



The Hon Russell Northe MP

Minister for Energy and Resources
Minister for Small Business

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Mr Chris Pattas
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By email: AMIcharges2015@aer.gov.au

Dear Mr ~~Pattas~~ *Chris,*

AMI CHARGES REVISION APPLICATIONS 2015

Please find attached a submission on the metering services "charges revision applications" submitted by each of the five Victorian electricity distributors for 2015.

I am concerned about the level of expenditure incurred by AusNet Services, Jemena and United Energy in 2013, which they are now seeking to recover from Victorian electricity consumers.

To protect the interests of Victorian electricity consumers, it is important that the AER undertakes a robust assessment of the prudence of the expenditure incurred in 2013. In assessing the prudence of the excess expenditure, the AER must benchmark the expenditure incurred by these electricity distributors in 2013 to the expenditure incurred by CitiPower and Powercor who faced the same factors in undertaking their smart meter roll out.

I am also concerned about the revised expenditure forecasts submitted by these distributors for 2014 and 2015. It is also important that the AER give detailed consideration to the justification for these expenditure forecasts.

If you have any queries in relation to this submission, please contact Mark Feather, Executive Director, Energy Sector Development Branch by phone on 9092 1880 or by email mark.feather@dsdbi.vic.gov.au.

Yours sincerely

The Hon Russell Northe MP
Minister for Energy and Resources
Minister for Small Business

6 /10/2014

Encl.



Submission from the Victorian Minister for Energy and Resources to the Australian Energy Regulator on the Victorian electricity distributors' 2015 AMI charges revision applications

Key points

- **The expenditure incurred by AusNet, Jemena and United Energy in 2013 was substantially higher than the budgeted expenditure (74% higher, 71% higher and 122% higher respectively).**
- **AusNet, Jemena and United Energy have submitted that the higher expenditure was due to a deferral in the installation of meters, but the overspends in 2013 are not offset by the underspends in prior years and they are each forecasting higher than budgeted expenditure in 2014 and 2015.**
- **To protect the interests of Victoria's electricity consumers, the AER must robustly assess that the expenditure incurred in 2013 and forecast for 2014 and 2015 by AusNet, Jemena and United Energy is prudent (efficient) by, for example:**
 - **Benchmarking the expenditure incurred and forecast with the expenditure incurred and forecast by CitiPower and Powercor;**
 - **Taking into account the risk management strategies of the electricity distributors;**
 - **Taking into account the costs incurred in 2011 and 2012;**
 - **Assessing whether the electricity distributors have appropriately risk managed the "best endeavours" obligation to roll out meters; and**
 - **Not allowing for the "double dipping" of costs.**

Introduction

Following the decision by the Victorian Government to mandate that the five Victorian electricity distributors install Advanced Metering Infrastructure (AMI), the electricity distributors' metering services charges for small customers have been determined separately to the revenue determination for distribution use of system charges.

During the period 2009-15, the metering services charges are determined in accordance with an Order in Council originally gazetted on 28 August 2007, as amended on 12 November 2007, 25 November 2008, 2 April 2009, 21 October 2010, 22 December 2011 and 5 August 2014, made under sections 15A and 46D of the *Electricity Industry Act 2000*.

When the AMI program commenced, there was a high level of uncertainty as to the costs that would be incurred by the electricity distributors in implementing the AMI program. As a result, the metering services charges are now regulated using a cost pass through mechanism during the implementation of the AMI program, with a pass through of the prudent costs to consumers, rather than under an incentive-based regulatory regime.

The metering services charges are determined on an ex ante basis, based on the costs estimated to be incurred by the electricity distributors with an ex post adjustment based on the difference between the allowed costs incurred and the estimated costs.

On 31 October 2011, the AER determined the estimated costs (or budgets) that were expected to be incurred by the electricity distributors for the period 2012-15, and the metering services charges for each of those years.

On or before 29 August 2014, the electricity distributors submitted their applications for the 2015 metering services charges. The applications include an adjustment based on the difference between the costs incurred and budgets for 2013 and the costs forecast for 2014 and 2015 and the budgets in the initial determination, and a proposed new manual meter charge.

Under clause 5G.3 of the Order in Council, as it currently stands, the AER is required to make a determination on the 2015 metering services charges by the end of October 2014.

Background

The total expenditure provided for in the electricity distributors' applications for the 2015 metering services charges are summarised below in Table 1, with further detail provided as Attachment A.

Table 1: Summary of the variance between total expenditure, either incurred to 2013 or forecast in 2014 and 2015, and the budgeted expenditure, as set out in the electricity distributors' applications

In real \$2013		AusNet	CitiPower	Jemena	Powercor	United Energy
2013	Budget - initial determination	\$ 102,124,919	\$ 42,778,049	\$ 36,318,643	\$ 107,735,834	\$ 43,923,285
	Incurred	\$ 177,656,120	\$ 41,926,880	\$ 61,972,831	\$ 105,506,977	\$ 97,613,060
	Variance	\$ 75,531,200	-\$ 851,169	\$ 25,654,188	-\$ 2,228,857	\$ 53,689,774
		74.0%	-2.0%	70.6%	-2.1%	122.2%
2011-13	Budget - initial determination	\$ 426,970,036	\$ 155,892,222	\$ 148,668,545	\$ 393,925,792	\$ 282,921,037
	Incurred	\$ 526,513,856	\$ 162,987,311	\$ 160,962,138	\$ 409,820,433	\$ 293,742,163
	Variance	\$ 99,543,820	\$ 7,095,089	\$ 12,293,594	\$ 15,894,640	\$ 10,821,127
		23.3%	4.6%	8.3%	4.0%	3.8%
2011-15	Budget - initial determination	\$ 470,293,455	\$ 186,233,176	\$ 193,597,964	\$ 469,749,600	\$ 341,427,722
	Incurred/Forecast	\$ 672,681,564	\$ 193,214,713	\$ 228,361,133	\$ 485,290,625	\$ 378,107,934
	Variance	\$ 202,388,109	\$ 6,981,538	\$ 34,763,169	\$ 15,541,025	\$ 36,680,212
		43.0%	3.7%	18.0%	3.3%	10.7%

Sources:

1. 2011 budget from AER's final determination on 2009-2011 budget
2. 2012-15 budgets from AER's final determination on 2012-15 budget
3. 2011-13 expenditure incurred and 2014-15 reforecasts from electricity distributors' 2015 charges applications

Note: A positive variance indicates an overspend relative to budgeted expenditure; a negative variance indicates an underspend relative to budgeted expenditure.

While the expenditure incurred by CitiPower and Powercor in 2013 was less than their budgeted expenditure, the expenditure incurred by AusNet Services (AusNet), Jemena and United Energy in 2013 was significantly in excess of their budgeted expenditure.

AusNet, Jemena and United Energy have submitted that the expenditure incurred in 2013 was greater than their budgeted expenditure principally due to variances in the cost for installing meters and variances in the volume of meters supplied and installed.

United Energy has also submitted that its higher than budgeted project management costs in 2013 are attributable to a decision to bring the AMI project in house, rather than the project being continued to be managed by Jemena Asset Management. United Energy has justified this decision on the basis that the risks of the project are reduced and by savings in installation costs.

Jemena's expenditure in 2013 was 70.6 per cent higher than the budgeted expenditure, predominantly due to the higher than budgeted costs for the supply and installation of meters. The

cost overruns in 2013 were offset to some extent by cost underruns in previous years, with an 8.3 per cent variance in total expenditure from 2011 to 2013. However, the expenditure for 2014 and 2015 has been reforecast in its application and is higher than the budgeted expenditure, resulting in a forecast 18.0 per cent overspend in total expenditure from 2011 to 2015.

United Energy's expenditure in 2013 was 122.2 per cent higher than the budgeted expenditure in 2013 predominantly due to the higher than budgeted costs for the supply and installation of meters, with the cost overruns largely offset by cost underruns in previous years. However, the cost underruns on meter supply and installation in 2011 and 2012 masked cost overruns in operating expenditure, IT capital expenditure, and other capital expenditure, with a 3.8 per cent overspend in total expenditure from 2011 to 2013. The expenditure for 2014 and 2015 has been reforecast in its application and is higher than the budgeted expenditure, resulting in a forecast 10.7 per cent overspend in total expenditure from 2011 to 2015.

AusNet's expenditure in 2013 was 74.0 per cent higher than budgeted expenditure predominantly due to the higher than budgeted costs for the supply and installation of meters, but also due to higher than budgeted communications capital expenditure and operating expenditure. Despite the delays in the rollout, AusNet also had higher than budgeted expenditure in 2011 and 2012, resulting in a 23.3 per cent forecast overspend in total expenditure from 2011 to 2013.

AusNet has also reforecast its expenditure for 2014 and 2015 in its application, which is higher than the budgeted expenditure. The forecast overspend in total expenditure from 2011 to 2015 is 43.0 per cent.

However, as advised in its application, this excludes any additional remediation expenditure identified as a result of a Technical Review of its AMI solution "to address issues of instability"¹. On 24 September 2014, AusNet disclosed to the Australian Securities Exchange (ASX) that the expected remediation expenditure would be \$175 million, which would bring the total expenditure subject to future regulatory approval to \$351 million².

As shown in Table 2, based on the information in AusNet's metering services charges application, the forecast overspend in total expenditure from 2013 to 2015 with the remediation expenditure included is \$353 million. When the overspends in 2011 and 2012 are also included, the total overspend for the 2011-15 period is \$377 million or 80.2 per cent of the budgeted expenditure for that period.

¹ AusNet Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application*, 29 August 2014, page 4

² Refer <http://www.asx.com.au/asxpdf/20140924/pdf/42sdwz3xr8f83k.pdf>

Table 2: Forecast variance between AusNet’s total expenditure and the budgeted expenditure, with the inclusion of the remediation expenditure

In real \$2013		AusNet
Forecast overspend in application		
	2013	\$ 75,531,200
	2014	\$ 74,034,645
	2015	\$ 28,809,643
Remediation expenditure		\$ 175,000,000
Total overspend 2013-15 subject to regulatory approval		\$ 353,375,489
Prior overspends		
	2011	\$ 15,020,463
	2012	\$ 8,992,158
Total overspend 2011-15		\$ 377,388,109
		80.2%

The metering services charges proposed by each of the electricity distributors for 2015 are set out in Table 3, and the proposed changes in metering services charges from 2014 to 2015 are set out in Table 4. The proposed changes in metering services charges from 2014 to 2015 range from a decrease of 5.5 per cent by Powercor to an increase of 30.4 per cent by AusNet.

Those electricity distributors with the highest metering service charges in 2014 have proposed the largest increases in metering services charges from 2014 to 2015. The Victorian Government is concerned that some electricity consumers will be paying more than twice the amount paid by other electricity consumers for metering services, solely due to the way in which the respective electricity distributor has implemented its AMI program.

Table 3: 2015 metering services charges as proposed by the electricity distributors

	Proposed 2015 metering services charges (\$ per NMI p.a., GST exclusive)				
	AusNet	CitiPower	Jemena	Powercor	United Energy
Single phase	\$208.87	\$115.49	\$231.28	\$108.96	\$160.44
Single phase with contactor	\$240.02		\$231.28		\$160.44
Three phase	\$289.98	\$150.94	\$284.22	\$143.76	\$180.94
Three phase with contactor	\$321.67				
Three phase CT connected	\$414.20	\$190.65	\$315.99	\$190.45	\$193.01

Table 4: Proposed change in metering services charges from 2014 to 2015

	Proposed change in metering services charges from 2014 to 2015				
	AusNet	CitiPower	Jemena	Powercor	United Energy
All meters	30.4%	(0.9%)	19.3%	(5.5%)	13.5%
Single phase	\$48.66	(\$1.06)	\$37.46	(\$6.31)	\$19.11
Single phase with contactor	\$55.92		\$37.46		\$19.11
Three phase	\$67.56	(\$1.39)	\$46.03	(\$8.28)	\$21.55
Three phase with contactor	\$74.94				
Three phase CT connected	\$96.50	(\$1.75)	\$51.18	(\$11.02)	\$22.99

The metering services charges proposed by CitiPower and Powercor for 2015 are less than the initial charges determination and are less than the 2014 charges.

While United Energy has proposed an increase in metering services charges from 2014 to 2015, the proposed metering services charges are less than the initial charges determination.

Jemena and AusNet have proposed metering services charges for 2015 that are more than the 2014 charges and more than the initial charges determination, substantially more so in the case of AusNet. The metering services charges proposed by AusNet and Jemena are significantly higher than for CitiPower, Powercor and United Energy.

Given the increases in metering services charges proposed by AusNet, Jemena and United Energy, and the nature of the cost pass through mechanism, it is important that the AER scrutinises the electricity distributors' applications carefully to ensure that only prudent costs that are within scope are passed through to Victorian electricity consumers.

Prudency - benchmarking

Clause 5I.7 of the Order in Council allows the AER to exclude any expenditure in excess of the budget if the distributor has not satisfied it that the expenditure excess is prudent. The Order in Council further states that:

- 5I.7A For the purposes of clause 5I.7, the expenditure excess is prudent where that expenditure excess reasonably reflects the efficient costs of a business providing the Regulated Services.*
- 5I.7B For the purposes of it being satisfied that an expenditure excess reasonably reflects the efficient costs of a business providing the Regulated Services, the Commission may take into account:*
- (a) where the expenditure excess is a contract cost, whether the contract was let in accordance with a competitive tender process; and*
 - (b) the matters set out in clause 5I.8.*
- 5I.8 The matters that the Commission may take into account include the following:*
- (a) the information available to the distributor at the relevant time;*

- (b) *the nature of the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems;*
- (c) *the nature of the rollout obligation;*
- (d) *the state of the technology relevant to the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems;*
- (e) *the risks inherent in a project of the type involving the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems;*
- (f) *the market conditions relevant to the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems;*
- (g) *any metering regulatory obligation or requirement; and*
- (h) *any other relevant matter.*

In assessing expenditure forecasts, the AER uses “benchmarking techniques to ... better inform [its] determinations”³. Benchmarking is used “in conjunction with a number of other techniques to review expenditure forecasts”⁴.

In assessing the prudence of the metering services costs incurred by AusNet, Jemena and United Energy, the Victorian Government expects that the AER will use benchmarking techniques. The AER is able to benchmark the expenditure required to roll out of meters by AusNet, Jemena and United Energy to the expenditure incurred by CitiPower and Powercor.

The expenditure incurred by CitiPower and Powercor in 2013 was less than the budgeted expenditure, and the proposed metering services charges for 2015 are less than the initial metering charges determination and the approved metering services charges for 2014. The variance in total expenditure by CitiPower and Powercor over the 2011 to 2015 period is forecast to be less than 5.0 per cent, significantly less than for AusNet, Jemena and United Energy.

AusNet, Jemena and United Energy have identified a number of exogenous events that contributed to the overspend in their AMI programs. However, CitiPower and Powercor were also exposed to these same exogenous events as AusNet, Jemena and United Energy, but did not experience overspends in 2013 or the same order of magnitude of overspend over the 2011 to 2015 period.

Each of the electricity distributors had the same obligation, under clause 14A of the Order in Council to have a risk management strategy to:

- (a) *Identify, address and mitigate technological or other risks of and in connection with the provision, installation, maintenance and operation of advanced metering infrastructure and associated services and systems; and*
- (b) *Manage expenditure increases arising from those risks.*

As well as benchmarking expenditure, the AER should also benchmark the electricity distributors’ risk management strategies to determine whether AusNet, Jemena and United Energy have had in place the appropriate risk management strategies to mitigate the risks of overspends.

³ AER, *Better Regulation, Explanatory Statement, Expenditure Forecast Assessment Guideline*, November 2013, page 121

⁴ *ibid*

The use of benchmarking is consistent with the Order in Council.

Prior to the changes made to the Order in Council in 2011, the AER had no discretions under clause 5I of the Order in Council. It is now provided with very broad discretions.

The test for prudence is an efficiency test. The circumstances of the distributor are no longer determinative. Instead the efficiency test is cast in terms of “a business” (emphasis added).

In addition, the matters that the AER is able to take into account in terms of the efficiency test are now expanded by the inclusion of “any other relevant matter”.

The effect of the amendments is that the focus is no longer on the circumstances of a particular distributor. Rather, it is a broader test that looks to the hypothetical efficient business providing metering services.

Benchmarking is an “other relevant matter” that the AER is able to take into account.

Prudence of AusNet’s metering project

The Victorian Government has significant concerns in relation to the prudence of AusNet’s AMI project. Compared to the other electricity distributors, AusNet has:

- incurred significantly higher costs in implementing the AMI project to date
- compared to the other electricity distributors, a significantly greater variance between the costs incurred in aggregate from 2011 to 2013 and from 2011 to 2015, and the budgeted costs
- announced to the ASX that it would be seeking to recover an additional \$175 million for remediation costs to address issues of instability with its AMI solution
- proposed a much higher increase in metering services charges from 2014 to 2015 than the other electricity distributors
- proposed much higher metering services charges in 2015 than the other electricity distributors.

To protect the interests of small electricity customers in AusNet’s area, the AER must assess, in detail, the prudence (efficiency) of AusNet’s AMI program.

In assessing the prudence (efficiency) of AusNet’s AMI program, the AER should consider, for example:

- Benchmarking the costs incurred by AusNet in implementing its AMI program to the other Victorian electricity distributors, as discussed above.
- There should have been full reconsideration by AusNet of the use of WIMAX prior to it submitting its new budget for the 2012-15 budget period.⁵ A consistent approach should be taken between the expenditure removed from the 2012-15 budget and the assessment of

⁵ Appeal by SPI Electricity Pty Limited [2013] ACompT7 at [41]

the prudence (efficiency) of the expenditure incurred. In particular, AusNet should not be able to recover any more than the efficient costs associated with a mesh radio solution.⁶

- The extent to which costs have been incurred as a result of AusNet not having in place appropriate risk management strategies, in particular, whether AusNet has incurred higher manual meter reading costs because of the issues it experienced with logically converting interval meters to be able to remotely read.
- That AusNet did not undertake a competitive tender exercise for meter installation contracts⁷. It appears to have a higher installation cost than the other electricity distributors that sought to apply competitive pressure, even if they were unable to tender, to ensure installation costs were prudent.
- The allocation by AusNet of shared corporate costs to metering services, as discussed below.

In addition, the AER should note that Deloitte was engaged to assess the prudence of its excess expenditure but:

- Deloitte only assessed the expenditure in excess of the budgeted expenditure rather than the total expenditure, noting that the expenditure that was considered to not be excess, and therefore not assessed by Deloitte, may not be prudent.
- Deloitte has not conducted a review of primary documentation supporting the information provided by AusNet⁸.

Prudence – balancing cost and best endeavours obligation to roll out meters

Clause 14.1 of the Order in Council states that the electricity distributors must use best endeavours, to the extent possible, to install smart meters to all small electricity customers by 31 December 2013.

The Essential Services Commission (ESC) is currently auditing the electricity distributors to determine whether they have met their regulatory obligations with regard to the rollout of smart meters.

It is important that the AER engages with the ESC on distributor compliance with the best endeavours obligation and what this might mean for the recovery of costs by each of the electricity distributors.

In particular, the AER must assess the extent to which the electricity distributors themselves have contributed to an increase in the costs for installing meters by not appropriately considering the extent to which it was possible to use best endeavours to meet the obligated timeframe for rolling out smart meters.

⁶ If AusNet is now installing more than one communication system, then the AER should consider only the efficient costs associated with the installation of one communication system.

⁷ AusNet Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application – Expenditure Excess Application*, 29 August 2014, page 38

⁸ Deloitte Access Economics, *Ex-post review of AMI expenditure in 2013*, 29 August 2014, page 4

Activities within scope – reliance on audit reports

Clause 51.2 of the Order in Council states that AER must include actual costs that are certified in an audit report and is for activities within scope at the time of commitment to or incurring of that expenditure. However, the Order in Council importantly states that:

an audit report provided for the purposes of this clause is not conclusive as to whether expenditure is for activities that are within scope.

In considering the reliance that is placed on the audit report to certify that activities are within scope, the AER must be cognisant of the limitations of any audit that has been undertaken.

For example:

- Deloitte’s audit reports for CitiPower and Powercor state that it is the directors’ responsibility to determine “that the basis of preparation is appropriate to meet the requirements of the Act and the Order”. The auditor is responsible for expressing an opinion as to whether there is a material misstatement. A misstatement may not be material from an auditor’s perspective, but may be material to the AER for the purpose of determining metering services charges.
- Similarly, KPMG’s audit report for AusNet services states that “it is possible that fraud, error or non-compliance may occur and not be detected”.

In assessing the costs incurred in 2013, the AER needs to scrutinise the electricity distributors’ regulatory accounting statements carefully to assess the extent to which it can rely on the audit reports.

Prior year expenditure

As illustrated in Table 1, the overruns in expenditure experienced by AusNet, Jemena and United Energy in 2013, due to the volume variance arising from the delay in the rollout, are not fully offset by underruns in 2011 and 2012.

While Jemena and United Energy had an underspend in 2011 and 2012, they did not fully offset the overspend in 2013 and their metering services charges applications for 2014 did not refer to any timing differences in expenditure. By contrast, AusNet referred to “timing differentials” in its 2014 metering services charges application, but experienced overspends in both 2011 and 2012, as well as 2013.

The AER must therefore also review and compare information from the regulatory accounting statements of 2011, 2012 and 2013 to protect the interests of electricity consumers.⁹

In assessing the prudence of the expenditure incurred in 2013, the AER is able to consider “any other relevant matter”. The prudence of expenditure incurred in 2011 and 2012 is an “other relevant

⁹ It could be argued that customers’ interests are protected because any difference between the budget and allowed costs incurred is passed back to customers in subsequent years. However, the amount passed back to customers could have been higher if the expenditure incurred had been assessed to be not prudent. The level of overspends in 2013 should raise concerns with the AER that the level of expenditure in 2011 and 2012 may not have been prudent.

matter” that the AER must take into account in assessing the prudence of expenditure incurred in 2013; AusNet, Jemena and United Energy have each referred to the deferral of expenditure from 2011 and 2012 to 2013 as a relevant matter in their metering services charges applications.

The interests of consumers are not protected if the electricity distributors are able to underspend in some years, with the expenditure not subjected to any scrutiny, and then overspend in subsequent years with the overspend not offset by prior underspends.

When assessing the prudence (efficiency) of expenditure across the three year period (2011 to 2013), and the forecasts for 2014 and 2015, the AER should also consider the prudence (efficiency) of the deferral in expenditure. AusNet, Jemena and United Energy have stated that the deferral was due to the delayed installation of meters. However, as the legislative timeframes for installing smart meters did not change until relatively recently, any decision to delay the installation was made by the businesses themselves.

Cost shifting

When scrutinising the electricity distributors’ regulatory accounting statements, a particular area of focus for the AER should be to ensure that costs that are being recovered from consumers through an incentive-based regulatory regime, are not also being passed through to consumers through the AMI cost pass through mechanism. The “double dipping” for these types of costs would invariably not be identified through an audit report.

AusNet has referred in its application to the allocation of corporate overheads, management services¹⁰ and IT (metering data services) capital expenditure¹¹ to metering using an agreed cost allocation methodology.

Jemena has also allocated overheads¹² and IT costs¹³ using an agreed cost allocation methodology.

As illustrated in Figure 1 below, businesses like AusNet and Jemena would have a pool of corporate overheads that are allocated to each of their regulated businesses, such as metering, electricity distribution, electricity transmission (in the case of AusNet) and gas distribution.

The amount that is recovered from their customers for each business operating under an incentive-based regulatory regime is the amount of corporate overhead that is estimated to be allocated to that business for the regulatory control period, on an ex ante basis.

The regulated business has an incentive to reduce the corporate overheads so that the amount recovered from its customers is greater than the costs incurred.

¹⁰ AusNet Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application – Expenditure Excess Application*, 29 August 2014, pages 32 and 33

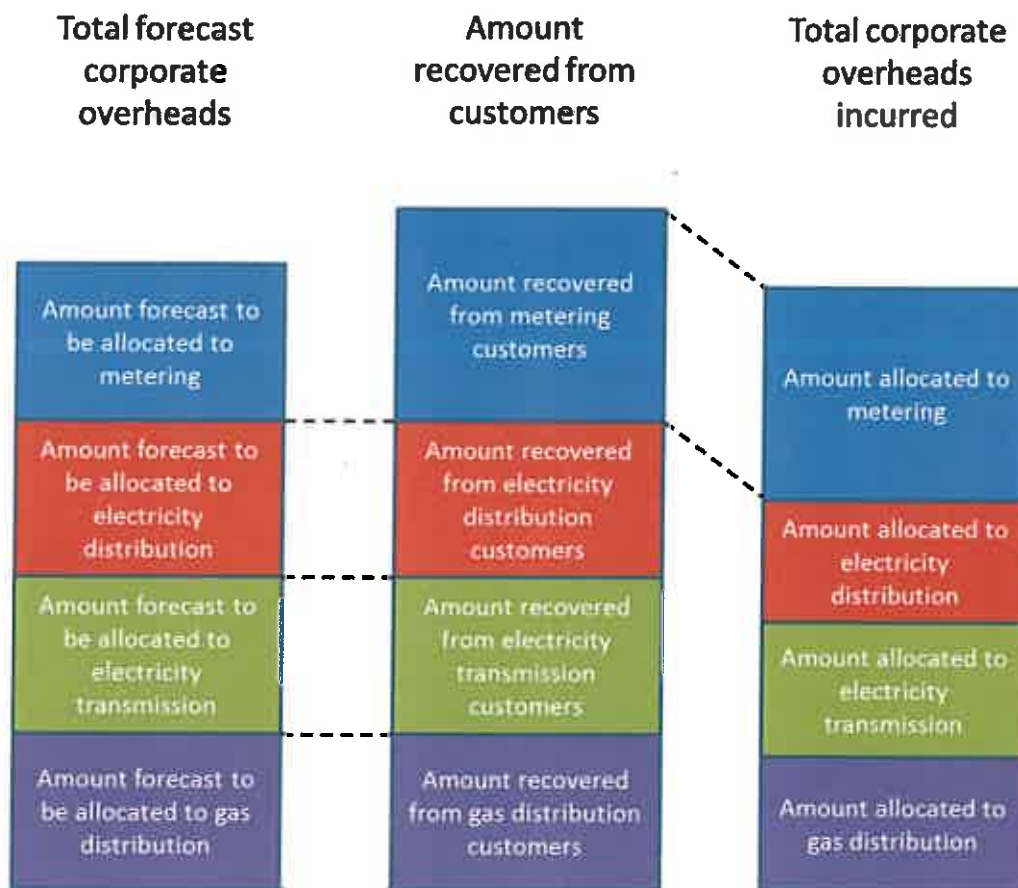
¹¹ Deloitte Access Economics, *Ex-post review of AMI expenditure in 2013*, 29 August 2014, page 38

¹² Jemena Electricity Networks (Vic) Ltd, *AMI Charges Revision Application for CY2015, Appendix D, Expenditure Excess Explanation for CY2015*, 29 August 2014, page 40

¹³ Jemena Electricity Networks (Vic) Ltd, *AMI Charges Revision Application for CY2015, Appendix D, Expenditure Excess Explanation for CY2015*, 29 August 2014, page 61

However, where one of the businesses is regulated under a cost pass through mechanism, as is the case with metering services during the rollout of smart meters, there is an incentive to allocate more costs than estimated to that business as these costs are then recovered from customers.

Figure 1: Potential for regulated businesses to “double dip” on the recovery of allocated costs



In the example in Figure 1 above, the total corporate overheads incurred are less than the forecast corporate overheads. However, the proportion of corporate overheads allocated to the business regulated under a cost pass through mechanism is increased and the proportion of corporate overheads allocated to the businesses regulated under an incentive-based regulatory regime is decreased. By doing so, the amount that is recovered from customers is increased relative to the forecast corporate overheads and the corporate overheads incurred.

The allocation of costs that are already recovered from customers through some other mechanism should be classified by the AER as an out of scope activity.

Even if the AER is of the view that the allocation of overhead costs is within scope, it is not prudent (efficient) (from a regulatory perspective) to allocate costs to the AMI project that are already being recovered from other customers, despite this being an acceptable accounting treatment.

Similarly, the shifting of IT costs from distribution use of system charges to metering services charges was a particular issue in the determination of the metering services revenue for the 2006-10 period. The AER needs to review the regulatory accounting statements carefully to ensure that the IT costs

that are recovered through the metering services charges are consistent with the following principle¹⁴:

... the costs of those IT systems that are required for all customers, regardless of whose meter is installed, should be recovered through the DUoS price control... The costs of those IT systems that are required only for customers who have the distributor's meter installed should be recovered through the metering price control.

If the electricity distributors are able to recover the costs for IT systems that are included in the electricity distributors' distribution use of system revenue determination, customers will similarly be paying twice.

Prudence of United Energy bringing its AMI project in house

United Energy is seeking to recover \$4.7 million of additional costs incurred for project management¹⁵. The overrun in project management costs is due to:

- The delay in the completion of the AMI project – the budgeted expenditure assumed that the rollout would be complete by the end of June 2013, but the project management office was required for the full year.
- The bringing of the AMI project in house – this was justified, in part, on the basis that the savings in installation costs would offset the costs for bringing the project back in house.

The budgeted costs for operating the project management office for six months were \$2.425 million. If it is assumed that the costs incurred by the project management office due to the delay in the rollout of smart meters was \$2.4 million, then the remaining overspend (approx. \$2.3 million) would need to be recovered by savings in installation costs.

Jemena's average installation cost per meter in 2013 was \$185.82¹⁶.

After bringing the project back in house, it is estimated that United Energy would be installing approximately 185,000 meters¹⁷ in the second half of 2013, in 2014 and in 2015. This requires a saving on the installation cost of \$12.43 per meter.

Given that United Energy's average installation cost per meter was \$209.30 in 2013¹⁸, it is unclear whether the purported savings in installation costs are achievable, and therefore whether it was prudent (efficient) to bring the project back in house.

¹⁴ Essential Services Commission, *Electricity Distribution Price Review 2006-10, Final Decision Volume I: Statement of Purpose and Reasons*, October 2005, page 533

¹⁵ United Energy, *Appendix C: Review and explanation of United Energy's 2013 AMI expenditure*, 26 June 2014, pages 25 and 30

¹⁶ Jemena Electricity Networks (Vic) Ltd, *AMI Charges Revision Application for CY2015, Appendix D, Expenditure Excess Explanation for CY2015*, 29 August 2014, page 51

¹⁷ United Energy, *United Energy 2015 AMI Charges Revision Application*, 26 June 2014, page 10

¹⁸ KPMG, *Advanced metering infrastructure expenditure 2013, Independent expert opinion*, 30 June 2014, page 48

Manual meter charge

Clause 14AAB.2 of the Order in Council allows an electricity distributor to apply to the AER for the determination of a manual meter charge.

Each of the electricity distributors, other than AusNet, has proposed a manual meter charge that is equivalent to the existing special meter read charge.

AusNet has indicated in its submission that it expects that there will only be 7,500 accumulation meters connected to its network by 1 April 2015 and that the costs associated with reading these meters is estimated at \$517,000.

It has advised that it is not seeking to recover these costs from electricity customers with accumulation meters, and that these costs have been excluded from the building block forecasts for the metering services charges.

While AusNet has the discretion to not impose a manual meter charge, the Victorian Government considers that it is important that:

- customers are suitably incentivised to accept the installation of a smart meter
- customers with smart meters are not subsidising the costs of manually reading the meters for those that refuse to accept a smart meter.

Should AusNet continue to adopt this approach, the AER must ensure that the costs associated with manually reading meters are not recovered through the metering services charges (or distribution use of system charges), particularly given the large number of meters that are currently read manually due to the issues that AusNet has experienced logically converting interval meters to being remotely read¹⁹.

Attachment A: Comparison of the Victorian electricity distributors' metering services expenditure incurred and budgeted expenditure, 2011 to 2015

¹⁹ As at 31 December 2013, AusNet was reading approximately 335,000 meters (46 per cent of its meter fleet) manually. Refer AusNet Services, *Advanced Metering Infrastructure, 2015 Charges Revision Application – Expenditure Excess Application*, 29 August 2014, page 25

(In real \$2013)	AusNet	CitiPower	Jemena	Powercor	United Energy
Capital expenditure					
2011					
Budget - initial determination	\$ 118,196,805	\$ 44,371,106	\$ 39,280,463	\$ 115,611,872	\$ 80,512,706
Incurred	\$ 118,997,443	\$ 49,297,589	\$ 30,688,142	\$ 129,939,884	\$ 73,456,442
Variance	\$ 800,638	\$ 4,926,483	-\$ 8,592,321	\$ 14,328,012	-\$ 7,056,265
	0.7%	11.1%	-21.9%	12.4%	-8.8%
2012					
Budget - initial determination	\$ 138,072,646	\$ 46,749,560	\$ 36,537,739	\$ 120,186,711	\$ 104,531,282
Incurred	\$ 143,658,844	\$ 45,172,201	\$ 30,086,296	\$ 121,926,838	\$ 64,212,023
Variance	\$ 5,586,198	-\$ 1,577,359	-\$ 6,451,443	\$ 1,740,127	-\$ 40,319,259
	4.0%	-3.4%	-17.7%	1.4%	-38.6%
2013					
Budget - initial determination	\$ 71,290,322	\$ 32,895,609	\$ 17,746,066	\$ 83,404,954	\$ 18,252,170
Incurred	\$ 137,111,621	\$ 32,020,897	\$ 41,843,085	\$ 83,565,864	\$ 71,724,891
Variance	\$ 65,821,299	-\$ 874,712	\$ 24,097,020	\$ 160,910	\$ 53,472,721
	92.3%	-2.7%	135.8%	0.2%	293.0%
2011-13					
Budget - initial determination	\$ 327,559,774	\$ 124,016,275	\$ 93,564,268	\$ 319,203,538	\$ 203,296,159
Incurred	\$ 399,767,909	\$ 126,490,687	\$ 102,617,524	\$ 335,432,586	\$ 209,393,356
Variance	\$ 72,208,135	\$ 2,474,412	\$ 9,053,256	\$ 16,229,049	\$ 6,097,197
	22.0%	2.0%	9.7%	5.1%	3.0%
2014					
Budget - initial determination	\$ 5,293,294	\$ 6,088,295	\$ 5,740,987	\$ 16,745,894	\$ 6,076,673
Forecast - 2015 charges application	\$ 58,729,964	\$ 6,088,295	\$ 17,846,313	\$ 16,745,894	\$ 33,332,976
Variance	\$ 53,436,670	\$ -	\$ 12,105,326	\$ -	\$ 27,256,303
	1009.5%	0.0%	210.9%	0.0%	448.5%
2015					
Budget - initial determination	\$ 1,887,793	\$ 5,634,568	\$ 5,431,399	\$ 13,701,291	\$ 5,847,097
Forecast - 2015 charges application	\$ 9,552,383	\$ 5,634,568	\$ 10,928,753	\$ 13,701,291	\$ 8,246,096
Variance	\$ 7,664,590	\$ -	\$ 5,497,354	\$ -	\$ 2,398,998
	406.0%	0.0%	101.2%	0.0%	41.0%
2011-15					
Budget - initial determination	\$ 334,740,861	\$ 135,739,138	\$ 104,736,654	\$ 349,650,723	\$ 215,219,929
Incurred/Forecast	\$ 468,050,255	\$ 138,213,550	\$ 131,392,590	\$ 365,879,771	\$ 250,972,428
Variance	\$ 133,309,394	\$ 2,474,412	\$ 26,655,936	\$ 16,229,049	\$ 35,752,498
	39.8%	1.8%	25.5%	4.6%	16.6%

(in real \$2013)	AusNet	CitiPower	Jemena	Powercor	United Energy
Operating expenditure					
2011					
Budget - initial determination	\$ 30,985,776	\$ 11,296,176	\$ 15,534,451	\$ 24,724,621	\$ 22,822,421
Incurred	\$ 45,205,600	\$ 14,665,519	\$ 17,752,201	\$ 29,476,502	\$ 28,887,250
Variance	\$ 14,219,825	\$ 3,369,343	\$ 2,217,750	\$ 4,751,881	\$ 6,064,829
	45.9%	29.8%	14.3%	19.2%	26.6%
2012					
Budget - initial determination	\$ 37,589,889	\$ 10,697,331	\$ 20,997,249	\$ 25,666,754	\$ 31,131,341
Incurred	\$ 40,995,849	\$ 11,925,122	\$ 20,462,668	\$ 22,970,231	\$ 29,573,389
Variance	\$ 3,405,960	\$ 1,227,791	-\$ 534,581	-\$ 2,696,523	-\$ 1,557,952
	9.1%	11.5%	-2.5%	-10.5%	-5.0%
2013					
Budget - initial determination	\$ 30,834,598	\$ 9,882,440	\$ 18,572,577	\$ 24,330,880	\$ 25,671,115
Incurred	\$ 40,544,499	\$ 9,905,983	\$ 20,129,745	\$ 21,941,113	\$ 25,888,168
Variance	\$ 9,709,901	\$ 23,543	\$ 1,557,168	-\$ 2,389,767	\$ 217,053
	31.5%	0.2%	8.4%	-9.8%	0.8%
2011-13					
Budget - initial determination	\$ 99,410,262	\$ 31,875,947	\$ 55,104,277	\$ 74,722,255	\$ 79,624,878
Incurred	\$ 126,745,948	\$ 36,496,624	\$ 58,344,614	\$ 74,387,847	\$ 84,348,807
Variance	\$ 27,335,685	\$ 4,620,677	\$ 3,240,338	-\$ 334,408	\$ 4,723,929
	27.5%	14.5%	5.9%	-0.4%	5.9%
2014					
Budget - initial determination	\$ 18,823,449	\$ 9,451,601	\$ 16,810,025	\$ 22,824,594	\$ 23,180,079
Forecast - 2015 charges application	\$ 39,421,424	\$ 9,453,705	\$ 21,353,839	\$ 22,832,680	\$ 20,994,361
Variance	\$ 20,597,976	\$ 2,105	\$ 4,543,814	\$ 8,086	-\$ 2,185,717
	109.4%	0.0%	27.0%	0.0%	-9.4%
2015					
Budget - initial determination	\$ 17,318,883	\$ 9,166,490	\$ 16,947,009	\$ 22,552,028	\$ 23,402,836
Forecast - 2015 charges application	\$ 38,463,936	\$ 9,050,834	\$ 17,270,090	\$ 22,190,327	\$ 21,792,338
Variance	\$ 21,145,053	-\$ 115,656	\$ 323,081	-\$ 361,701	-\$ 1,610,498
	122.1%	-1.3%	1.9%	-1.6%	-6.9%
2011-15					
Budget - initial determination	\$ 135,552,594	\$ 50,494,038	\$ 88,861,310	\$ 120,098,877	\$ 126,207,792
Incurred/Forecast	\$ 204,631,308	\$ 55,001,164	\$ 96,968,543	\$ 119,410,853	\$ 127,135,506
Variance	\$ 69,078,714	\$ 4,507,126	\$ 8,107,233	-\$ 688,024	\$ 927,714
	51.0%	8.9%	9.1%	-0.6%	0.7%

(In real \$ 2013)	AusNet	CitiPower	Jemena	Powercor	United Energy
Total expenditure					
2011					
Budget - initial determination	\$ 149,182,581	\$ 55,667,282	\$ 54,814,914	\$ 140,336,493	\$ 103,335,128
Incurred	\$ 164,203,044	\$ 63,963,108	\$ 48,440,343	\$ 159,416,387	\$ 102,343,691
Variance	\$ 15,020,463	\$ 8,295,825	-\$ 6,374,571	\$ 19,079,893	-\$ 991,436
	10.1%	14.9%	-11.6%	13.6%	-1.0%
2012					
Budget - initial determination	\$ 175,662,536	\$ 57,446,891	\$ 57,534,988	\$ 145,853,465	\$ 135,662,624
Incurred	\$ 184,654,693	\$ 57,097,323	\$ 50,548,964	\$ 144,897,069	\$ 93,785,412
Variance	\$ 8,992,158	-\$ 349,568	-\$ 6,986,024	-\$ 956,396	-\$ 41,877,211
	5.1%	-0.6%	-12.1%	-0.7%	-30.9%
2013					
Budget - initial determination	\$ 102,124,919	\$ 42,778,049	\$ 36,318,643	\$ 107,735,834	\$ 43,923,285
Incurred	\$ 177,656,120	\$ 41,926,880	\$ 61,972,831	\$ 105,506,977	\$ 97,613,060
Variance	\$ 75,531,200	-\$ 851,169	\$ 25,654,188	-\$ 2,228,857	\$ 53,689,774
	74.0%	-2.0%	70.6%	-2.1%	122.2%
2011-13					
Budget - initial determination	\$ 426,970,036	\$ 155,892,222	\$ 148,668,545	\$ 393,925,792	\$ 282,921,037
Incurred	\$ 526,513,856	\$ 162,987,311	\$ 160,962,138	\$ 409,820,433	\$ 293,742,163
Variance	\$ 99,543,820	\$ 7,095,089	\$ 12,293,594	\$ 15,894,640	\$ 10,821,127
	23.3%	4.6%	8.3%	4.0%	3.8%
2014					
Budget - initial determination	\$ 24,116,743	\$ 15,539,895	\$ 22,551,012	\$ 39,570,488	\$ 29,256,752
Forecast - 2015 charges application	\$ 98,151,388	\$ 15,542,000	\$ 39,200,152	\$ 39,578,574	\$ 54,327,338
Variance	\$ 74,034,645	\$ 2,105	\$ 16,649,140	\$ 8,086	\$ 25,070,586
	307.0%	0.0%	73.8%	0.0%	85.7%
2015					
Budget - initial determination	\$ 19,206,676	\$ 14,801,058	\$ 22,378,408	\$ 36,253,319	\$ 29,249,933
Forecast - 2015 charges application	\$ 48,016,319	\$ 14,685,403	\$ 28,198,843	\$ 35,891,618	\$ 30,038,433
Variance	\$ 28,809,643	-\$ 115,656	\$ 5,820,435	-\$ 361,701	\$ 788,500
	150.0%	-0.8%	26.0%	-1.0%	2.7%
2011-15					
Budget - initial determination	\$ 470,293,455	\$ 186,233,176	\$ 193,597,964	\$ 469,749,600	\$ 341,427,722
Incurred/Forecast	\$ 672,681,564	\$ 193,214,713	\$ 228,361,133	\$ 485,290,625	\$ 378,107,934
Variance	\$ 202,388,109	\$ 6,981,538	\$ 34,763,169	\$ 15,541,025	\$ 36,680,212
	43.0%	3.7%	18.0%	3.3%	10.7%

Sources:

1. 2011 budget from AER's final determination on 2009-2011 budget
2. 2012-15 budgets from AER's final determination on 2012-15 budget
3. 2011-13 expenditure incurred and 2014-15 reforecasts from electricity distributors' 2015 charges applications