

16 April 2008

Ms Sarea Coates,
Chair, Smart Meter Working Group
MCE Secretariat
Department of Resources, Energy and Tourism
GPO Box 1564, Canberra ACT 2601

Dear Ms Coates,

NERA final report into cost benefit analysis of smart metering and direct load control

Integral Energy is pleased to provide a response to the recent NERA report on the *Cost benefit analysis of smart metering and direct load control* (the NERA report) published by the Ministerial Council on Energy's (MCE's) Standing Committee of Officials (SCO) in March 2008.

Integral Energy notes that the MCE has previously mandated the rollout of smart meters in regions where there is a positive net benefit. In summary, Integral Energy:

- agrees with NERA's comments that the cost benefit analysis is subject to a number of uncertainties including the need to finalise the national functional specification;
- agrees with NERA's conclusion that a distributor-led smart meter rollout best satisfies the MCE's assessment objectives;
- submits that the most effective way to realise the associated net benefits is to:
 - put in place an industry-led governance regime tasked with:
 - completing the functional specification, including setting service levels and the need for systems interoperability, and developing the required technical specifications; and
 - scoping, planning and undertaking the rollout, including conducting appropriate trials, in the relevant regions by a realistic but firm deadline (subject to further analysis, tentatively 2017); and
 - put in place a regulatory regime that creates the certainty required to deliver those benefits by ensuring a full cost recovery for distributors in relation to:
 - the planning, trialling and rollout of the smart meters; and
 - the ongoing provision by distributors of metering related services over the twenty year period in respect of which NERA concluded that a distributor led rollout would generate the greatest positive net benefits.

Going further for you is what we do

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The power is in your hands

The industry-led governance regime should provide suitable accountability to policy stakeholders with respect to finalising the functional specification and meeting key delivery milestones. It should also have full participation in the development of a suitable regulatory framework including changes to the associated legislation and National Electricity Rules.

A number of more detailed comments concerning NERA's report are attached to this letter. Integral Energy also endorses the ENA's submission on the NERA report.

Overall, Integral Energy's preliminary view is that a realistic timeframe for completing the rollout would be by 2017. In particular, that end point would also provide the opportunity to work closely with Victorian stakeholders to ensure the strongest alignment of specifications and systems interoperability and thereby maximise the benefit to consumers nationally.

Integral Energy believes that the national rollout of smart meters offers a platform for delivering meaningful supply and demand side efficiencies for the benefit of consumers and the wider community. Given the nature, size and complexity of the undertaking required, Integral Energy firmly considers that the only effective way to deliver that platform is through a distributor led-rollout complemented by policy and regulatory frameworks that provide the requisite investment certainty. Integral Energy looks forward to working with the MCE and other stakeholders to meet those challenges.

Should you wish to discuss any aspect of this submission, please contact Anthony England on (02) 9853 6511.

Yours faithfully



Vince Graham

Chief Executive Officer

Attachment

Costs and benefits

Integral Energy notes that NERA has indicated that it has taken a conservative position with respect to its assessment of both the benefits and costs associated with a rollout. While this may be true, Integral Energy is concerned that the analysis fails to capture all of the costs and benefits that would accrue to retailers and customers. For example, the analysis:

- does not capture the potential for a greater demand side response as the result of the Federal Government's imminent greenhouse policies, including the introduction of an emissions trading scheme (this is presumably an issue of timing);
- significantly understates the costs associated with a retailer led rollout scenario in relation to meter churn and the increased complexity of IT systems required to support metering contestability — those higher costs may have implications for the effectiveness of competition under such a scenario;
- may have failed to adequately cater for specific local distributor conditions and therefore potentially understate the costs faced by those businesses in implementing the required solutions; and
- ignores the potential benefits to retailers from delivering additional services through the Home Area Network (HAN).

Notwithstanding the above, Integral Energy considers that the deficiencies in NERA's analysis do not affect the relativities of the outcomes. Clearly, a distributor led rollout has the potential to deliver the greatest net benefits to consumers.

In this regard, Integral Energy notes that the draft Regulatory Impact Statement recently published by the SCO raises the possibility of providing contestable franchises for, rather than mandating, the rollout of smart meters. This option was not identified as a scenario in NERA's report and Integral Energy intends to address the feasibility of such an approach in its response to the draft RIS. As a preliminary comment, Integral Energy notes that doing so would suffer a number of the disadvantages of the retailer-led scenario rejected by NERA including foregoing the benefits from having more aligned infrastructure under a national distributor-led rollout.

Maximising the net benefits under a distributor-led rollout

There are several matters raised in NERA's discussion of the costs and benefits that would need to be addressed to ensure that a distributor-led rollout was able to deliver the maximum possible net benefits to consumers.

First, the analysis suggests that most of the benefits initially accrue to distributors rather than retailers. The implication could therefore be drawn that there is in fact no market failure with respect to smart metering provision. Integral Energy notes that, were this the case, then a distributor led rollout would be likely to have occurred already. This has not taken place, a fact that suggests that NERA may have misallocated the relative share of the net benefits between distributors and retailers. The issue is raised in the context that distributors' costs are regulated. It will therefore be crucial that a regulatory regime is put in place that ensures that distributors are able to recover their full costs of undertaking a smart meter rollout. It should not simply be assumed that the costs of doing so are network business efficiencies that can be quickly clawed back for the benefit of customers without jeopardising the incentives on the business or the customer service levels. Distributors must be able to recover the value of installing and operating the requisite systems over a sufficient period of time. In this regard, it is submitted that a reasonable period for doing so would be the twenty year timeframe that formed the basis of the net benefits identified by NERA in its analysis.

Second, the size of the net benefits obtained by customers also depends on there being a holistic policy and regulatory framework that encourages the potential benefits to be realised. Fundamentally, smart meters are an enabler for more efficient demand and supply side responses. However, as is well understood, there are currently a number of policy and regulatory barriers that prevent participants from fully realising those benefits including, for example, tariff controls at both the distributor and retail levels. Taking positive steps to remove or reduce those barriers would therefore be desirable. In addition, changes to the National Electricity Rules would be required to provide the authority for distributors to undertake a mass market rollout of smart meters.

Finally, while not impacting on the outcomes of the analysis, NERA also indicated a degree of uncertainty regarding the rollout costs for Victorian distributors. Integral Energy notes that the most effective way to address the issue would be to put in place an effective industry-led governance process for distributors delivering the smart meter rollout. This is discussed further in the section below.

Processes forward

The matters identified above have implications for the timeframes and processes for implementing a distributor-led rollout.

First, NERA's analysis was undertaken on the basis of the national functional specification developed as part of the Phase 1 activities. While that specification has been significantly progressed, there are a number of areas that require further development. Integral Energy notes that a Technical Working Group (TWG) is being set up to progress that task and expects that the TWG process will interact with the development of the technical specifications for the smart meters and related systems to be finalised during a trialling period. In this regard, it is essential that the rollout timeframes incorporate an adequate period for trials to ensure that

what is delivered meets the final functional and technical requirements. This would include both proof of concept and field trials. Integral Energy's judgement is that a period of approximately three years would be required to undertake that part of the process.

Second, given that the overall program will involve planning, trialling and rollout stages and that each point will involve significant business expenditure, Integral Energy submits that:

- the MCE's timetable would need to include suitable review points to ensure that mandated outcomes were being achievable in a timely and efficient way; and
- the regulatory framework would need to provide for a staged cost recovery process at intervals less than current regulatory review periods (five years).