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Mr Warwick Anderson
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson

Submission on the Stage 2 F&As and Transitional Regulatory Proposals - NSW and ACT Electricity Distributors

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Australian Energy Regulator's ("AER") Stage 2 Framework and Approach papers ("F&As") and transitional regulatory proposals for regulated electricity distributors in NSW (Ausgrid, Endeavour Energy and Essential Energy) and ACT (ActewAGL), dated January 2014. The Stage 2 F&As are intended to cover the transitional regulatory control period from 1 July 2014 to 30 June 2015 and the subsequent regulatory control period from 1 July 2015 to 30 June 2019.

2. Vector is one of New Zealand's largest listed companies. We provide services in the New Zealand electricity, gas and telecommunications sectors. Our metering business, Advanced Metering Services ("AMS"), is New Zealand's leading smart meter provider.

3. While our operations are currently limited to New Zealand, we are investigating commercial opportunities in the NSW and ACT smart metering markets. Our submission is therefore focused on the AER's views on metering services in these markets.

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

5. Vector's contact person for this submission is:

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Types 5 and 6 metering services

6. Vector considers that the AER's classification of Types 5 and 6 metering services as "alternative control services" (excluding metering installation services in NSW, which are unregulated) in the Stage 1 F&As for NSW and ACT supports the Australian government's approach to achieving a competitive electricity market. The government's market-led approach is embodied in policy settings, including:

   - the National Electricity Objective, which aims "to promote efficient investment in and efficient operation of, electricity services for the long term interests of consumers of electricity";

   - the Australian Energy Market Commission's Power of Choice review, which makes recommendations supporting market conditions that facilitate efficient demand side participation in the electricity market; and

   - the Standing Council on Energy and Resources' rule change request, intended to provide competition in metering services. This would pave the way for the provision of metering services not only by distributors but also by retailers, independent meter owners and end users.

7. Vector agrees with this market-led approach. Our view is supported by our experience in the New Zealand metering market, where the government and the Electricity Authority (the electricity market regulator) have found it unnecessary to regulate metering as market arrangements are working effectively.[1] The New Zealand model has led to the rapid deployment of approximately 1.1 million smart meters (55% penetration) over the past few years.

8. Vector agrees with the AER's assessments that:

> . . .There is potential for contestability of metering provision, maintenance, reading and data services in the near future. [Stage 1 F&A for NSW distributors, page 44]
>
> . . .There is competition potential [*sic*] for type 5 and 6 metering services in the near future…we consider that retaining an alternative control classification will enhance competition should contestability for these services change. If charges for these services were bundled in distribution charges, any future changes in contestability may be far less effective. [Stage 1 F&A for ActewAGL, page 23]

9. Vector considers that the AER's classification of Types 5 and 6 metering services as alternative control services reduces (but does not eliminate) the risk of cross subsidies from natural monopoly services (lines) to contestable or potentially competitive services (metering). This would result in more efficient and transparent

[1] Electricity Authority (2012), Nomination of MEP and access to metering data – decisions and reasons, 13 April 2012, Wellington, http://www.ea.govt.nz/our-work/programmes/priority-projects/part-10-review/

pricing, providing more accurate signals to retailers wishing to enter the smart metering market to provide better services to their customers.

10. Ultimately, we believe that metering services should be removed from price regulation altogether. Regulators should focus on identifying, removing and avoiding unnecessary barriers to market entry and competition. As competitive metering markets are being developed in NSW and ACT, the need for greater regulation of these services should fall away.

Principles of cost recovery for regulated distributors

11. Vector considers that the following principles should apply to determining how regulated distributors recover the costs of their legacy metering investments:

    - Where regulators have approved investment by distributors in legacy metering technologies, the distributors can reasonably expect to recover those costs.
    - However, the recovery of those costs should be undertaken in a way that has the lowest distortionary effect on the emerging workably competitive smart metering market.

12. In order to ensure that the migration to smart meters is not unduly distorted by distributors' need to recover the costs of past investments, the options the AER could consider include:

    - exit fees; or
    - accelerated depreciation.

13. These are discussed further below.

Exit fees

14. Exit fees can be a significant barrier to market entry and competition and, in our view, should be minimised or, preferably, avoided altogether.

15. Vector understands, through its discussions with industry representatives, that regulated distributors in NSW are proposing non-uniform exit fees. For example, we understand Ausgrid's proposed fees are expected to be much higher than those proposed by Endeavour Energy and Essential Energy.

16. While we appreciate these differentials could be driven by cost differentials, the presence of cost differentials could imply that the transition to smart metering may only be commercially sensible for retailers whose customers are not on networks

with high exit fees. This arrangement would reduce competition from retailers intending to provide improved levels of service to customers on those networks.

17. We **recommend** that the AER investigate whether significant differentials between exit fees across distributors exist.

18. If cost differentials exist, one way to determine if they reflect the legitimate costs of metering to the distribution companies is to make those costs transparent. We **recommend** that the AER seek full disclosure by regulated distributors of how their metering costs have been determined - that the levels at which these fees are set represent the true costs of running the metering and relevant parts of the regulated businesses. This could include, for example, benchmarking of their equipment and installation costs to ensure that the actual per NMI investment is reasonable. This would support the government's efficiency objectives for the electricity sector.

19. Because exit fees can be a significant barrier to market entry and competition, we **recommend** that the AER review the impact of exit fees on competition and the development of the smart metering markets in NSW and ACT. Such a review can inform a strategy for transition, including strategies that do not include exit fees.

20. We **recommend** that, if exit fees are introduced, the AER consider placing a cap on exit fees to avoid these fees becoming excessive and becoming a significant barrier to market entry and competition.

Accelerated depreciation

21. To enable a transition to smart meters that does not create a barrier to market entry and allows regulated distributors to recover their regulated costs and no more, Vector **recommends** that the AER consider approaches to significantly reduce exit fees, for example, through accelerated depreciation. This would provide the right incentives for metering market participants to make efficient investment decisions and pursue innovation.

22. In New Zealand, smart metering is being deployed rapidly. Vector is accelerating the depreciation of its legacy metering asset base in New Zealand. We are three-quarters of the way through the rollout of approximately 840,000 smart meters that we have been contracted to supply to New Zealand retailers.

23. We **recommend** that the AER consider approaches for accelerating the depreciation of regulated distributors' legacy metering assets. This would enable exit fees to be eliminated, remove barriers to entry, speed up the transition to smart metering, and facilitate the achievement of the government's objectives for the electricity sector.

Concluding comments

24. To recap, we **recommend** that the AER:

    a. investigate whether significant differentials between exit fees and costs across distributors exist and, if they do, how they can be managed to facilitate the transition to smart meters;

    b. seek full disclosure by electricity distributors of how their metering costs and exit fees are calculated;

    c. review the impact of exit fees on competition and the development of the smart metering markets in NSW and ACT;

    d. consider placing a cap on exit fees to avoid these fees inhibiting the uptake of smart meters; and

    e. consider approaches for the accelerated depreciation of regulated distributors' legacy metering assets as an alternative to exit fees.

25. Our preference is for an approach that does not include exit fees and facilitates the development of a competitive smart metering market, while ensuring distributors are able to recover their reasonable costs.

26. We are happy to discuss with AER officials our experience in the competitive New Zealand metering market, including how we depreciate our legacy metering asset base.

Yours sincerely

Bruce Girdwood
Group Manager Regulatory Affairs