 January 2012 to 31 December 2015. The responsibility for determining UED's budget for this period was transferred from the Essential Services Commission to the AER on 1 January 2009. This submission is UED's budget application for the period from 1 January 2012 to 31 December 2015 in accordance with the CROIC. It is accompanied by a charges application for the same period.

### 1.2 AIMRO obligations

UED notes that the AIMRO obligations were reviewed by the Victorian Government and the industry in 2008. UED's obligations under the CROIC are:

- to use best endeavours to install AMI meters by 31 December 2015 for all customers with annual consumption of less than 160 MWh (for which UED is the responsible person);
- to install AMI meters that meet the minimum functionality and service levels specified under the Functionality and Service Levels OIC; and
- to use best endeavours to observe the following percentages of the total number of AMI meters to be installed<sup>7</sup>:
  - by 30 June 2010 – 5 per cent;
  - by 31 December 2010 – 10 per cent;
  - by 30 June 2011 – 25 per cent
  - by 31 December 2012 – 60 per cent;
  - by 20 June 2013 – 95 per cent; and
  - by 31 December 2013 – 100 per cent.

In addition to deploying new, complex and advanced meters to replace all existing residential meters, UED is also required to:

- implement a large-scale, high-performance, two-way communications network to enable data to be transmitted to and from the meters;
- establish new business processes for the roll-out and ongoing management of the new metering environment;
- put in place processes and information systems to capture data at half hourly intervals (48 reads per meter per day);
- integrate new information systems to validate, process and store metering data;

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<sup>7</sup> Each number includes the previous percentage.



- establish new processes and systems to manage the new meter, network and systems environment and to achieve associated service obligations; and
- employ business processes to ensure that the current manual meter-reading, back-office environment and current IT systems can be efficiently and effectively operated over the four-year period in which they are being replaced by AMI.

### 1.3 Joint AIMRO program for delivery of AMI

As explained in UED's first budget application<sup>8</sup>, the scale, complexity and novelty of the AMI roll-out presents challenges to cost effective delivery of the project. As a result, UED has identified cost sharing arrangements as a means of:

- achieving a more effective and efficient project delivery through a larger, better-equipped program team; and
- realising lower costs through synergy benefits and economies of scale.

In light of the benefits available through cost sharing arrangements, UED has entered into an agreement with Jemena Asset Management (JAM) to provide a joint AMI roll-out program for UED and JEN. The objective of the joint program is to plan, develop and implement a solution to meet the businesses' AMI obligations.<sup>9</sup> The joint program has been designed to reduce risk, ensure compliance with UED's regulatory obligations and to maximise synergies as a result of delivering almost one million meters instead of developing stand-alone programs to effect the AMI roll-out for each distributor separately.

UED benefits from the sharing of costs under the joint program, and these benefits are immediately passed on to our customers. The program is described in more detail in section 4 and in Appendix A of this submission. Appendix B provides a copy of the AMI Operational Services Requirements agreement between UED and JAM.

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<sup>8</sup> United Energy, AMI Budget Application 2009 – 2011 to the Australian Energy Regulator, 28 February 2009.

<sup>9</sup> The 'AMI obligations' are established through the Cost Recovery OIC and the Functionality and Service Levels OIC and related specifications.

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## 2 AMI Regulatory framework

### 2.1 Introduction

The legal and regulatory framework for the AMI roll-out in Victoria has been clarified by the CROIC. This section provides an overview of this framework and also comments briefly on the NEM metrology procedure and the National Smart Meter project.

### 2.2 Budget and charging approval process

The CROIC prescribes the framework under which distributors will be able to recover the cost of providing metering services to customers. The CROIC explains that the regulatory model is a cost pass through arrangement whereby the charges for metering services are, in general terms, set as follows:

- (a) Charges for 2009 are set by reference to the metering charges already set by the ESC for that year.
- (b) In 2009, initial charges are set for 2010 and 2011, based on an approved budget for 2009 to 2011 and actual expenditure and revenues for 2006 to 2008.
- (c) In 2010 the initial charges for 2011 will be revised to take account of actual expenditure and revenues known for 2009 and revised forecasts for 2010 to 2011.
- (d) This process is repeated in 2011 by setting the charges to apply for the years 2012 to 2015 based on actual expenditure and revenues known to 2010, revised forecasts for 2011 and an approved budget for 2012 to 2015.
- (e) In 2012 the initial charges for 2013 will be revised to take account of actual expenditure and revenues known to 2011 and revised forecasts for the period to 2015. This process of revising charges is then repeated for 2014 and 2015 to take account of actual expenditure and revenues for 2012 and 2013 as they become known. The same process applies in years 2016 and 2017 to take account of actual expenditure and revenues for 2014 and 2015 as they become known.
- (f) The charges will be designed so that the net present value of building block costs incurred to date must always equal the net present value of revenues recovered to date unless a distributor decides (and the Commission agrees) for a particular year that it will not recover its full building block costs in which case unrecovered expenditure will be carried over to a later year. In setting charges, actual expenditure is to be used along with actual revenue or if actual figures are not available then a distributor's most recent forecasts are used.

This budget application relates to step (d) in the above description. The AER is required to assess this budget application in accordance with the provisions of the CROIC, rather than the network regulation provisions set out in Chapter 6 of the National Electricity Rules. UED obtained approval for its initial budget (step (b) above) following appeal to the Australian Competition Tribunal. In addition, the AER approved UED's proposed AMI charges in October 2010, following UED's charges application on 31 August 2010.

### 2.3 Functionality and Service Levels Specifications OIC

The Functionality and Service Levels Specifications OIC<sup>10</sup> defines the minimum meter functionality and AMI system service levels to be provided by UED.

The Functionality and Service Levels OIC were gazetted in October 2007 and updated in September 2008. This budget application is based on the updated September 2008 Functionality and Service Levels.

For the purposes of this budget application, UED assumes that the final versions of the specifications required for AIMRO will be:

- Release 1.1 of the Functionality Specification; and
- Release 1.1 of Service Levels Specification.

Should these specifications change, UED will seek recovery of any associated cost impact through the pass through mechanism in the CROIC, or through any subsequent revisions to its budget.

### 2.4 Exclusivity derogation application

On 29 January 2009, Australian Energy Market Commission finalised the *National Electricity Amendment - Victorian Jurisdictional Derogation (Advanced Metering Infrastructure Roll Out)*. This Rule change was initiated by the Victorian Government in order to obtain a jurisdictional derogation to implement the AMI roll-out project. The Rule change establishes the local Distribution Network Service Provider (i.e. the distributor) as the party responsible exclusively for small customer metrology and, in particular, for the roll-out of advanced metering infrastructure. The request for the derogation was made to support the Victorian Government's policy that smart meters be rolled out to all small electricity customers in Victoria within an accelerated timeframe.

This budget application is based on this finalised amendment in the *National Electricity Amendment - Victoria Jurisdictional Derogation (Advanced Metering Infrastructure Rollout) Rule 2009 No.2*. It is noted that this derogation is scheduled to expire by 31 December 2013 or sooner if certain amendments to the National Electricity Law and Rules are introduced. For the purposes of this budget application, UED assumes that there will be no further changes to the derogation and it remains in place until the AMI roll out is completed.

### 2.5 NEM Metrology Procedures

Parties who provide metering services in the National Electricity Market (NEM) must comply with the Metrology Procedures, made pursuant to the National Electricity Rules. Distributors, as providers of AMI systems, will be under an obligation to comply with these rules and procedures and any subsequent amendments. This budget application assumes that the existing Metrology Procedures remain unchanged.

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<sup>10</sup> Gazetted on 12 November 2007.

## 2.6 National Smart Metering Project

In parallel with the Victorian AMI roll-out program, a National Smart Metering project has been examining the costs and benefits of a national roll-out of interval meters with two way communications. This project has been conducted under the auspices of the Ministerial Council on Energy (MCE).

An important outcome from the National Smart Metering project is the smart meter initial Rule which came into effect on 1 January 2011 as Part ZF of Chapter 11 of the National Electricity Rules. The initial Rule supports the National Electricity (South Australia) (Smart Meters) Amendment Act 2009 (the Act) and implements the policy decision made by the MCE in June 2008 that electricity distribution businesses should be exclusively responsible for meter provision and meter data services for the period of a mandated smart meter roll-out in a jurisdiction.

The National Electricity Law now provides a head of power for State and Territory energy ministers to require distribution businesses to conduct pilots of smart meters or related technology, including direct load control, or to roll-out smart meters. The Act supports COAG's commitment to a staged national mandated roll-out of electricity smart meters to areas where benefits outweigh costs.

Neither the Act nor the initial Rule have any effect other than where a Minister of a particular jurisdiction makes a decision to issue a determination under the Act, and neither is intended to preclude market participants deploying smart meters in the absence of a Ministerial determination where appropriate.

UED has consistently expressed the view that it is desirable for the Victorian AMI framework (including the CROIC and the Functionality and Service Levels Specifications OIC) and the national smart meter framework to be aligned. There are substantial risks arising to Victorian and national market participants in the event of any misalignment of the frameworks.<sup>11</sup> This budget application has not allowed for any costs associated with any future re-alignment of the Victorian and National arrangements.

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<sup>11</sup> For example, from incompatibility of technology and stranding of assets.

## 3 Budget application structure and context

### 3.1 Introduction

This budget application is the second budget submission made to the AER under the CROIC. Clause 5.3 of the CROIC states:

An application must set out the information and identify the documents upon which the distributor relies. Provided that if a distributor relies on information it previously provided to the Commission for an application or a Pricing Proposal, it does not need to set out that information again in its application if the distributor identifies where that information may be found in that previous application or Pricing Proposal (as the case may be).

UED's first budget application submitted to the AER 27 Feb 2009 relied on the following submissions to the Essential Services Commission, which provided cost forecasts and supporting data:

- 24 September 2007: Response to ESC Consultation Paper No 1 (August 2007) – Framework and Approach.
- 31 December 2007: *Advanced Metering Infrastructure Pricing Proposal: Submission to the Essential Services Commission*. The pricing proposal sets out prices for the provision of Advanced Metering Infrastructure (AMI) in UED's distribution network area<sup>12</sup>.
- 25 January 2008: *Data Templates*. The information in the December 2007 pricing proposal was supplemented with data templates containing cost and volume information in the format prescribed by the ESC. Both the December 2007 pricing proposal and January 2008 templates detailed the forecast capital and operating costs of delivering AMI in line with the timelines, functionality and service levels mandated by the Victorian Government.
- 12 March 2008: *AIMRO Program: Further Information on Costs – Submission Prepared for Essential Services Commission*. This submission supplemented the December 2007 pricing proposal and the 25 January 2008 templates.
- 16 May 2008: *Response to ESC data clarification questions*. This submission provided specific responses to cost and data template questions.
- 18 June 2008: *Updated pricing proposal and Joint AMI solution and cost substantiation and supporting materials*. These submissions provided updated cost forecasts and substantiation based on request for tender results.

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<sup>12</sup> Clause 9.1(b) of the Cost Recovery OIC required Victorian Distributors to submit to the Commission their proposed prices for the provision of metering services, including AIMRO, for customers with annual electricity consumption of less than 160 MWh, by 31 December 2007.

In addition to the above information, UED's first budget application explained the rationale for UED's decision to engage JAM to manage the joint program and to pay a 6% management fee. The Australian Competition Tribunal determined that the management fee is within the scope of activities defined by the CROIC<sup>13</sup>. In accordance with clause 5.3 of the CROIC, for the purposes of this budget application, UED relies on its first budget application and the supporting documents described above in relation to any consideration by the AER as to whether:

- UED acted prudently in engaging JAM and paying a management fee;
- UED will incur expenditure that involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances; and
- the management fee payable by UED to JAM is within the scope of activities defined by the CROIC.

Notwithstanding UED's reliance on the documents noted above, for ease of reference and in order to assist the AER, this budget application also provides information relating to these matters.

### 3.2 Structure of this budget application

This budget application is provided to comply with the CROIC and with the AER's Framework and Approach paper. It includes:

- This application document;
- Appendix A – *Substantiation of base costs to provide regulated services*. This report has been prepared by JAM to provide detailed information on the joint program with JEN, including the tender process employed to procure inputs to the joint program, tender outcomes to date, cost information and detailed activities required to meet the mandated AIMRO program. It also includes cost information relating to prescribed metering services;
- Appendix B - *AMI Operational Services Requirements agreement*. This is the agreement between UED and JAM to provide the joint AIMRO program; and
- completed AER templates.

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<sup>13</sup> Australian Competition Tribunal, Application by United Energy Distribution Pty Ltd [2009] ACompT 10 (23 December 2009), paragraph 55.

## 4 Joint program

### 4.1 Benefits of the joint program

Following the Government's decision to commit to the AMI roll-out, a clear opportunity existed for UED and JEN to establish a joint AMI program that would enable both businesses to reduce the costs and risks associated with AIMRO. A joint program provides an effective way for JEN and UED to minimise costs and lessen risks because many of the program deliverables and solutions would be common. For example, program deliverables and solutions with cost sharing benefits include (but are not limited to):

- project plans/management processes;
- target IT architectures;
- target business processes;
- information systems products/vendors;
- procurement strategies; and
- deployment plans (but with some elements network dependent).

There remain some areas where each business may require separate deliverables or solutions. These have been clearly defined and scoped. In some areas, such as the implementation of IT applications, the potential for joint savings is high. In other areas, such as in the procurement and deployment of the metering infrastructure, each distributor intends to purchase separate equipment.

In light of the identified synergy benefits and the unique scale and complexity of the AMI roll-out, UED conducted lengthy negotiations with Alinta Asset Management (JAM's predecessor) to establish the joint program. The positive outcomes of these negotiations included the following:

- The terms and conditions upon which AAM will deliver the AMI roll-out are documented in detail in a purpose-designed contract, the AMI Operational Services Requirements agreement as described in further detail in sections 4.2 and 4.3 below.
- AAM structured its AMI program to enable optimal cost sharing with UED and JEN and the leverage of joint buying power.
- The agreement contains the following benefits for UED:
  - ownership of all intellectual property developed by the program;
  - complete transparency of both capital and operating costs, and these actual costs form the basis of the contract fee;
  - control over expenditure through the approval of budgets and budget variations;

- active participation by UED in the development of plans, strategies and approaches, including UED program team members and steering committee members;
- appointment of key personnel on the program that cannot be removed or redeployed by AAM without the agreement of UED; and
- the ability to terminate the agreement for non-performance.

Under the current AMI Operational Services Requirements agreement, JAM has committed to operate its AMI program for the benefit of UED.

### 4.2 Program objectives and scope

The AMI Operational Services Requirements agreement with JAM sets out the following objectives for the AMI roll-out:

- to define the services that JAM will provide (the AMI Services);
- to ensure efficient delivery of the AMI Services, safely and in accordance with the Service Standards and Performance Targets;
- to ensure compliance with all legal and regulatory obligations in relation to the AMI Services;
- to establish a governance and reporting structure to ensure full cooperation, flexibility, openness and continuous improvement in the performance of the AMI Services;
- to ensure that the AMI Services are market competitive in terms of cost and quality;
- to maintain a collaborative working relationship between the parties; and
- to set out an AMI charges model that provides value for money and cost transparency for UED.

The joint program covers the following activities:

- the selection, procurement and installation of:
  - meters
  - communications systems
- design, development, implementation and post implementation support of IT systems and infrastructure;
- participation in industry activities relating to AMI; and
- business process design, change design, planning and implementation.

Appendix A includes further details of the joint program.



### 4.3 Effective project management and governance

The AMI Operational Services Requirements agreement between UED and JAM places obligations on the parties to ensure that the project management and governance arrangements are robust. UED is currently negotiating a renewal of the agreement with JAM as the existing agreement expires with the OSA in July 2011. UED is seeking to negotiate incremental improvements to the existing agreement, although the principal terms and conditions will remain substantially unchanged. The improvements are likely to relate to matters such as contract management arrangements and the transition arrangements following the completion of the AMI roll-out in December 2013. The remainder of this section provides an overview of the key features of the existing agreement which are key to ensure the success of the joint program.

The overall relationship between UED and JAM is directed and governed by the Operations Steering Committee, which has the following responsibilities:

- defining the responsibilities and roles of UED and JAM;
- endorsing the plans and budgets submitted to it; and
- managing the flow of information between UED and JAM.

The Operations Working Group supports the Steering Committee by managing and coordinating the day-to-day relationship between UED and JAM. The Operations Working Group is the principal vehicle for addressing any operational issues relating to the AMI roll-out. Its roles and responsibilities include:

- implementing decisions and directions of the Operations Steering Committee;
- managing issues relating to the achievement of the performance targets; and
- identifying and assessing opportunities for improvements and innovations in the methods for delivering the AMI Services defined in the agreement.

The chairman of the Operations Working Group is the General Manager- CROIC Regulated Services, Cameron Dorse. As General Manager, he is responsible for:

- the day-to-day management of the AMI roll-out;
- reviewing and updating of the Service Delivery Plan and Transition Plan for endorsement by the Operations Steering Committee and approval by UED;
- implementing the directions and decisions of the Operations Steering Committee or UED;
- assembling, developing, managing and sustaining a high performance team to undertake the AMI Services defined in the agreement; and
- providing performance and other reports to the Operations Steering Committee members, and attending the Operations Steering Committee meetings.

Schedule 4, annexure 1 of the AMI Operational Services Requirements agreement defines the Service Delivery Plan. This Schedule describes how JAM plans to achieve the AMI roll-out and ensure that the appropriate project management processes and quality standards

are in place. The overarching objective of the Service Delivery Plan is to deliver the AMI roll-out in a manner that achieves:

- the level of service required to meet regulatory obligations;
- cost efficiency;
- clearly defined and effective roles and interfaces with UED;
- high quality outcomes;
- flexibility for responding to the changing business environment;
- effective mechanisms to ensure issue resolution; and
- an ability to handle ad-hoc requests from UED.

The Services Delivery Plan provides a number of project management tools and safeguards to achieve the above objectives. For example, the Service Delivery Plan addresses the following matters:

- Client relationship management, including governance arrangements, key interfaces and contacts;
- Service performance management, including key performance indicator metrics;
- Vendor management, which addresses various matters including procurement policy and sourcing strategies;
- Quality management, which references JAM's quality policy and provides for a quality plan audit to ensure that JAM maintains its accreditations in accordance with its quality policy;
- Business continuity planning, which sets out provisions relating to emergency management and disaster recovery arrangements; and
- Risk management, which explains that JAM conducts risk analysis in a way that is consistent with UED's Risk Management Policy and Framework.

It is important to emphasise that a significant component of roll-out costs will be incurred in a series of major contracts with external suppliers. In accordance with the Service Delivery Plan, an extensive and robust procurement process has been implemented to obtain the most cost effective pricing for the program. In particular, the procurement process ensures that all acquisitions accord with best-practice probity requirements and minimise program costs and exposure to the risk of delays in AMI delivery. Major features of the arrangements are:

- transparent procedures to deliver optimal outcomes, including considerations of costs, compliance and delivery risk, from supplier selection of AMI technology, AMI workforce and business systems and delivery of related services;
- balanced use of multiple suppliers and period contracts for AMI technology, based on the results of the AMI selection and procurement trials to reduce contractual risk exposure;

- use of systems integrators and delivery partners who have AMI experience and are recognised centres of excellence for delivering the given product or service; and
- application of periodic payment schedules for all suppliers based on acceptance criteria to minimise vendor delivery risk.

UED considers that the procurement process and the contractual arrangements described above are consistent with the requirements of the CROIC. In particular, a substantial majority of the costs of the AMI roll-out is subject to competitive tender. The contract costs that arise from the AMI Operational Services Requirements agreement between UED and JAM are consistent with the CROIC, which requires that such costs should reflect “the commercial standard that a reasonable business would exercise in the circumstances”. As explained in the following section, the effectiveness of the joint program and the project management arrangements that have been put in place is reflected in the program’s achievements to date. The next section provides an overview of these achievements.

#### 4.4 Satisfying the AMI milestones

As explained in further detail in Appendix A of this budget application, the joint program has achieved a number of significant milestones during the current budget period. In particular:

- **The roll out targets have been achieved.** By 7 November 2010, 8 weeks ahead of schedule, JAM had successfully installed 10% of AMI meters. By 17 January 2010, 98,192 AMI Meters had been installed on behalf of UED; representing 15.3% of UED’s meter base. The program is therefore on schedule to roll-out 25% by June 2011.
- **Prudent technology selection demonstrated.** UED and JEN are the first, and presently the only distribution businesses in Victoria, operating AMI meters in the market as remotely read interval meters with daily delivery to market of the meter data.
- **Effective preparations completed.** Efficient and effective technology investigations and trials informed the selection and procurement processes. Effective programs and project plans were developed and implemented to manage the design and delivery of the AMI solution and the capital works program, and to manage associated AMI delivery risks and issues. A sound conceptual design guided the development and implementation of the AMI technology and supporting IT systems and infrastructure.
- **Competitive tenders conducted.** JAM conducted competitive tenders to contract for the provision of:
  - AMI communications technology and associated management systems;
  - AMI meter providers;
  - Installation services;
  - IT system and infrastructure integrators;

- IT hardware and high availability infrastructure required to meet AMI performance and service level obligations;
- Back office IT systems to support business processes required to meet AMI obligations; and
- Production IT Data Centre and Disaster Recovery Data Centre.

The initiatives described above have enabled UED to ensure that the AMI roll-out achieves the planned outcomes whilst minimising risks to UED and our customers. The table below summarises the achievements of the joint program against the AMI roll-out obligations.

**Table 1 – Project delivery against AMI roll-out obligations**

Date	Milestones	Status
Dec 2008	Signing of contracts with AMI technology providers	Achieved
	Signing of contracts with IT and System Integrators	Achieved
Sept 2009	Commence rollout of AMI meters and communications equipment	Achieved
April 2010	AEMO accreditation for new AMI solution	Achieved
June 2010	Production Go-live of full AMI solution	Achieved
June 2010	5% AMI meters installed and operating as remotely read interval meters in market	Achieved (22 July 2010)
Dec 2010	10% AMI meters installed and operating as remotely read interval meters in market	Achieved (7 Nov 2010)
June 2011	25% AMI meters installed	On schedule
June 2012	60% AMI meters installed	On schedule
May 2013	AMI meter rollout complete	On schedule

It is noted that whilst the June 2010 target date slipped to 22 July 2010, the joint program achieved the December 2010 target by early November. UED regards the early delivery of the AMI roll-out against the December target as an indication that the joint program is performing well. As noted earlier, UED is on track to meet the June 2011 target of 25% of meters installed.

## 5 Submitted Budget

### 5.1 Introduction

This chapter sets UED’s Submitted Budget, and is structured as follows:

- Section 5.2 presents a summary of the Submitted Budget.
- Section 5.3 provides details of the Submitted Budget, and cross reference to Appendix A, which substantiates the costs of the services provided by JAM under the AMI Operational Services Requirements agreement.
- Section 5.4 provides further substantiation of governance and insurance costs incurred by UED in relation to its AMI roll-out obligations, which are outside the scope of the Operational Services Requirements agreement (but within the scope of the CROIC).
- Section 5.5 provides further substantiation of the costs of raising equity to finance UED’s AMI roll-out program. These costs are also outside the scope of the Operational Services Requirements agreement (but within the scope of the CROIC).
- Section 5.6 sets out UED’s metering installation number forecasts.
- Section 5.7 sets out the three key changes to the program in this forth coming budget period when compared to the current budget period.

### 5.2 Application Amount

The Submitted Budget for this AMI budget period (“the subsequent AMI budget period”) is set out in Table 2.

**Table 2 – Submitted Budget for this AMI budget period**

Year	\$M – Real 2011
2012	134.2
2013	45.0
2014	32.4
2015	32.2
<b>Total</b>	<b>243.8</b>

### 5.3 Application Detail

Table 3 below:

- sets out expenditure for Regulated Services for each year of the subsequent AMI budget period;

- sets out the total operating and capital expenditure for that period; and
- distinguishes between capital expenditure and maintenance and operating expenditure.

Further details of cost information can be found in the templates, included as part of this submission.

**Table 3 – Details of Submitted Budget for this AMI budget period - \$M Real 2011**

Description	2012	2013	2014	2015	Total
<b>Capital expenditure</b>					
- Meters (Mass Rollout)	58.2	5.9	-	-	64.1
- Installation (Mass Rollout)	21.7	3.3	-	-	25.0
- New Connections, Adds and Alts	7.6	5.7	5.9	5.8	25.0
- AMI Technology and Communications	5.9	3.7	0.7	0.9	11.2
- IT Infrastructure and Systems	10.8	2.3	3.8	3.4	20.3
- Projects (AMI Phase 6)	-	-	-	-	
MRO Back Office	1.7	0.5	-	-	2.2
<b>Total Capex</b>	<b>105.9</b>	<b>21.4</b>	<b>10.4</b>	<b>10.1</b>	<b>147.8</b>
<b>Maintenance and operating expenditure</b>					
- Asset Strategy and Planning	1.7	1.7	1.8	1.8	7.0
- Asset Operations	1.1	1.1	1.5	1.6	5.3
- Customer Contact and Back Office	3.8	2.7	2.6	2.7	11.8
- AMI Network Operations	1.0	1.0	1.1	1.1	4.2
- Meter Data Collection	1.1	0.2	0.0	-	1.3
- AMI Transitional Business Activities	2.0	0.5	-	-	2.5
AMI Back haul Communications	0.5	0.5	0.5	0.5	2.0
Management	0.7	0.8	0.8	0.8	3.1
Finance and HR	0.7	0.6	0.6	0.6	2.5
Service Delivery and Contract Management	1.0	1.0	0.9	0.9	3.8
Stakeholder Relations	0.2	0.2	0.2	0.2	0.8
Premises	0.5	0.5	0.5	0.5	2.0
AMI IT	14.0	12.8	11.5	11.5	49.8
<b>Total Opex</b>	<b>28.3</b>	<b>23.6</b>	<b>22.0</b>	<b>22.2</b>	<b>96.1</b>
<b>Total Opex and Capex</b>	<b>134.2</b>	<b>45.0</b>	<b>32.4</b>	<b>32.2</b>	<b>243.9</b>

Further supporting information is provided in the remainder of this budget application, including Appendix A, and the various appendices and the templates also provided.

Table 4 below provides cross-references to the forecast information contained in Appendix A. This application also includes an excel spreadsheet that provides a reconciliation of forecast costs between Appendix A and Table 3 above.

**Table 4 – Cross references to detailed forecast information**

Description	Appendix A reference
<b>Capital expenditure</b>	
- AMI technology	Referenced in Chapter 11
- AMI IT	Referenced in Chapter 13
- AMI installation services	Referenced in chapter 11
- AMI program management	Referenced in Chapter 2
- AMI business and industry transition	Referenced in Chapter 12
<b>Maintenance and operating expenditure</b>	
- AMI IT	Referenced in Chapter 13
- Operational costs	Referenced in Chapter 12
- Communications	Referenced in Chapter 12
- Governance	Referenced in Section 5.4

Section 6 of this budget application discusses the tests for approval of the Submitted Budget.

### 5.4 Governance

In addition to the operating expenditure incurred through the joint program, UED incurs additional costs that relate directly to its AMI roll-out obligations. These include:

- legal fees incurred in negotiating and managing the AMI services agreement with JAM;
- legal fees (Mallesons Stephen Jaques) to independently review contracts between JAM, UED and end suppliers;
- management of UED’s rights and obligations under the agreement with JAM;
- annual preparation and audit of the charges applications;
- preparation of budget applications; and
- independent advice on the technical solution and regulatory framework.

These activities are reasonably required for the provision of Regulated Services and to comply with a metering regulatory obligation or requirement. They are listed as within scope (see Schedule 2, 2.1(b)(2)(xi) and (xiii) of the CROIC)



The expenditure relating to these activities will be incurred in the management of UED's corporate activity and UED's expenditure on these activities is consistent with the commercial standard that a reasonable business would exercise in the circumstances. This expenditure relates to resources that have specialist capability or knowledge and a familiarity with the UED business. Engaging such resources avoids the need for other service providers to 'come up to speed' with the businesses working arrangements and priorities. For example Mallesons Stephen Jacques are long-standing solicitors to UED in relation to contracting and intellectual property matters and Ernst Young are UED's auditors and they will be engaged to undertake the audit of any charges applications.

### 5.5 Meter numbers

This section sets out UED's metering installation number forecasts for the 2012 to 2015 roll-out and demonstrates how these reconcile to current meter numbers. Meter numbers are a key driver of AIMRO program costs as well as the units upon which revenue is forecast (i.e. the unit against which metering charges will be levied).

UED has established its meter customer number forecasts based on:

- the current stock of meters by type; and
- forecast net customer growth.

UED's forecast metering customer numbers are provided below.

**Table 5: UED installation profile**

Meter Type	2012	2013	2014	2015	Total
<b>AMI Meters</b>					
Single Phase	110,266	23,676	10,276	10,276	154,494
Single Phase Off-peak	113,218	5,959	280	280	119,737
Three Phase	58,603	4,845	3,680	3,680	70,808
<b>Total AMI Meters</b>	<b>282,087</b>	<b>34,480</b>	<b>14,236</b>	<b>14,236</b>	<b>345,039</b>
<b>Accumulation Meters</b>					
Single Phase	0	0	0	0	0
Single Phase Off-peak	0	0	0	0	0
Three Phase Direct Connected	0	0	0	0	0
Three Phase CT Connected	0	0	0	0	0
<b>Total Accumulation Meters</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Meters</b>	<b>282,087</b>	<b>34,480</b>	<b>14,236</b>	<b>14,236</b>	<b>345,039</b>

To deliver AMI meters in line with its working assumption, the joint program has developed a mass AMI roll-out plan which includes the following elements:

- meter replacements for existing manually read meters (i.e. accelerated replacements);
- meter replacements for faulty meters; and
- AMI meter installations for new connections.

### 5.6 Differences to current program

UED has approved two key initiatives that are included in the forecasts presented earlier in this section. These are:

- Two element metering; and
- Customer trials.

These initiatives are explained in appendix A however further details are provided in the remainder of this section.

#### 5.6.1 Two element metering

Two element metering is required for those customers that have electric hot water and/or slab heating. Electric hot water and slab heating appliances are wired directly to the 2<sup>nd</sup> element of the meter and this enables these customers to take advantage of off peak pricing during specified time periods.

UED has approximately 130,000 sites where there is existing two element metering. The company's original plan was to replace this type of metering installation with a single element AMI meter and transfer those customers onto a time of use pricing structure. This would enable all appliances in the household to receive an off peak energy rate during the specified periods rather than be limited to hot water and/or slab heating.

There is currently a moratorium in place whereby UED (and all Victorian distributors) are not able to mandate a change to time of use pricing. Therefore UED is unable to support the existing pricing structure of a customer that has a two element meter with a single element AMI meter. During the moratorium UED has avoided two element metering customers and therefore not replaced these types of metering arrangements.

To date UED has been able to continue to meet its requirements under the CROIC to install the required number meters, however the ability for UED to meet its statutory requirements under the CROIC will be placed at jeopardy unless:

- The moratorium is lifted and UED is able to mandate a tariff change; or
- UED installs two element metering at sites where there is already this type of installation in place.

Unless the moratorium is lifted the only way that UED will be able to meet its statutory requirements under the CROIC will be to install two element metering. At this stage UED does not believe that the moratorium will be lifted and has therefore forecast some additional costs for the provision of two element metering.

Therefore UED will not be able to mandate time of use pricing however customers can still choose to have time of use pricing based on their own assessment of benefits. In these cases UED will install a single element AMI meter.

### 5.6.2 Customer trials

During the next budget period UED will have completed the roll out of meters and will at stage where customers will be able to access benefits of the program. Some of those benefits will be only accessible in conjunction with other technology. This technology includes (but not limited to) home area network, in home display, wireless communications etc. UED is committed to realising the full benefits of the AMI program and trialling technology that will deliver the benefits. More details of proposed trials are contained in appendix A.

### 5.7 Other benefits of AMI

The installation of AMI meters will enable other system wide benefits that will not be funded by the AMI program. These include:

- Better safety programs through the use of neutral screen testing (NST) at the meter
- Better response times
- Free remote reading if data is required the next day or nominal charge is re-wired immediately
- Remote connection and disconnection
- Better fault management

For example, funded outside of the program , but leveraging AMI technology is a project to install safety testing at each customer site. UED is working collaboratively with suppliers and other technical experts to develop safety firmware that can be installed in each meter that will automatically detect safety issues. This technology is available only with AMI meters and is another tangible benefit of the program. Although this device is not part of the AMI scope, UED is committed to improved customer safety and is funding this project outside of the program. It is an exciting technological advancement that is expected to be trialled during 2011 and following successful trails will be installed in all new meters in 2012 and retrofitted to all existing AMI meters by the end of 2015.

These benefits and more can only be achieved through the use of AMI technology. These initiatives will be funded by UED outside of the AMI charges and be implemented over the course of the next five years.

## 6 Reconciliation of forecast costs

As detailed in section 3 of this submission UED has made numerous submissions to both the ESC and AER in relation to forecasting expenditures for the AMI program. The submission made to the ESC on 31 December 2007 that provided a full forecast of capital and operating costs over the entire roll-out period (noting that at that stage the roll-out was due to be completed in 2012 rather than 2013). The tables below provide a reconciliation of actual expenditure incurred to date and forecasts up to 2013 and compares them to the company's "original" forecast.

**Table 6: Capital forecast comparison**

\$M Real 2011	Dec 2007 Submission	February 2011 Submission
Total Capital Expenditure	\$443.6	\$376.0

**Table 7: Operating and maintenance forecast comparison**

\$M Real 2011	Dec 2007 Submission	February 2011 Submission
Average Operating Expenditure (per annum)	\$25.9	\$24.1

Notably the current forecast of the program is within the forecast provided earlier in the submission. This difference can be attributed to better economic conditions now (i.e. the favourable exchange rate) and the project management of the joint program with the ability to achieve synergies and cost savings compared to earlier forecasts. The reconciliation demonstrates the efficiency and prudence of the program over the course of the roll out period. Customers can be satisfied that the joint program has delivered an optimal outcome.

## 7 Approval Process for UED's Submitted Budget

### 7.1 Overview of relevant CROIC provisions

The CROIC includes requirements regarding the scope and content of a budget application (set out in Section 5B - Budget Application), and the process that the AER must adopt in reviewing it (set out in Section 5C – Budget Determination). This chapter addresses particular aspects of the Budget Determination provisions, and explains how these provisions should be applied to this budget application.

Clause 5C.2 of the CROIC requires that the AER must approve the Submitted Budget unless the AER establishes that the expenditure (or part thereof):

- (a) is for activities outside scope at the time of commitment to that expenditure and at the time of the determination; or
- (b) is not prudent.

Clause 5C.3 states that expenditure is prudent and must be approved:

- (a) where that expenditure is a contract cost, unless the AER establishes that the contract was not let in accordance with a competitive tender process; or
- (b) where that expenditure:
  - (i) is not a contract cost; or
  - (ii) is a contract cost and the AER establishes that the contract was not let in accordance with a competitive tender process,

unless the AER establishes that:

- (iii) it is more likely than not that the expenditure will not be incurred; or
- (iv) the expenditure will be incurred but incurring the expenditure involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

It is evident from the above provisions that the AER's review of a budget application is a two-step process:

- The first step is for the AER to consider if it can establish that an activity is outside scope at the relevant times; and

- The second step is for the AER to consider if it can establish that expenditure (or part thereof) is not prudent. The considerations that are relevant to this determination are defined clearly in the various sub-paragraphs of clause 5C.3, as noted above.

The remainder of this chapter comments on this two-step process as it applies to this budget application.

## 7.2 Are the budget activities within scope?

As noted above, the first step in the AER's examination of this budget application is to consider if it can establish that an activity is outside scope. Scope is defined in the CROIC to mean the scope of activities:

- (a) set out in Schedule 2 of the Order in Council; or
- (b) published pursuant to clause 14B

as amended from time to time.

Currently only part (a) of the above definition sets out the activities that are within scope. In essence, activities within scope are those activities reasonably required for the provision of Regulated Services and to comply with a metering regulatory obligation or requirement. Schedule 2, Part 1 of the CROIC lists inclusively the activities that are within scope for UED.

It is not up to UED to demonstrate that an activity is reasonably required for the provision of Regulated Services and to comply with a metering regulatory obligation or requirement or that it is within the list set out in the Schedule. It is for the AER to establish that an activity is not so reasonably required<sup>14</sup>. An activity not on the list may still be reasonably required<sup>15</sup>. Nevertheless, UED makes the following comments.

The activities to be undertaken by the joint program under contract from UED for the provision of Regulated Services is discussed in Appendix A of this budget application and identified in the supporting templates. As explained in section 4 of this submission, the joint program was developed to meet the regulatory requirements of the AMI roll-out.

As AMI is rolled out progressively over a number of years, during the program delivery phase UED must continue to incur costs associated with business as usual metering. UED will also incur direct costs associated with the governance and management of the joint program and to comply with its metering regulatory obligations. Schedule 2, Part 1 of the CROIC clearly defines all of these activities as being within scope as discussed in Appendix A and sections 5.3 and 5.4 above. UED's Submitted Budget in section 5 of this budget

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<sup>14</sup> As the AER acknowledges at page 27 F & A.

<sup>15</sup> Ibid.

application therefore also only relates to activities that fall within the scope of the CROIC as that expenditure relates to joint program activities, including business as usual metering, and direct costs to manage the AMI roll-out.

UED has explained that significant effort is being committed to the effective governance and management of the joint program. To illustrate that these activities are within scope, it is useful to identify the relevant activities specified in Schedule 2, Part 1 of the CROIC:

- participation in State and national industry activities relating to industry co-ordination, industry governance and developing related cross industry material;
- planning, program and project management, and administration;
- procurement, contract and supplier management;
- audits and quality assurance;
- obtaining expert advice and external surveys using independent consultants;
- contractors and system integrators including necessary facilities, administration, travel and accommodation;
- legal and regulatory, including budget, charges and fees application processes; and
- insurances and warranties;

The CROIC also specifically includes the following activities as being within scope:

- program financing, including obtaining business approvals and funding, raising debt and/or equity finance, foreign exchange hedging, interest rate hedging, treasury and administration, business case development and financial, technical, legal and regulatory, due diligence reports; and
- executive and corporate office services.

In light of the above provisions, it is evident that the joint program, UED's governance and management of the joint program and the business as usual metering activities all clearly fall within the scope of activities described by the CROIC. UED notes that the AER's determination in relation to its initial budget application accepted UED's submission in relation to scope, with the exception of the treatment of the margin paid to JAM. This matter is discussed in further detail in section 6.5.

### 7.3 Is the Budget expenditure prudent?

Section 4 of this budget application provides details of the governance and project management arrangements negotiated in the agreement between UED and JAM. It explains that these arrangements provide substantial benefits to UED in terms of project risk management and cost minimisation, especially in relation to:

- project plans and project management processes;
- target IT architectures;

- target business processes;
- information systems products/vendors, and procurement strategies; and
- deployment plans.

Prior to establishing the joint program and cost sharing arrangements, the UED board recognised that the AMI roll-out was a significant risk for the business. AIMRO is an innovative project involving the development, installation and operation of cutting-edge metering and communications technology on a very large scale in a very short time. Board members had personal experiences of large new technology IT projects and the strong likelihood of overruns - in terms of time and budgets - in relation to such projects. The Board considered the risks associated with the AMI roll-out to be serious and significant, and it wanted to be assured that appropriate project management arrangements were in place.

Following the Victorian Government's decision to mandate the AMI roll-out in July 2006, UED recognised that it involved a new project-based activity that it had never performed in house and so it did not have the immediate capability to deliver the project in house. UED examined its existing OSA with AAM and considered whether alternative arrangements would better meet the requirements of the business regarding AIMRO. UED recognised that clause 13 of the OSA would provide AAM with a gross margin<sup>16</sup> in addition to the incremental costs of delivering the AIMRO project. Whilst AAM would provide management expertise in return for the gross margin UED wanted to ensure that the payment of a margin reflected a reasonable commercial decision in the circumstances at that time.

Having considered the availability of other options and its legal position, UED concluded that the OSA arrangement, including the payment of a margin, would provide the best project outcomes on the condition that appropriate project management arrangements could be established with AAM. As explained in this budget application, suitable project management arrangements were established following extensive negotiations between UED and AAM (and subsequently JAM), which provided UED with further confidence in relation to the effective and efficient management of project risks and costs.

Importantly from UED's perspective, the negotiation of the agreement with JAM resulted in UED maintaining a considerable degree of control over the program budget. In particular, UED has access to sufficient information in order to satisfy itself that the budget and all invoices are able to be substantiated fully. As indicated in section 4 of this budget application, UED regards the milestones delivered by the joint program as vindicating its decision to adopt the joint program solution, rather than expose customers to the higher costs and risks that were likely to result from the internal provision of services.

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<sup>16</sup> The gross margin covers general management involvement/oversight, other overheads and profit



The governance arrangements for the joint program, its contractual obligations to make payments and UED's active role in reviewing cost estimates provides strong assurance that the expenditure outlined in this budget application is likely to be incurred. In terms of the CROIC provisions, UED fully expects that the AER will not be able to establish the requirements of 5C.3(b)(iii).

Where a contract has not been let in accordance with a competitive tender process, clause 5C.3(b)(iv) of the CROIC states that the AER must approve the expenditure unless the AER establishes that:

“the expenditure will be incurred but incurring the expenditure involves a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.”

UED notes that Appendix A to this budget application explains that the vast majority of the joint program costs will be subject to a competitive tender process. As discussed in this budget application, it is this tendering process - undertaken within the context of the joint program - that will deliver substantial benefits to UED in terms of economies of scale; reduced contract selection and management costs; and lower project risks.

Notwithstanding the extensive tendering undertaken by the joint program, UED notes that some expenditure in relation to the joint program also arises from a contract between itself and JAM that was not let in accordance with a competitive tender process. UED's initial budget application examined in detail the rationale for entering into the agreement with AAM (and subsequently JAM). In that submission, UED noted that its December 2007 pricing proposal to the ESC (section 7.2.3) examined alternatives to the AAM joint program on the following basis:

- UED undertakes the project on a stand-alone basis with AAM; or
- UED undertakes the project 'in-house'.

UED's analysis indicated that the likely cost outcomes from the joint program would deliver substantial savings compared to the next best alternative options available to UED. UED updated this cost comparison for the purposes of its initial budget application, which confirmed the findings presented to the ESC. For the purposes of this budget application, UED relies on these earlier submissions. In addition, UED notes that the program is on track to satisfy UED's AMI obligations and UED's costs to date are consistent with UED's initial budget application. In light of these observations, UED maintains its view that the joint program represented the best available terms to UED.

UED also notes that its initial budget application referred to a report from an independent expert from Ferrier Hodgson Forensics Pty Ltd (Ferrier Hodgson Forensics), regarding the

reasonableness of the gross margin<sup>17</sup>. Greg Meredith is a forensic accountant with Ferrier Hodgson Forensics. Mr. Meredith found that the gross margin paid by UED was comfortably within the range of gross margins that would be reasonable and efficient for AAM to receive for provision of its services in respect of the roll-out of advanced interval metering.

UED's initial budget application noted that Mr Meredith's comments provided further support for UED's view that the contract with AAM (now JAM) does not reflect a substantial departure from the commercial standard that a reasonable business would exercise in UED's circumstances. For the purposes of this budget application, UED relies on the earlier submissions provided by UED to the AER including the expert opinion of Mr Meredith. UED notes that the Australian Competition Tribunal concluded that<sup>18</sup> 'so long as the third party is performing activities within scope, then the profit margin payable to the third party is a cost for those activities within scope.'

UED also notes that it is currently negotiating a renewal of the agreement with JAM as the existing agreement expires with the OSA in July 2011. UED does not regard the renewal of this agreement as a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances. In particular, it would be imprudent to discontinue the joint program with JAM as such action would expose UED and its customers to unacceptably high risks of non-compliance and cost increases. UED therefore considers that a continuation of the principal terms and conditions in the existing agreement with JAM is the most appropriate course of action.

### 7.4 Concluding comments

The CROIC defines the AER's budget determination process and the approach that the AER must adopt in either approving or rejecting the budget application. In this chapter, UED has explained that the Submitted Budget in this budget application reflects activities that are within the scope defined by the CROIC.

UED has also explained that the expenditure presented in this budget application should be regarded as prudent. In particular, the majority of the expenditure is subject to competitive tender processes. Where costs arise in relation to the agreement between UED and JAM that was not subject to competitive tender, UED has demonstrated that the expenditure will also be prudently incurred. In the terminology adopted by the CROIC, UED's likely expenditure does not involve a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances.

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<sup>17</sup> See UED's Updated Pricing Proposal to the Essential Services Commission, 18<sup>th</sup> June 2008, pages 35-36.

<sup>18</sup> Australian Competition Tribunal, Application by United Energy Distribution Pty Ltd [2009] ACompT 10 (23 December 2009), paragraph 55.

UED would be pleased to provide the AER with any further information that it considers necessary in relation to the budget determination process set out in the CROIC.

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**APPENDIX A: Substantiation of Base Costs to Provide Regulated Services**

**APPENDIX B: AMI Operational Service Requirements (SRA). This is the agreement between UED and JAM to provide the joint program**

**AER Templates and reconciliation of forecast cost information**