

**AEMC staff paper
Stakeholder workshop
1 August 2014**

WORKSHOP 2: NETWORK REGULATORY ARRANGEMENTS

On 26 June 2014 the AEMC hosted the first stakeholder workshop for the competition in metering and related services rule change request. The workshop discussed the role of the Metering Coordinator, whether this party should be a Registered Participant and/or accredited with AEMO, and the obligations/functions of the gate keeper role.

The second stakeholder workshop will discuss issues related to the network regulatory arrangements needed to support competition in the provision of metering and related services.

This paper has been prepared to guide discussion at the second workshop on the following four issues:

1. Arrangements to determine the costs associated with existing, regulated type 5 (interval) and type 6 (accumulation) meters (in jurisdictions other than Victoria) that are no longer required, and how these costs should be recovered.
2. The potential ring fencing arrangements to apply to a distribution network business that chooses to (or is required to under the transitional rules) be a Metering Coordinator.
3. Arrangements for distribution network businesses to offer payment for smart meters as part of a regulated demand side participation (DSP) business case.
4. Arrangements to ensure existing load control capability is maintained.

The rule change request also included a proposal that distribution network businesses be required to unbundle metering charges from distribution use of system charges. Processes to do so are either complete or underway across the NEM as a result of the AER's classification of metering services, independent of this rule change request. We will address this issue in the draft determination but will not discuss it in detail at the workshop.

Other issues for consideration

We note that there are a number of other issues that intersect with the network regulatory arrangements needed to support the Metering Coordinator role. These include:

- Arrangements for parties to access value-added energy services enabled by the functionality of smart meters

This issue will be explored under the 'Relationships' work stream, as it relates to the incentives on the Metering Coordinator to contract with other parties to provide access to the functionality of smart meters at a fair price and on reasonable terms and conditions. This issue will be discussed at the workshop on 31 August 2014.

- Transitional and supporting arrangements

There are a number of transitional and supporting arrangements that need to be worked through, including:

- Arrangements for Victoria.
- Minimum specification and governance arrangements

- The proposal that jurisdictions should be able to prescribe exclusivity to a particular Metering Coordinator to provide basic (eg type 6) metering services to residential and small business consumers.
- Consequential procedural/guideline changes and implementation.

These issues will be discussed at separate stakeholder workshop in September (dates and locations to be confirmed).

For further information, refer to the consultation paper and the materials from the first stakeholder workshop (both available on the AEMC website)¹.

¹ <http://www.aemc.gov.au/Rule-Changes/Expanding-competition-in-metering-and-related-serv>

1. Exit fees for existing, regulated type 5 and 6 meters

The COAG Energy Council proposed that a transparent exit fee be determined by the AER and applied where a consumer, retailer or other party (on behalf of the consumer) chooses to replace or upgrade an existing, regulated type 5 or 6 meter.

The rule change request proposes to remove the current arrangement that requires retailers and distribution network businesses to negotiate in good faith to determine an appropriate exit fee². In place of this arrangement, the COAG Energy Council proposes to give the AER explicit responsibility to determine the costs associated with redundant metering, and the fee to be charged to recover those costs, applying the following principles:

- The fee must be reasonable.
- The fee should be based on the average depreciated value of the stock of existing type 5 or 6 meters, and operating costs.
- The fee may include efficient and reasonable costs of transferring the consumer to another Metering Coordinator.
- The fee for type 5 metering installations may differ from the fee for type 6 installations.
- The distribution network business cannot recover an exit fee for a meter installed after the commencement of a jurisdictional new and replacement policy that is not compliant with that policy.

The rule change request also proposes that the AER could consider whether a cap on the exit fee that could be charged to the consumer/business would be appropriate and, if so, the level of the cap.

The objective of the proposed arrangement is to establish an exit fee that reasonably compensates a distribution network business when its regulated meter is replaced, but one not so high that it inhibits investment and innovation in advanced metering and energy services.

1.1 Stakeholder views

In submissions to the consultation paper, most stakeholders acknowledged that distribution network businesses should be able to recover costs associated with a meter that is no longer required. However, stakeholders highlighted that we need to clarify what the proposal means by the term 'exit fee' and exactly what costs a distribution network businesses might seek to recover, eg:

- asset costs
- administration/operational costs
- IT/system costs

Some stakeholders questioned whether the term 'exit fee' is appropriate, and suggested that 'meter transfer fee' or 'residual meter charge' is a more accurate description.

Stakeholders generally agreed that changes need to be made to the existing provision in Chapter 7 of the Rules regarding the recovery of costs associated with the replacement of meters provided by a distribution network business as part of its regulated business.

Stakeholders also agreed that the AER should have an explicit role in determining exit fees

² NER 7.3A(g)

using a set of agreed principles. Most distribution network businesses considered that a cap is unnecessary because the exit fee paid by the consumer/business should be no less than the true cost imposed by the meter's replacement.

1.2 Options for discussion

In determining an approach for exit fees, there are a number of issues to consider, including:

1. What costs are associated with a distribution network business's type 5 or type 6 meter that is no longer required?
2. Should these costs be recovered through an exit fee to the consumer or business that seeks to upgrade/replace the meter, or some other approach?

Question 1: What are the costs associated with a type 5 or type 6 meter that is no longer required? Are these reflected adequately in the proposed principles?

Under the current arrangements, in jurisdictions where type 5 and 6 metering services are classified as an alternative control service³, distribution network businesses recover an exit fee from the retailer to cover the costs associated with the upgrade or replacement of a type 5 or 6 meter. The AER sets these exit fees as part of the regulatory determination process, with regard to the National Electricity Objective and the principles outlined in Chapter 6 of the NER for the regulation of direct control services.

Stakeholders are seeking greater transparency around how distribution network businesses arrive at the figures outlined in their regulatory proposals, including more detail on the cost components sought to be recovered through the exit fee.

In considering what costs should be recovered, we are seeking stakeholder views on the following questions:

- Is the average depreciated value of the stock of existing type 5 or 6 meters appropriate?

This principle was proposed by the COAG Energy Council for simplicity and administrative ease, as an alternative to attempting to determine the age of each individual meter at each premise. This approach appears to be a reasonable and effective way of assessing the value of the meter to be removed. There is a separate question as to whether this principle should be applied separately to type 5 and type 6 meters (see below).

- What should constitute 'operating costs'?

This principle was proposed as a means to allow a distribution network business to recover the costs incurred as a result of operating and maintaining those meters. Operating costs could include IT or other related costs. We consider it is necessary to determine which associated costs are reasonable to recover, and how these costs might be calculated.

- What are the 'costs associated with transferring the consumer to another Metering Coordinator'?

This principle is intended to cover the relevant administrative costs that may be incurred for the consumer transfer. It is necessary to consider what components are reasonable to recover and clarify that these costs are different to the 'operating costs' referred to above.

³ ACT, NSW, South Australia and Tasmania.

- Should the fee for type 5 meters be different from the fee for type 6 meters?

Under the current arrangements, distribution network businesses have tended to set a flat exit fee for both type 5 and 6 meters (ie a bundled fee). Our preliminary view is that the fees should be different because the value and expected life of a type 5 meter (and associated costs) can be quite different to that of a type 6 meter.

Question 2: How much of these costs should be recovered through an exit fee to the consumer or business that seeks to upgrade or replace the meter?

The costs associated with a meter no longer required could be recovered by the distribution network business in a number of ways. Some principles to consider when deciding on the most appropriate means to recover these costs include:

- The price signal that would/should be sent to a consumer to enable choice in the range of products and services it can take up (reducing barriers to entry).
- Minimising transaction costs.
- Consistency of the regulatory framework for distribution network businesses.
- Impact on a distribution network business's investment risk.

There are a number of options that could be considered. We are seeking stakeholder views on the following:

1. An exit fee that recovers the full costs of the meter no longer required directly from the consumer/business that seeks to replace/upgrade it. This is what occurs under the current arrangements.
2. Allowing some costs to be recovered through an exit fee and the remainder through distribution use of system charges. Further consideration is needed to determine what can be done within the existing regulatory framework, or whether amendments to the Rules would be required to enable this.

If the AER is given the obligation to determine the costs associated with a type 5 or 6 meter that is no longer required, and how these costs are recovered, we will need to consider how prescriptive the Rules should be about the AER's role in this regard.

2. Ring fencing arrangements

To facilitate a smooth transition to the new arrangements, the COAG Energy Council proposed that the distribution network business would become the initial Metering Coordinator for those meters for which it was previously the Responsible Person. The distribution network business would undertake this role as a ring fenced business.

A distribution network business would also be required to ring fence its Metering Coordinator business where it seeks to compete with other Metering Coordinators in the market for the provision of metering services.

The COAG Energy Council stated that the objective of the proposed arrangement is to ensure competitive neutrality between a distribution network business proposing to take on the Metering Coordinator role and any other party that may wish to provide those services.

2.1 Stakeholder views

Most stakeholders were supportive of distribution network businesses taking on the Metering Coordinator role as a transitional arrangement, and provide Metering Coordinator services through a ring fenced business. These stakeholders indicated that ring fencing would be required to provide certainty in the market and the confidence to invest.

Several distribution network businesses suggested that the current cost allocation methodologies required by the AER are sufficient to demonstrate financial ring fencing. The ENA noted that legal or operational separation would not be necessary because most of the services are 'inward looking' and any additional ring fencing obligations would ultimately increase distribution costs.

2.2 Why might ring fencing be required?

Existing ring fencing obligations for distribution network businesses generally require the separation of certain aspects of regulated (direct control) services from other (unregulated, negotiated) services. Chapter 6 of the NER provides that distribution ring fencing guidelines may be developed by the AER, which may include provisions for legal separation, accounting arrangements, cost allocation, information flows and amendment or waiver provisions.

There are a number of reasons why ring fencing might be appropriate where a distribution network business takes on the Metering Coordinator role, including:

- to prevent cross subsidisation of the costs of its Metering Coordinator services through its regulated business;
- to prevent/limit the distribution network business from having access to information not available to other parties providing Metering Coordinator services (eg indication of the likely timing of meter replacements); and
- to prevent/limit the potential for a distribution network business to provide its Metering Coordinator business with access to services on more favourable terms than other parties providing Metering Coordinator services.

A range of ring fencing measures can be used to counter the incentive a distribution network business may have to engage in these kinds of anti-competitive behaviour. These are set out in Table 1 below.

Table 1: Ring fencing measures

Behaviour	Measures that could be used to address behaviour
Cross-subsidisation	<ul style="list-style-type: none"> - Accounting separation - Requirement to comply with the cost allocation method approved by the AER⁴ - Explicit prohibition on cross-subsidisation
Inappropriate information flows	<ul style="list-style-type: none"> - Physical separation of staff with access to confidential information - Prevention on staff that have access to commercially sensitive information from working for both parties - Separation of information systems, or restrictions on access - Requiring the distribution network business to provide all Metering Coordinators with equal access to information
Discriminatory access to services	Requirement for distribution network businesses to provide access to any services required by Metering Coordinators on a non-discriminatory basis.
Limiting consumer choice	Requirement for distribution network businesses to inform consumers of their ability to appoint their own Metering Coordinator (if the ability of a consumer to appoint a Metering Coordinator is permitted under the new Rules)

Onerous ring fencing requirements may increase costs to the distribution network business, which may affect the competitiveness of its offer to provide Metering Coordinator services. The costs of requiring full legal and operational separation are likely to be significant, and it is not clear that it would give rise to any additional benefits. Further, on its own, full legal separation may not be sufficient to prevent the distribution network business and Metering Coordinator business from engaging in certain behaviours, such as cross-subsidising and anti-competitive behaviour. If adopted, legal separation would most likely need to be supplemented by some of the ring-fencing measures referred to above.

2.3 Options for discussion

Question 1: What is the best approach for giving effect to the ring fencing arrangements?

Ring fencing obligations are currently administered by the AER based on those that were developed by jurisdictions. In their current form, the jurisdictional guidelines only apply in a narrow set of circumstances (eg separation of generation and retail businesses) and there are marked differences in the measures adopted by each jurisdiction. Significant changes

⁴ NER 6.15

may be needed to these guidelines to apply to the provision of Metering Coordinator services.

Rule 6.17 of the NER gives the AER discretion to develop ring fencing guidelines that distribution network businesses must comply with. Clause 6.17.2(b) outlines a set of broad provisions that the AER may include in their guidelines. Our preliminary assessment of the existing Rules is that these existing provisions may provide an appropriate framework to support ring fencing of the Metering Coordinator role. In 2011, the AER commenced a process to develop a national ring fencing guideline, but deferred further consultation due to the number of rule changes that were likely to occur as a result of the *Power of Choice* review.

In recognition of the benefits of a nationally consistent approach, our preliminary view is that the Rules be amended to require the AER develop a national ring fencing guideline within a specified timeframe. This could occur in the transitional period following the final determination.

A national ring fencing guideline is likely to cover the whole range of services provided by a distribution network business's ring fenced entity (not just metering and related services). It is therefore important that the ring fencing requirements in the national guideline align with the outcomes of the rule change. We will need to consider whether further guidance in the Rules is required relating to the provision of Metering Coordinator services.

Question 2: Should distribution network businesses be required to ring fence their Metering Coordinator business on the day that the Rules commence?

The rule change request suggests that distribution network businesses would be subject to the ring fencing obligations from the day the Rules come into effect. Our initial view is to agree to this approach in order to create a level playing field from the outset and ensure protections against the behaviours referred to above.

It is likely that there will be a transitional period between the final rule determination and the date the new Rules come into force. Distribution network businesses would have this period to ensure that they can comply with any new ring fencing obligations when the Rules commence.

We recognise that some distribution network business may not seek to compete in the Metering Coordinator market and/or may be replaced by the retailer's chosen Metering Coordinator soon after the Rules commence. These businesses risk incurring the costs of establishing a ring fenced business (if one doesn't already exist) only to be replaced.

We are interested in stakeholder views on this issue, and whether the ring fencing waiver provisions could be used in these circumstances. Ring fencing waiver provisions could also apply in areas where competition is not expected to emerge and the distribution network business can demonstrate that complying with the ring fencing obligations would be unnecessary and onerous.

3. Deploying smart meters as part of a regulated demand management (DSP) business case

The COAG Energy Council stated that nothing in the rule change request would prevent a distribution network business from offering payment for metering services or purchasing services enabled by smart meters to support a demand side participation (DSP) business case.

The discussion at the workshop will focus on circumstances where there is not already a smart meter in place at a premise, and the question of whether a distribution network business should be able to install a smart meter for network efficiencies as part of its regulated business.

Where a smart meter has already been installed, the distribution network business should be able to recover the costs associated with access to its functionality, provided that the AER deemed it to be an efficient non-network alternative. As noted, the arrangements for a distribution network business to access the services enabled by smart meters, and at an efficient price will be the focus of discussion at the third stakeholder workshop.

Under the current arrangements in Chapter 6 of the NER, there are three ways in which a distribution network business can fund its DSP projects. These are outlined on page 53 of the consultation paper, available on the AEMC website⁵.

The objective of the COAG Energy Council's proposal is to ensure that any new regulatory arrangements allow distribution network businesses to capture the network operational benefits of advanced metering and consider it as an alternative to network augmentation.

3.1 Stakeholder views

The AER and most retailers were of the view that a distribution network business should not be able to install smart meters as part of their regulated business. The ENA and distribution network businesses were in favour of this where it is prudent and efficient to do so for network purposes, even just for a limited time until competition develops.

A few retailers acknowledged that a distribution network business may seek to install smart meters as part of a DSP business case to address network constraints in a specific location. However, these retailers were of the view that the distribution network business should be required to carry out a transparent, competitive tender process and not just grant the work to its own ring fenced Metering Coordinator business.

3.2 Options for discussion

It is important that distribution network businesses can capture the network benefits of more advanced metering. As such, a distribution network business should be able to provide payment for the installation of a smart meter at a site where there is not already one in place and the incumbent Metering Coordinator does not see a business case to do so.

At the workshop, we will consider three scenarios under which a distribution network business could potentially deploy smart meters. The Metering Coordinator at a site could be a Metering Coordinator business established by a retailer or other party (as outlined in Scenario A) or a ring fenced distribution network business (Scenario B). Scenario C discusses the possibility of a distribution network business carrying out a targeted installation of smart meters as part of its regulated business in areas where there is no competition for

⁵ <http://www.aemc.gov.au/Rule-Changes/Expanding-competition-in-metering-and-related-serv>

Metering Coordinator services and the AER has waived the distribution network business's obligations under the ring fencing guidelines.

Scenario A: A distribution network business provides payment to a Metering Coordinator in its network area for the installation of a smart meter to help address a network constraint or achieve network operational efficiencies.

Under this scenario, the Metering Coordinator is either the retailer's Metering Coordinator or other Metering Coordinator business. A distribution network business could negotiate with the Metering Coordinator at that site and provide funding (in full or in part) to install a smart meter. Subject to AER approval, the distribution network business could recover the costs of the contract through normal processes for a DSP program or non-network solution (ie as part of its operating expenditure).

We consider that the Metering Coordinator would have an incentive to enter into an arrangement for the installation of a smart meter where it is being funded by the distribution network business. However, a number of distribution network businesses have raised a concern that the Metering Coordinator may refuse to negotiate with the distribution network business or quote an inefficient price for the installation. We understand that these issues are linked, and will discuss the incentives on the Metering Coordinator to negotiate with other parties and contract at competitive prices at the third stakeholder workshop.

This option raises some questions to consider, including:

- Is there anything in the Rules that prohibit a distribution network business from recovering expenditure incurred through a contract with a Metering Coordinator?

Our preliminary assessment is that nothing in the rules prevent the recovery of these costs, provided that the AER deems it to be an efficient non-network alternative.

- What notification arrangements might be required for the retailer at that site?

Scenario B: A distribution network business provides payment to its ring fenced metering business (as the Metering Coordinator for that site) to install a smart meter to help address a network constraint or achieve network operational efficiencies.

This scenario is similar to Scenario A, except it applies in circumstances where the Metering Coordinator at the site is the distribution network business's own ring fenced entity. Under this scenario, the distribution network business could provide funding (in full or in part) to the Metering Coordinator to install a smart meter.

We consider that nothing in the proposed arrangements for the competitive framework would prevent a distribution network business from recovering the costs of the contract with its ring fenced entity through normal processes for a DSP program (ie as part of its operating expenditure), subject to AER approval. The AER would be able to consider the extent that the contract had been agreed at arm's length as part of its assessment of the efficiency of the proposed expenditure.

This option raises some questions, such as:

- What incentive does the distribution network business have to keep costs down?
- Are existing AER processes sufficient to scrutinise related party transactions?

Scenario C: A distribution network business carries out a targeted installation of smart meters as part of its regulated business where the AER has granted it a ring fencing waiver for that network area and it can demonstrate that no other party is willing to upgrade the meter at that site.

This scenario reflects a circumstance where a distribution network business might be able to install smart meters as part of its regulated business. We see this scenario as a fall back option that could apply in an exceptional circumstance where there is no competition for the provision of Metering Coordinator services (for example in a rural or regional area), and where there are provisions for the ring fencing obligations to be waived. In this case, there may be an argument for the distribution network business itself to install the smart meters if it can demonstrate that there is a net economic benefit to the consumer.

This option raises some questions to consider, such as:

- Is there a case for the metering asset to be:
 - o provided as part of a regulated service and form part of the distribution network business's regulated asset base; or
 - o should the distribution network business's ring fenced Metering Coordinator business provide the service through an arrangement with the distribution network business (ie Scenario B)?
- How would the distribution network business demonstrate that there is no competition for Metering Coordinator services in that area?
- What happens if competition does emerge in that network area and the retailer decides to appoint another Metering Coordinator at that site?

We consider that this scenario may have implications for the competitive framework.

4. Arrangements for existing load control

The COAG Energy Council proposed that where there is existing load control capability or functionality, this must be retained and be operational if the meter is replaced.

This is based on the principle that consumers should continue to have access to those services (eg controlled hot water) and that the network operational benefits continue to be captured.

4.1 Stakeholder views

Generally, there is industry consensus about maintaining existing load control capability, thus most stakeholders in their submissions did not comment on the issue.

Several distribution network businesses raised a concern that an existing device used for network operational purposes would be removed by a Metering Coordinator without their consent if appropriate arrangements were not put in place.

Some distribution network businesses suggested that they should be allowed to retain their existing load control device if they cannot negotiate a satisfactory arrangement with the Metering Coordinator to access equivalent functionality in the new meter.

4.2 Issues for consideration

Question 1: What obligations should be placed on a Metering Coordinator to ensure that existing load control capability is maintained? Should such obligations be provided in Rules or could they form part of the metrology or service level procedures?

We outlined in the consultation paper for the rule change that there are different forms of load control capability currently operating in the NEM, for example the management of hot water during off-peak periods or the cycling of air conditioners as part of a network peak demand management program.

It is worthwhile to note that the existing load management capability (or infrastructure) which currently exists can be either:

- form part of the metering installation for the purposes of the NER: or
- sit within the 'meter box' but not constitute part of the metering installation (ie separate relay devices).

While there is general agreement that existing load control capability should be maintained, we need to consider what additional arrangements might be required to facilitate this. This includes the scenarios where:

1. The Metering Coordinator upgrades/replaces a meter that contains load control capability.

Under the proposed arrangements, the Metering Coordinator would need to make sure that the new meter provides at least the same level of load control capability/functionality as the existing meter. In this scenario, a key question to consider is how these existing services continue to be accessed and used by the distribution network business. Since the distribution network business is already using the capability and has no viable alternative in the short-run, its ability to negotiate a reasonable charge could be lessened.

2. The existing load control capability does not form part of the existing meter but sits within the 'meter box' (eg a relay device).

Under the NER, the Responsible Person is responsible for, among other things, the provision, installation and maintenance of a metering installation⁶. A metering installation is defined under Chapter 10 of the NER as “the assembly of components ... that are controlled for the purpose of metrology.” Chapter 7 of the NER qualifies this definition by providing additional requirements regarding the components that may form part of a metering installation.⁷ In our view, these provisions operate to exclude load control devices from forming part of a metering installation in circumstances where such devices are not, at least in part, controlled for the purposes of metrology.

However, this interpretation of a 'metering installation' exposes an inconsistency between the NER and AEMO's metrology procedures. The metrology procedures expressly refer to load control equipment as forming part of a metering installation in certain circumstances. We will consider this inconsistency in the context of any supporting changes that need to be made.

Under this scenario, issues arise with respect to the rights and obligations of the distribution network business when a Metering Coordinator seeks to upgrade components of the 'meter box'. Under the proposed arrangements, the Metering Coordinator would not be able to remove or alter the existing load control capability (where it is located in the physical meter box but does not form part of metering installation) without the agreement of the distribution network business. We will consider what changes might be required in the Rules to enable this to occur.

⁶ NER Clause 7.2.1 (a) (1).

⁷ NER Clause 7.3.1 (b) and (c).