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Manager, MCE Secretariat,
Department of Industry, Tourism and Resources,
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Re: Regulatory Impact Statement on Smart Meter Rollout

AGL Energy Limited¹ (**AGL**) welcomes the opportunity to comment on the "Regulatory Impact Statement that accompany Phase 2 of MCE's consideration of a smart meter rollout" issued by the Ministerial Council on Energy (**The RIS**).

AGL understands that the RIS facilitates the input from stakeholders to assist the government in considering and determining policy issues relating to the potential rollout of smart meters nationally. Specifically, the RIS seeks to complement the considerations on smart meter rollout as reported in a Phase 2 Cost Benefit Analysis (CBA) by including broader policy issues such as competition, regulation and legal frameworks.

AGL considers the RIS a critical part of making prudent decisions that not only involves a potential investment of \$3 to \$5 billion but also the long term interest of customers and the energy industry.

AGL has recently provided a written response to MCE on the CBA, which should be considered in conjunction with this response. It outlines AGL's:

- detailed comments on the findings of the CBA;
- concerns on the assumptions of the analysis; and
- suggestion that more consideration should be given to the effect of competition.

This response focuses on competition issues that AGL believes are critical in the making of a decision on "how" and "why" smart meter should be introduced. It provides AGL's responses to a number of the questions raised in the RIS and discusses others that may not have been raised in the RIS.

In making decisions on smart meter rollout, AGL strongly urges the SCO to consider all factors that may or may not have been explicitly covered by the RIS and CBA report.

¹ AGL is Australia's largest retailer of gas and electricity with around 4 million customer accounts in New South Wales, Victoria, South Australia and Queensland (including ActewAGL). AGL has significant investments in upstream energy markets. We own and operate 645 MW of hydroelectric power generation assets, the 1280 MW Torrens Island Power Station and the Somerton gas-fired power stations. AGL also has a 32.5% equity investment in the Loy Yang A power station.

AGL supports competition in metering, data and communication services

AGL believes that a decision to adopt a regulated or monopoly approach in introducing smart meters should only be made when there is strong evidence to suggest that the existing market is not efficient or competitive, or there are inherent factors that do not allow a competitive market to be developed. As far as AGL is aware, there has not been a formal evaluation of the existing smart metering market to determine if competition is effective or the market is capable of becoming effective.

Smart meters are currently installed and operated through competitive provisions for larger customers and to a lesser extent, the smaller customers. Under the existing rules, the retailers choose their smart meter suppliers and separate meter data agents for remote collection and transmission of metering data². In the event of a customer churn, the meter may stay on the wall and there may or may not be a change in meter data agent. That is, customer churn does not automatically mean meter churn.

In some cases, customer churn may result in a churn of meter data agent, facilitated by interoperability and provisions in the current rule. In other cases, customer churn may involve meter churn, with no financial penalty to customers or retailers. This may be a result of improved offering and the inability of the incumbent metering supplier to compete with an alternative supplier or a lack of appropriate contractual arrangements between retailers and service providers³. AGL would argue that this competitive tension is desirable and necessary as long as the financial and technology risk resides with the party best able to manage those risks, which is most likely to be the meter device suppliers or retailers not consumers. This arrangement promotes competition by eliminating switching cost and encouraging the metering suppliers to continuously stay competitive in order to retain or increase their market share.

It is not apparent from the CBA report as to why the current competitive arrangement may not be suitable for a larger market of small customers, or a modified form should not be considered to ensure effectiveness of competition can be achieved. The CBA appears to assume that in a retailer-led scenario, competition will lead to considerable churn of meters and refresh of modems, a significant cost impost that is unlikely to materialise if there is effective competition. AGL would argue that if there is effective competition, there would be a downward pressure on the up-front and on-going cost in the provision of smart metering services, a factor that has not been incorporated in the CBA⁴.

It is not clear from the CBA report as to why the effect of competition on the provisions of meter and data services should not be incorporated in the CBA⁵. While scenario 2 is noted as "Retailer-led", competition in the provision of meter and data services are effectively between suppliers of meters, data and communication. The retailer's role is to determine the customer's energy needs and to deliver the best value through innovation of product and services. It is in the interest of the retailer that there is effective competition in the supply of meter, data and communication services to facilitate the creation of value, product and service differentiation. This is particularly effective when the market for meters and data are separated, as is currently the case. It ensures that the long-term interest of customer and efficiency of energy market is promoted through competition in retailers and suppliers.

AGL strongly encourages the SCO to consider the merit of a competitive approach to the introduction of smart meters that is similar to the existing structure or practices, or some modified form that best meets the long term interest of customers and the electricity market.

² Provision of smart meters and meter data services are separate competitive services that are contracted by the retailers.

³ More contractual arrangements are now in place to promote market efficiency.

⁴ Page 41 of NERA Report on CBA indicates that the impact of a greater scope of competition on cost and benefits have not been incorporated in the study.

⁵ Ibid, page 41, indicates that detailed analysis on competition in metering and data services has been excluded from the study.

AGL believes that monopoly in smart metering services should be the last resort

AGL believes that the existing smart metering market or some industry-agreed modified form should be given the time and opportunity to be developed and tested before any market intervention is introduced.

The existing rule for remotely read meters permits the competitive provision of smart meters and provides the starting point for the introduction of smart meters to the small customer segments. This incremental approach offers the opportunity for the industry to determine the viability of a market-based approach for smart meters to be introduced at a scale larger than the existing market. AGL believes that a contestable approach offers the best opportunity for the intended service performance to be achieved or exceeded and new services to be continuously developed and implemented.

In AGL's view, the decision on the best approach to introduce smart meters should be based on economic principles rather than technical arguments. It should consider the long-term impact on the efficiency and growth of the electricity market. While the CBA has dealt comprehensively with a whole range of issues, it is somewhat limited to the assessment on static technical parameters of the rollout⁶. It ignores the dynamic efficiency that can be gained from a competitive market that drives service and product innovation and cost reduction. AGL is concerned that the full economic benefits of smart meter may not be fully realised with a market design that does not allow full competition to exist or be developed.

A larger scale introduction of smart metering providing two-way connectivity to a large number of homes and small businesses has the potential to open up new market and new opportunities for players inside and outside electricity industry. It has the potential to change the economics and market dynamics for the provision of electricity and non-electricity-related services to smaller customers and other businesses. By pursuing a market-based approach in the first instance, AGL believes the electricity industry could determine if there is greater benefit to be gained from the efficiency achieved in a wider pool of mature industries and financial resources.

AGL believes a competitive approach will allow the industry to achieve the best possible outcome that can be obtained from the existing and future market. It includes the possibility for the distribution business to compete for the provision of smart meter services in a competitive setting. The smart meter services may initially be underpinned by basic industry requirements defined by the stakeholders to fulfil NEM obligations. The retailers and distributors may then decide on a commercial basis to contract additional smart metering services with the independent service providers to achieve business efficiency and customer service requirements similar to some of the benefits discussed in the CBA. This approach allows the split-benefits to be captured by each energy business as they arise with additional services funded by positive net benefit. The customer benefits from lower cost through retail competition and sharing of distributor's efficiency gain provided by incentive regulation⁷.

AGL believes the retailer should be the responsible person of smart metering in the national electricity market

AGL believes that retailer should be the responsible person for ensuring smart meter is installed and for appointing meter data agents for the collection of meter data and services as per current rules for remotely read meters. A retailer is the customer's agent for energy services and smart meter enhances customer offering and experience. In AGL's view, the retailer is best placed to develop the value propositions for each customer or groups of customers, and provide the appropriate level of service at a market price. As discussed earlier, this arrangement does not

⁶ AGL does not consider the "retailer-led" scenario to be equivalent to a competitive model as the effect of competition has not been adequately considered.

⁷ The removal of retail regulation will enhance this process.

preclude the distribution business in engaging with smart meter service providers to deliver services that increase the efficiency of network operation and investment.

In the NEM, a retailer is the FRMP and is exposed to trading risk relating to consumption, pricing, transfer and settlement. A retailer relies on accurate and timely data to support its product offerings and services as well as billing and settlements. The exposure of the retailer to financial and operational liability is materially increased with smart meter delivering services that are significantly bigger in volume, more complex and time critical. To manage this risk, the retailer must have the flexibility to source smart metering services from a competitive market that can best meet its obligations with the customer and the market operation at an efficient cost.

In addition, retailers are not constrained by geography and many operate with a national footprint. They are in the best position to launch smart metering services nationally and achieve cost efficiency through economy of scale⁸. It provides a nationally consistent platform for the development and introduction of new retail products and services to customers across all participating jurisdictions. Smart metering policy decision needs to reflect this national character and should be supported by a set of nationally consistent metrology, market processes and rules. AGL believes that a national approach is the best way to achieve maximise operating efficiency in retailing, which can only be achieved when business systems and processes operate seamlessly across all jurisdictions.

AGL supports an industry approach to determine the most effective and efficient way to introduce smart meters

The CBA report suggests that based on the indicative cost and benefit analysis, there is likely to be net benefit in rolling out smart meters in the electricity market. As indicated in our previous response to CBA, the report also highlights the significant uncertainty in the estimates resulting in a wide range of possible outcomes.

It appears that there is some doubt regarding the feasibility of the technology trialled in Victoria. While this technology may be potentially a lower up-front cost option, there may be significant risk in increased on-going cost and flow-on-cost to the retailers in the event of a service failure.

In addition, the responses from the distribution businesses to the CBA suggest that there may be significant under-estimation on costs and over-estimation on benefits⁹. AGL is concerned that this uncertainty would distort the relative merits of different approaches to rollout as proposed in the CBA and compromise the integrity of the decision making on smart meter policy by the MCE.

This uncertainty necessary means that a firm decision on whether to introduce smart meters or the most appropriate way of introducing smart meters should not be made until further review is done to verify the findings in the report. As indicated in this and our previous response, AGL suggests that the merit of competition should also be further considered before a definitive direction is determined.

It is our understanding that an industry-led steering committee would shortly be formed to consider the implications of the CBA study on smart meters and the impending policy decisions by MCE scheduled in June 2008.

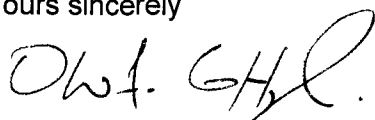
AGL strongly supports the formation of the steering committee and the proposed working groups and looks forward to contribute further to the decision process ahead.

⁸ Cost efficiency can also be achieved by the smaller retailers as the installation of meters and communication is carried out by a number of suppliers across the nation.

⁹ For example, on page 14, 15 of its response, UED indicates that most of its costs is significantly higher than the high end of CBAs' (eg IT and communication CAPEX is twice and 60% higher respectively, OPEX for IT and communications is 60% and 10 times higher etc)

Should you have any questions regarding this submission please contact myself on (03) 8623 8404 or Kong Min Yep on (03) 8633 6988 or kongmin.yep@agl.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read "Owen Coppage". The signature is written in a cursive style with a large initial 'O' and a long horizontal stroke.

Owen Coppage
Chief Information Officer