

27 March 2015



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Submission on the Proposed Alternative Approach to the Recovery of Residual Metering Capital Costs

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Australian Energy Regulator's ("AER") consultation paper, *Alternative approach to the recovery of the residual metering capital costs through an alternative control services annual charge*, dated March 2015.
2. This submission pertains to the regulatory proposals of electricity distributors in NSW, ACT, Queensland and South Australia, and decisions made by the AER, so far, in relation to these proposals for the next regulatory control period.
3. We believe **Option 2** would better promote the policy objective of expanding competition in metering services, and deliver more significant and timely benefits to consumers in the National Electricity Market ("NEM"). We discuss our position below; however, the full impact on the unbundled fees needs to be understood.
4. No part of this submission is confidential and we are happy for it to be made publicly available.
5. Vector's contact person for this submission is:

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Alternative recovery options for residual capital costs

6. We reiterate our support for mechanisms that remove exit fees for the replacement of type 5 and 6 ("legacy") meters with smart meters for the next regulatory control period. Exit fees create a barrier to market entry that is likely to frustrate the policy objective of expanding competition in metering services in the NEM.
7. While we oppose exit fees, we recognise that distributors should be allowed to recover the cost of their efficient regulated investment, i.e. residual capital costs of their legacy metering assets.
8. We therefore support the AER's consideration of options that would not impose exit fees, where previously considered options, even if more desirable, are not found to be implementable.
9. In our view, **Option 2** (as presented in the consultation paper) more closely represents the AER's Draft Decisions for NSW and ACT electricity distribution, released in November 2014.
10. We believe that Option 1, which will result in a bigger unavoidable annual charge compared to Option 2, will have a materially adverse impact on new and potential entrants. It puts potential entrants to the metering market at a cost disadvantage, making entering this market prohibitively challenging, if not impossible.
11. We are of this view because it seems to us that Option 1 will increase costs and therefore prices for consumers who switch to smart meters (i.e. we expect that the unbundled service fee would increase). If consumers face this increased price, they are unlikely to switch to a smart meter. If, instead, metering service providers would need to reduce their own charges in order to ensure overall prices to consumers who switch do not increase, this would make the metering service business unviable and the market unattractive to potential entrants.
12. While Option 2 is administratively more complex than Option 1, we note that Option 2 is effectively similar to the AER's Draft Decision for NSW and ACT which proposed to shift the residual capital costs to Standard Control Services. It therefore does not involve significant additional costs compared to what was previously proposed.
13. To enable us to make an informed and more definitive response on the two options provided, the avoidable annual charge needs to be represented by a 'real number'. The example in the consultation paper does not provide sufficient information that would enable us to assess each option's overall impact on the unbundled services fee. (While we understand the time constraints the AER is facing, we consider a 5-day consultation on a very critical issue to be unreasonable.)
14. For clarity, Vector is not suggesting that the unbundled pricing representations should be changed. These have been published for some time now and the

assumptions we have been using in our commercial planning are based on this information. We **recommend** that the AER make no further changes to this information to ensure certainty and confidence in the regulatory system.

15. While Option 2 may be administratively more complex and involve more cross subsidy towards churned customers, it provides much stronger switching incentives to smart meters. This would hasten the uptake of more innovative services such as price reflective tariffs, which benefit consumers and promote “demand side participation” in the electricity sector. As the AER’s Draft Decision on NSW distribution itself states:

...[a]ny concern with residual cross subsidies is mitigated by the fact that there are likely to be collective benefits from switching to advanced metering technologies such as better demand side participation which may help lower overall network costs for all customers.¹

16. In our view, an option that promotes ‘dynamic efficiency’ (where innovation and investment incentives are sustained over time) over short-term costs is consistent with promoting market competition for the long-term benefit of consumers. It is consistent with the Government’s competition and efficiency objectives for the electricity sector, including promoting demand side participation in the NEM.

17. The New Zealand Commerce Commission recognises the primary importance of considering innovation in assessing regulatory trade-offs:

...where a tension exists between short-term allocative efficiency and long-term dynamic efficiency, the Commission will give greater weight to the latter...**Ongoing innovation and efficient investment over time can deliver significant long-term benefits to end-users, and the adverse consequences of deterring or delaying such investment may be substantial.**² [emphasis added]

18. The AER’s Draft Decision on NSW distribution further states that:

...on balance, we prefer to err on the side of faster entry rather than too low entry...We make this decision on the basis that it is the clear intent of policy makers to see a competitive metering market develop in the NEM. We also consider that it will help further the NEO because advanced metering solutions

¹<http://www.aer.gov.au/sites/default/files/AER%20E2%80%93%20Draft%20decision%20Ausgrid%20distribution%20determination%20E2%80%93%20Attachment%2016%20E2%80%93%20Alternative%20control%20services%20E2%80%93%20November%202014.pdf>, Attachment 16, page 16-47

² Commerce Commission (2009). *Discussion Paper on Guide to Regulatory Decision Making for the Telecommunications Sector*, Wellington, <http://www.comcom.govt.nz/regulated-industries/telecommunications/archive/guide-to-regulatory-decision-making-for-the-telecommunications-sector-archive/>, pages 27-28

facilitate the move towards cost reflective tariffs which are fundamental to achieve efficient use of and investment in distribution networks.³

Administration fees

19. While the consultation paper focuses on the recovery of residual capital costs, we reiterate that administration fees proposed by distributors would also create a barrier to market entry and could frustrate the timely transition to smart metering, in a similar manner as exit fees.
20. Given the considerable uptake of solar technology in Australia, with “mainly rooftop PV with solar panels now on more than 1.2 million roofs”,⁴ it is not unreasonable to assume that distributors already process a large volume of meter replacements. This is therefore likely to be a mature process that does not require the establishment of systems at material costs.
21. Further, we understand that while some distributors in Victoria required their legacy metering assets to be removed, others left it to their Field Service Providers to responsibly recycle the displaced assets. The proceeds from recycling were then used to offset disposal costs. We consider this to be a very efficient process for the proposed competitive metering market, especially for aged type 6 meters. We acknowledge that type 5 meters will need to be returned and read, but we expect the competitive market to also deliver innovative solutions in relation to these meters.
22. For the reasons stated above, we therefore believe that the administration costs of switching to a smart meter would be immaterial, and **recommend** that the AER take into account existing and potential market solutions in making its decision on administration fees.

Transitional arrangements

23. The shifting of the residual cost to Alternative Control Services (“ACS”) will make the residual costs of the legacy metering assets much more transparent to market participants.
24. We **recommend** that the AER treat the new ACS charge as a transitional arrangement with the object of removing it within two regulatory control periods (10 years).

³<http://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20decision%20Ausgrid%20distribution%20determination%20%E2%80%93%20Attachment%2016%20%E2%80%93%20%20Alternative%20control%20services%20%E2%80%93%20November%202014.pdf>, Attachment 16, page 16-47

⁴ http://ewp.industry.gov.au/files/egp/energy_green_paper.pdf, page 29

25. We noted in our previous submissions to the AER that some distributors are willing to accelerate the depreciation of their type 5 and 6 metering assets. For example, Essential Energy earlier “propose[d] to recover the metering services asset base over an accelerated period of 5 years (as opposed to the 6.1 year remaining life in the standard control service PTRM)”.⁵
26. Endeavour Energy also “propose[d] to recover [its] asset base over an accelerated period of 5 years (as opposed to the 23 year remaining life in the standard control service PTRM)” to “help facilitate contestability in the market and avoid the need for exit fees in the long term”.⁶
27. Endeavour Energy stated that it “undertook sensitivity analysis to ensure that the accelerated recovery of these costs would not be overly burdensome to customers. Due to the small existing regulatory asset base value, the impact of changing the remaining life to 5 years within the AER’s PTRM was approximately \$1 per bill per customer”.⁷
28. In New Zealand, where smart metering is not a regulated service, we are accelerating the depreciation of our legacy metering asset base. We are required by the Electricity Authority to certify our assets by the end of 2015. We have successfully deployed more than 875,000 smart meters nationwide in recent years without additional cost to our customers.
29. We also **recommend** that the residual value of the legacy metering assets be ‘frozen’ at the time of its determination. At that time, electricity networks are aware they are making the investment in metering in the context of the market reforms and, as such, the need to preserve the legacy metering investment does not exist going forward.
30. While the AER has not released its Draft Decisions for Queensland and South Australian distribution, we are assuming that the customer contributions for new and replacement meters in the NSW and ACT Draft Decisions will similarly be adopted for Queensland and South Australia. This reinforces our view that the new ACS charge is a transitional arrangement.

⁵<http://vector.co.nz/documents/101943/167718/Vector+Submission+on+AER+Issues+Paper+on+NSW+Distributors%27%20Proposals.pdf/eea6970e-409e-41a1-8eb9-c79270c2dd19>, page 8

⁶ *Ibid.*, pages 8-9

⁷ *Ibid.*, page 9

Concluding comments

31. We would appreciate clarification from the AER on the issues we raised above, and preferably more time to consider the implications of the options presented on our future commercial decisions.
32. We are happy to discuss with AER officials and staff any aspect of this submission.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Ian Ferguson', written in a cursive style.

Ian Ferguson
Regulatory Policy Manager