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13 February 2015

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson

Submission on the AER's Draft Decisions on NSW and ACT Electricity Distributors' Regulatory Proposals for 2015-16 to 2018-19

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Australian Energy Regulator's ("AER") Draft Decisions on the regulatory proposals of electricity distributors in New South Wales (Ausgrid, Endeavour Energy and Essential Energy) and the Australian Capital Territory (ActewAGL), all dated November 2014. The proposals cover the 2015-16 to 2018-19 regulatory control period ("next regulatory control period").

2. As a New Zealand provider of metering services, among other energy and telecommunications services,[1] we are exploring commercial opportunities in the Australian smart metering market. As such, we focus our submission on regulatory proposals relevant to the metering market that are of particular interest or concern to us, particularly exit fees, the recovery of efficient investment in legacy metering assets, and the timely transition to smart metering.

3. No part of this submission is confidential and we are happy for it to be made publicly available.

[1] Vector is one of New Zealand's largest listed companies and the country's largest electricity distribution network, supplying the Auckland region. Vector also provides gas distribution network services in more than 20 towns and cities in New Zealand's North Island. It further provides gas supply and treatment, electricity and gas metering services, and fibre optic broadband communication networks in Auckland and Wellington.

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Vector supports competition and innovation in metering services

5. Vector supports, in principle, the Australian Government's market-led approach to achieving its efficiency and competition objectives in the metering market and the electricity sector. We believe a market-led approach, driven by retailers, provides the right incentives for competition, innovation and investment that benefit electricity consumers.[2] This approach would support the change request by the Council of Australian Governments – Energy Council to amend the National Electricity Rules ("NER") to expand competition in metering services in the National Electricity Market ("NEM").

6. Our view is consistently reflected in our submissions to the AER on the resets for NEM electricity distributors for the next regulatory control period, and submissions to other Australian regulators. We are reliably informed by our experience in the New Zealand metering market, which follows a market-led model that has enabled the successful deployment of approximately 1.2 million smart meters nationwide (60% market penetration) over the past few years.

7. The New Zealand metering market provides compelling evidence that consumer acceptance of smart meters can be achieved in a timely manner through commercial solutions, without intrusive regulation or consumer protest. The market can only afford to invest once in the new capability offered by smart meters; making that investment and taking that risk should be left to competitive market participants.

8. With the exception of exit fees (comprising residual capital costs and potentially, administration fees), we support the unbundling of other type 5 and 6 metering services, including metering provision, maintenance, reading, and data services. This would enable a more efficient electricity market by facilitating cost-reflective pricing and minimising cross subsidies.

[2] We particularly welcome the NSW Government's decision to pursue a "market-driven" rollout of smart meters, http://www.resourcesandenergy.nsw.gov.au/__data/assets/pdf_file/0008/536696/NSW-Smart-Meter-Task-Force-Report.pdf. This is a significant departure from the Victorian model of mandated rollout, which resulted in cost blowouts and consumer backlash.

We support the classification of residual capital costs as Standard Control Services

9. Consistent with our support for greater competition in metering services, we strongly support the AER's Draft Decision not to approve the exit fees proposed by NSW and ACT distributors for the replacement of existing meters.

10. As discussed in our previous submissions to the AER and the Australian Energy Market Commission ("AEMC"), exit fees are not the appropriate mechanism because they do not meet regulatory principles,[3] and importantly, do not promote competition. As such, they are likely to prevent the emergence of competitive metering markets in NSW and ACT, or their emergence in a timely manner.

11. The proposed exit fees would create a significant barrier to market entry. Potential market entrants would face these fees, which actively disincentivise investment. Exit fees would not create a level and competitive playing field as successive entrants do not face the same costs and can easily under-price the first movers.

12. We previously noted to the AER that transitions to more competitive arrangements have been undertaken in similar markets without resorting to exit fees. These include 1) the introduction of competitive electricity retail market in Australia, 2) the transition to competitive metering for large customers, also in Australia, and 3) we understand, for some environmentally friendly power generation and small generators overseas.[4] There may be an equity issue if large consumers were able to make the transition to a competitive metering market without exit fees but small consumers (or their metering providers) did face these fees.[5]

13. Our submissions recommended that the AER consider other approaches that do not require exit fees that disincentivise new entrants, particularly first-movers, and deprive consumers the benefits of market competition.

14. We therefore support the AER's Draft Decision on Ausgrid's regulatory proposal (which is similarly reflected in its Draft Decisions for Endeavour Energy and Essential Energy) regarding exit fees, which states:

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[3] Decisions on the recovery of investment costs should minimise market inefficiencies and distortions, provide the right incentives for market entry and investment, and promote consumers' interest or avoid harm to consumers. We recommended that to minimise market inefficiencies and distortions, any proposal should 1) not distort efficient investment, 2) minimise investors' perception of regulatory risk, and 3) not lead to stranded investment.
http://vector.co.nz/documents/101943/167718/Vector+Submission+Rule+Change+Expanding+Competition+in+Metering.pdf/b17aaa3e-1170-4d6f-91f0-b805c606e206, page 15
http://vector.co.nz/documents/101943/167718/Vector+Submission+on+AER+Issues+Paper+on+NSW+Distributors%27%20Proposals.pdf/eea6970e-409e-41a1-8eb9-c79270c2dd19, pages 3-4

[4] 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 5

[5] *Ibid*.

> The NSW distributors proposed exit fees that would allow them to recover costs associated with metering assets made redundant when a customer switches to an alternative metering provider…we have not accepted this approach. The NEL and NER require us to have regard to the development of competition in deciding appropriate service classification…As argued in submissions, an exit fee may impede the development of competition in the provision of metering services.[6]

15. While we object to exit fees, we believe the transition to new technologies should allow the recovery of efficient regulated investment. We therefore also support the AER's Draft Decision classifying the residual capital costs of legacy meters as Standard Control Services, enabling them to be recovered from the general network customer base, i.e. through DUoS charges.

16. According to the AER's Draft Decision:

> …[its] alternative is to classify residual capital costs (the capital costs the customer would have paid through annual charges had they remained a regulated metering customer) as a standard control service and recover these through network tariffs.[7]
>
> …With the opening of competition in metering services, we have determined that where a customer switches service providers during the 2015-19 regulatory control period, we will allow the distribution business to continue to recover residual capital costs through an annual addition to DUOS charges.[8]
>
> …If a customer chooses to switch to an unregulated metering provider, the remaining portion of residual capital costs attributable to that customer that risk becoming stranded is moved back into the standard control regulatory asset base.[9]

17. We agree with the above approach, which allows the recovery of efficient investment without creating a barrier to market entry.

18. The Draft Decision states that:

> …[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.[10]

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[6]http://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20Decision%20Ausgrid%20distribution%20determination%20%E2%80%93%20Overview%20%E2%80%93%20November%202014.pdf, page 61
[7]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, page 16-29
[8]*Ibid.*, page 16-44
[9]*Ibid*., page 16-46
[10]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, page 16-47

> …on balance, we prefer to err on the side of faster entry rather than too low entry (the risk if we accept Ausgrid's proposal to charge a high exit fee). 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 facilitate the move towards cost reflective tariffs which are fundamental to achieve efficient use of and investment in distribution networks.[11]

19. We further agree with the above approach, which would enable the timely introduction of smart metering for the benefit of NSW and ACT consumers.

Administration fees should also be classified as Standard Control Services

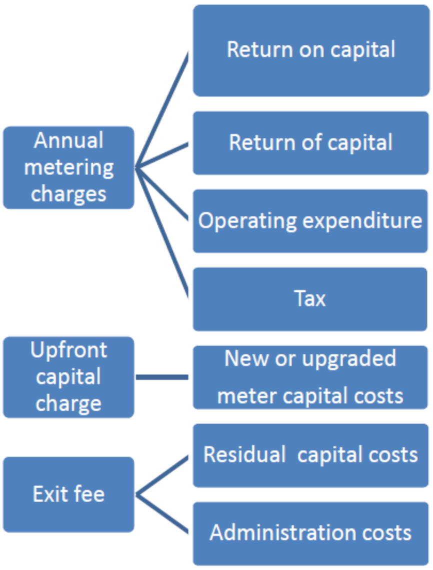
20. In addition to the residual capital costs of legacy metering assets, the regulatory proposals of NSW and ACT distributors also proposed "administration charges" or "administration fees" associated with the displacement of legacy meters. We do not support the imposition of administration fees, which also create a barrier to market entry.

21. Similar to residual capital costs, administration fees will be borne by new entrants or alternative providers. They are effectively a 'switching cost' imposed on non-incumbent parties, which create first-mover disadvantage and a barrier to market entry. Administration fees give distributors undue cost advantage by virtue of their incumbency and not as a result of greater efficiency or improvement in customer services.

22. As the figure from the Ausgrid regulatory proposal below (which is similarly reflected in the proposals of Endeavour Energy and Essential Energy) clearly shows, both residual capital costs and administration fees are linked to and are integral components of the same transaction – that of switching a customer to another metering provider. But for the displacement of the legacy meter, these costs would not be incurred. Both costs should therefore be treated in the same manner, i.e. administration costs should not be imposed where exit fees are not.

[11] 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, page 16-47

Figure 166.3 Ausgrid's proposed structure of metering tariffs



23. We agree with the AER's Draft Decision:

> …not [to] accept the administrative charges proposed by the NSW distributors that are associated with customers switching to an alternative metering provider.[12]
>
> …While we accept in principle that Ausgrid should recover incremental administration costs through an exit fee, we do not consider that Ausgrid demonstrated they will face incremental administration costs. As such, we do not accept that an exit fee should apply.[13]

24. The AER's Draft Decision, however, states that it:

> …consider[s] it prudent to indicate how [it] would classify such a service in the event that the NSW distributors are able to provide sufficient justification leading into our final decision. These costs, if substantiated, would be directly attributable to a customer seeking to switch meter providers. On this basis, we are satisfied the service 'meter transfers' should be classified as an alternative control service.[14]

25. With respect, we <u>disagree</u> with the AER's Draft Decision to classify administration costs as Alternative Control Services, subject to justification of these costs by distributors. While we support efforts to improve the ability of these services to become contestable, re-classifying them under Alternative Control in these circumstances does not promote contestability as it signals the cost of this

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[12] http://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20Decision%20Ausgrid%20distribution%20determination%20%E2%80%93%20Overview%20%E2%80%93%20November%202014.pdf, page 60

[13] 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%20Alternative%20control%20services%20%E2%80%93%20November%202014.pdf, page 16-29

[14] http://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20Decision%20Ausgrid%20distribution%20determination%20%E2%80%93%20Overview%20%E2%80%93%20November%202014.pdf, pages 60-61

component of the exit fee and discourages anyone else bar the incumbent from upgrading to a smart meter.

26. Administration fees are borne by non-incumbent providers and could create a barrier to market entry. While the amounts may not be 'material' for a single customer, or in the context of a distributor's overall cost levels, they are in aggregate likely to be material for smaller providers.

27. In their November 2014 regulatory proposals, Ausgrid, Endeavour Energy, and Essential Energy propose to recover AU \$59.8 million,[15] \$46.3 million,[16] and \$46.1 million[17] in administration fees, respectively, if all of their customers were to exit within the next regulatory control period. These amounts are, by any measure, not immaterial.

28. The AER opines:

> Ausgrid proposed administrative costs were calculated as estimated time taken multiplied by a labour rate—but this approach does not demonstrate that such costs are incremental. To demonstrate that Ausgrid will face incremental costs, we consider that it would have to show a reasonable forecast of additional staff they expect to hire over the regulatory period to process customer transfers.
>
> For example, the proposed administration charge would recover \$59.8 million if all customers were to exit. If all customers left in a five year period, this would imply that Ausgrid would have to hire an additional 65 dedicated full time staff per year to handle customer transfers to substantiate its proposed costs. This seems **implausible given the relatively simple administrative task involved to process a customer exiting**.
>
> Indeed, Ausgrid forecast metering customer numbers to grow overall over the period so it is not evident that they expect many customers to churn in the upcoming period. As such, **it may be possible that current levels of administrative staff have enough capacity to perform this additional administrative task without the business incurring further costs**.[18]
>
> [emphasis added]

[15] 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, page 16-48
[16] https://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20decision%20Endeavour%20Energy%20distribution%20determination%20%E2%80%93%20Attachment%2016%20%E2%80%93%20%20Alternative%20control%20services%20%E2%80%93%20November%202014.pdf, page 16-48
[17] https://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20decision%20Essential%20Energy%20distribution%20determination%20%E2%80%93%20Attachment%2016%20%E2%80%93%20%20Alternative%20control%20services%20%E2%80%93%20November%202014.pdf, page 16-47
[18] 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, page 16-48

29. We <u>agree</u> with the AER on this matter. We note that Essential Energy proposes an administration fee that implies a rate of AU $96 per hour[19] for the "simple administrative task involved to process a customer exiting", as described above by the AER. This rate seems excessive.

30. Also, we note that in the New Zealand metering market, a similar transaction is likely to involve a retailer-to-retailer process, with the transfer eventually reflected in the electricity registry being managed by the Electricity Authority (the regulator of the electricity sector).

31. In the event, however, that the AER decide to approve any administration costs, we propose that these costs be classified as Standard Control Services and set at efficient levels. Like residual capital costs, administration fees are incurred as part of the reform process that is intended to promote competition in the long-term interest of consumers. It is appropriate that these costs are recovered from the network customer base.

32. We **recommend** that the AER remove the administration fees proposed by the NSW and ACT distributors for the next regulatory period. Administration fees impose additional costs on potential entrants and create a barrier to market entry, inhibiting market competition that the policy reform is aiming to achieve.

33. We also **recommend** that should the AER allow the recovery of any administration fees, it should classify these fees as Standard Control Services and set them at efficient levels, to be recovered in a similar manner to residual capital costs. Both fees are incurred in relation to the reform process and should be classified and applied consistently.

Other issues

Upfront capital contribution

34. ActewAGL proposes that new and replacement metering capex be rolled into the unbundled metering charge.[20]

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[19] Essential Energy proposes an administration fee of $56.36 for 2015-16, http://www.aer.gov.au/sites/default/files/AER%20%E2%80%93%20Draft%20decision%20Essential%20Energy%20distribution%20determination%20%E2%80%93%20Attachment%2016%20%E2%80%93%20%20Alternative%20control%20services%20%E2%80%93%20November%202014.pdf, page 16-34. Based on 35 minutes of an administration employee's time, this implies an hourly cost of $96 for administration employees. The 35-minute assumption is based on Ergon's calculation in its regulatory proposal for 2015-2020, https://www.aer.gov.au/sites/default/files/Ergon%20Energy%20-%2005.03.01%20Default%20Metering%20Services%20Summary%20-%20October%202014.pdf, page 32.

[20] http://www.aer.gov.au/sites/default/files/FINAL_REVISED%20REGULATORY%20PROPOSAL%20%2020%20JAN%202015%20%28PUBLIC%29.pdf, section 14.3

35. The AER disagrees with this proposal and considers that the customer should be charged upfront for the capex component of new connections and customer initiated replacements.[21]

36. We support the AER's proposed approach on this matter, which is more transparent and would better facilitate the introduction of smart meters in NSW and ACT. As the arrangement being proposed for NSW does not provide for new and replacement metering capex to be rolled into the unbundled metering charge, we encourage the AER to apply a similar arrangement to ACT to promote consistency across NEM states.

Single unbundled metering charge

37. Essential Energy proposes a different unbundled metering charge for customers who make an upfront contribution for their meter.[22]

38. We believe this proposal adds to administrative complexity and costs, and prefer a single Alternative Control Service charge at the commencement of the next regulatory control period. However, we are happy for the AER to review this arrangement within the said period.

39. Should the AER consider this issue in the future, we again emphasise the desirability of adopting a consistent approach across the NEM.

Concluding comment

40. We are happy to discuss with AER officials any aspect of this submission.

Yours sincerely

Ian Ferguson
Regulatory Policy Manager

[21]http://www.aer.gov.au/sites/default/files/FINAL_REVISED%20REGULATORY%20PROPOSAL%20%2020%20JAN%202015%20%28PUBLIC%29.pdf, section 14.3

[22] http://www.aer.gov.au/sites/default/files/Essential%20Energy%20-%20Attachment%209.7%20%20-%20Charges%20for%20Metering%20Services%20-%20January%202015.pdf