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Ms Michelle Groves
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Michelle

Dear Ms ~~Groves~~

Draft Determination Victorian Advanced Metering Infrastructure Review 2009-11 AMI Budget and Charges Applications

The Department of Primary Industries (DPI) welcomes the opportunity to comment on the Australian Energy Regulator's (AER) Draft Determination on the *Victorian Advanced Metering Infrastructure Review: 2009-11 AMI Budget and Charges Applications, July 2009*.

DPI notes that the AER's key statutory objective is to promote efficiency in electricity services for the long term interests of consumers of electricity. DPI believes that the rollout of Advanced Metering Infrastructure (AMI) represents a vital investment in the modernisation of Victoria's electricity supply infrastructure and will deliver significant long term benefits to consumers, and, importantly, enable consumers to become more fully engaged in Victoria's response to climate change.

It is important that, as with any regulated investment of this type, the costs of the program are commensurate with a market price that is fair and reasonable for the specified program outcomes. For this reason, the Order in Council¹ (the Order) establishes a framework and process for the consideration of the electricity distributors' AMI-related budgets (and the associated charges to consumers) which seeks to ensure that AMI costs are based upon the best available actual or estimated market information.

Within this framework, a distributor can demonstrate that a fair and reasonable revenue requirement has been established by undertaking a competitive tender process. In addition, the Order allows for an alternative means to establish a fair and reasonable revenue requirement where a competitive tender process may not have sufficiently progressed by the date of submitting a budget for approval. This alternative pathway effectively requires that distributors propose a budget in

¹ Victorian Government 2008 Advanced Metering Infrastructure Order in Council, Victorian Government Gazette S314, 25 November 2008 (as amended)



accordance with commercial standards that a business would reasonably exercise in like circumstances.

Under either pathway, budgets proposed should be for those capital and operational expenditures that are fair and reasonable to meet the specified program outcomes, as established by the over-arching Minimum AMI Specifications² (primarily), supplemented by the distributor-specific "Scope of activities" schedule, included in the Order.

In this context, DPI has a number of concerns regarding the AER's Draft Determination.

1. Contract costs

The AER has determined that the majority of costs provided for in the Draft Determination were not considered to be contract costs, as defined in clause 5C.11 of the Order. The AER has therefore not determined whether the relevant products/services were procured in accordance with a competitive tender process.

The Draft Determination indicates that the AER has taken a narrow interpretation of what is meant by entering into a contract. There is no evidence in the Draft Determination to indicate that the AER has assessed whether the electricity distributors have, through actual conduct with suppliers prior to formal signing of contract documentation, effectively entered into contracts that relate to such budget costs.

Where expenditure is ultimately considered not to be a contract cost, clause 5C.3(b) of the Order requires that the AER must establish whether it is more likely than not that the expenditure will be incurred, and that the expenditure does not involve a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances. There is insufficient evidence in the Draft Determination to indicate whether the AER has assessed whether these tests have been met to provide assurance to Victorians that the AER is protecting their long term interests.

This concern is reinforced by comments from Energeia that:

*"... the commercial process for non-contact (sic) costs was unclear, stating there was insufficient supporting evidence of key procurement decisions, such as outsourcing versus insourcing, or the decision to require a multi-vendor network management system"*³.

Clause 5.6 of the Order provides the AER with the power to obtain any information required to determine an application. This power allows the AER to request relevant information from the electricity distributors which may include:

² Minimum AMI Functionality Specification (Victoria) and the Minimum AMI Service Levels Specification (Victoria)

³ Draft determination, page 38

- Relevant manuals, procedures and/or guidelines pertaining to tendering, contracts and procurement;
- Tender documents; and
- Contract documents that have been entered into after the submission of the budget application.

By reviewing these documents, the AER can assess firstly whether the electricity distributors' manuals, procedures and/or guidelines are consistent with a commercial standard of a reasonable business and, secondly, whether the tender and contract documents and processes are consistent with the distributors' manuals, procedures and/or guidelines.

In addition, the AER may be able to compare the cost estimates submitted by the electricity distributors with the costs that have been tendered to assure it that the electricity distributors are more likely than not to incur the relevant expenditures. If not satisfied with any of these assessments, the AER is able to determine appropriate costs.

2. Related party transactions

The Draft Determination states that "the revised Order does not permit the AER to undertake an efficient cost review of AMI related party margins".

DPI disagrees with this assertion.

If the cost estimates are contract costs, then the AER can assess whether the electricity distributor has undertaken a competitive tendering process. In assessing whether the electricity distributors have undertaken a competitive tender process, the AER should have regard to the consideration of related party transactions in the current regulatory determination by the Victorian Essential Services Commission: *Electricity Distribution Price Review 2006-10, Volume I: Statement of Purpose and Reasons* (in particular, pages 168 – 185).

If the cost estimates are not contract costs, then the AER is able to access information by using its information gathering powers under clause 5.6 of the Order and assessing whether there has been a substantial departure from the commercial standard that a reasonable business would exercise in the circumstances. It is DPI's view that, to procure products/services of this value, a competitive tendering process is the commercial standard for a reasonable business.

If the related party margins have not been established through a competitive tender process, then the AER is able to determine an appropriate level of expenditure.

3. Functionality and Service Level Specifications

The Order states that the approved expenditure must not be for activities that are outside scope. The schedules to the Order state that the activities that are within scope are those activities reasonably required for the provision of Regulated Services and to

comply with a metering regulatory obligation or requirement. Further, “metering regulatory obligation or requirement” is defined in clause 2(o) of the Order as an obligation or requirement of a distributor that relates to the provision of Regulated Services under, among other things, an Act or a subordinate instrument. The key subordinate instrument in this regard is the 2007 Order in Council⁴, which establishes the Minimum AMI Functionality and Service Level Specifications.

DPI is concerned that some expenditure has been approved in the Draft Determination which is for activities that are above the minimum specifications established by the 2007 Order in Council. Where expenditure is for activities that are above the minimum specifications, that is, outside the scope, the AER is able to determine an appropriate level of expenditure.

4. Double counting

In the last electricity distribution price review, the Essential Services Commission considered carefully the allocation of IT expenditure to the Distribution Use of System (DUoS) price control and the metering price control to ensure that the same IT expenditure was not provided for in both price controls. As a result, there was some reallocation of IT expenditure from the metering price control to the DUoS price control.

DPI is seeking assurance from the AER that it has assessed whether any electricity distributor has included IT expenditure (or any other expenditure) in the metering application for which the revenue has already been provided for (and for which customers are already paying for) under the DUoS price control.

5. The 2011-2015 distribution price review

DPI urges the AER to note that, consistent with the Ministerial Council on Energy’s *Statement of Policy Principles*, issued on 13 June 2008, the benefits arising to distributors from the AMI roll-out will require careful examination. It is expected that the AER will factor a robust assessment of these benefits into the next Victorian electricity distribution price review.

Conclusion

DPI would welcome further consideration of the budget and charges applications by the AER to ensure that the Final Determination reflects the intended and optimal outcome for Victorian electricity consumers.

⁴ AMI “Specifications” Order, Victorian Government Gazette S286, 12 November 2007

Please contact Mr Peter Clements (Director Retail and Distribution Policy) on telephone (03) 9658 4927 for any further information you may require.

Yours sincerely

MLO

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