



Department of
Natural Resources and Environment

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22 March 2001

Mr Rod Shogren
Commissioner
Australian Competition and Consumer Commission
470 Northborne Avenue
Dickson ACT 2602

Dear Mr Shogren

ACCC draft determination

Thank you for your letter of 9 March 2001 inviting further Victorian comments on issues related to the introduction of full retail competition, including entrenchment of profiling, the use of a 'new and replacement' meter strategy, and meter ownership.

The use of profiling to introduce full retail competition

The merits of profiling versus interval metering were addressed in our joint submission with New South Wales Treasury dated 11 October 2000, in the context of the FRC Code changes interim authorisation. As you would recall, the submission noted that load profiling is necessary for the effective implementation of full retail competition in Victoria, and that detailed analysis of profiling and interval metering contained in various studies confirms that roll-out of interval meters is currently economic for only a small group of customers in the sub 160MWh group.¹

In 1999, two consultancies commissioned by the Victorian Government examined profiling and metering options to implement full retail competition.² The resulting reports concluded that net system load profiling would be necessary for the effective implementation of full retail competition, and also recommended that the Victorian Government should give consideration to measures to accelerate the take-up of interval metering in a manner that would not be linked to customers' choice of retailer, due to the barrier to competition that would result from requiring a change of meter in

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¹ Analysis of profiling and interval metering is contained in a report prepared for the Victorian Distribution Businesses (*Evaluation of Metering Strategies for Full Retail Contestability*, Intelligent Energy Systems, December 1999 (Minor Revisions January 2000)), and the Office of the Regulator-General's *Consultation paper No.4, Electricity Retail Competition for Small Customers – Customer Metering*, May 2000.

² In 1999, PHB Hagler Bailly prepared a report for Energy Policy Division reviewing proposals for metering and settlement under full retail contestability. In the same year, Ernst and Young reviewed industry proposals for preferred trading arrangements.

order to change retailer, and from any attribution of interval meter costs to switching. (Costs of any mandated roll-out in Victoria of interval meters will be smeared: this is discussed further below). We stress that in our view, a meter roll-out policy must apply equally to first and second tier customers and must not be associated with switching retailer, not only for the competition reasons outlined above, but also for logical reasons such as the likelihood that a requirement to change meters before a customer could change retailers may deter them from switching.

We note the Commission's comment that 'only interval metering' is capable of delivering:

- pricing signals that encourage demand side responsiveness; and
- innovative retail tariffs;

thereby leading to more effective/genuine retail competition.

These are worthwhile outcomes that Victoria wishes to pursue. However, it needs to be kept in mind that interval metering of itself will not result in these outcomes. While Victoria will require an interval meter roll-out where a cost/benefit analysis justifies a roll-out, we will look to the market to deliver the benefits that interval meters can potentially provide, such as pricing signals and innovative retail tariffs. In our view, the use of interval meters is primarily a cost/benefit issue rather than a competition issue.

While interval metering has the potential to deliver the desired outcomes, and potential to eliminate energy cost cross-subsidies³, removing cross subsidies does not in itself result in a demand side response. While we agree that interval meters provide the *potential* for reflecting the sharper price signals from the wholesale market in retail tariffs, tariff structures will be a decision for retailers - the outcome will be determined by the market, not by the meter. The market response will determine whether interval meters result in greater price competition via innovation. Therefore, the benefits of interval metering may not necessarily be realised to the extent implied in your letter. However, Victoria will ensure that no barriers are set up to the roll-out of interval meters where they deliver net benefits, and allow market forces to deliver the optimal outcome.

While it is claimed that interval meters will result in more efficient energy usage, so far as we are aware research in this area has focussed on industrial and commercial customers, and the conclusions on demand side responsiveness may not necessarily apply to smaller customers. Arguments that enhanced price signals provided by interval metering can effect demand management are based on assumptions about the degree to which demand for electricity is elastic, how retailers pass these price signals to customers where the retailer's contract is likely to be based on ex ante pricing, the degree of sophistication of domestic customers and the tariffs that may be offered by the retailers. There would need to be far greater consumer awareness of time of use pricing signals before consumers can respond effectively to those pricing signals.

In relation to the potential of interval meters to provide for innovative retail tariffs, Energy Policy Division's (EPD) preliminary research indicates that customer preferences are for pricing stability. According to a recent study of customer attitudes to service attributes,⁴ prices under hourly rates would need to be considerably lower than under a fixed rate for customers to consider demand side responses. The study found that customer preferences ranked from most preferred to least preferred are for fixed rates, seasonal rates, time-of-day rates and hourly rates.

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³ Network tariff cross-subsidies will not be eliminated by interval meters.

⁴ *Customers' Choice Among Retail Energy Suppliers: The Willingness-to-Pay for Service Attributes*, Andrew A. Goett, Kathleen Hudson, and Kenneth E. Train., "Energy Journal" 2000 Vol. 21 No. 4.

To the extent that other parties have undertaken research or can identify reports that underpin the belief that interval metering can deliver significant demand side responses, greater price competition and improved price signals, we suggest that these should be provided to jurisdictional regulators for purposes of determining an efficient and effective interval meter roll-out program looking forward.

Transition from Profiling to a fully metered solution

Victorian Government medium to long term policy is to enable a full roll-out of interval meters (or the technological equivalent). As explained above, the use of net system load profiling (NSLP) facilitates the introduction of full retail competition in the short to medium term and is a satisfactory settlement mechanism while the economics of widespread interval meter installation is proven. It is difficult to predict the timeframe required to effect an efficient roll-out of interval meters in Victoria. Even if interval meter costs were to fall substantially (an assumption that underpins the commitment to interval meters), the logistics of mass-market procurement would not permit a full roll-out at this stage.

Nevertheless, adoption of load profiling at this stage does not prevent the discretionary installation of interval meters at any time, where customers and their retailers believe there are benefits in doing so. The NSLP is not expected to create a barrier to the efficient entry of interval metering for domestic and small business customers. Rather, it is a necessary step in the transition to interval metering, and will permit competition to be introduced in the key areas of overall price, levels of service and value added products.

Ultimately it can be expected that the cost of interval meters will drop to a point that it is economic to install those meters in a widespread manner. In Victoria, the Office has taken responsibility to determine the nature and timing for the optimal installation of such meters. In addition to any mandated/regulated metering policy (under which interval meters may be justified, for example, for new connections and in situations where basic meters reach the end of their service lives), it can be expected that metering will be taken up by individual customers and their retailers on a discretionary basis, in response to likely net incremental benefits over profiling. The incentives for retailers to offer interval meter packages to certain customers is discussed further in the joint Victorian/NSW submission, which concludes that market forces will help to drive a transition from profiling to interval metering.

The proposed Victorian Metrology Procedures will underpin the use of interval metering in settlement of the wholesale market. Under the proposed procedures, from July 1, 2002, interval meters may not be replaced by a basic ('accumulation') meter (clause 2.2.1). In addition, from July 1 2002, any interval meter installed at the premises of a second tier customer must be read as an interval meter and not as a basic meter.

Complexity of profiling

Given the expected timeframes for a roll-out of interval metering, I note your concerns that jurisdictions may encounter the same problems that emerged in the United Kingdom in relation to entrenchment of profiling, and the development of increasingly complex and costly profiling systems.

In our view, Victoria is highly unlikely to replicate the United Kingdom's experiences with profiling. This is partly because there is insufficient data available in Victoria of customer class profiles which would be necessary to introduce complex profiling systems. The United Kingdom's

profiling methodology is based on historical trends for seven different customer classes, updated annually based on a representative sample of half hourly interval meters, which are adjusted for actual temperature and sunset time data. In contrast, Victoria will use Net System Load Profiling (NSLP). NSLP is a dynamic profile that does not need to be adjusted for any other variables and is applied to all customer classes within a Local Network Service Provider (LNSP) area for which profiling is applicable.

The Victorian studies referred to above recommend the use of NSLP as the net benefits of moving to more sophisticated and costly profiles are not able to be justified. We are comfortable with the view that any further variations to the nature of profiling algorithms should be subject to a cost/benefit analysis. The Victorian Metrology Coordinator would apply a cost benefit analysis in any case, as this is a requirement under the recent Code changes. We would therefore support a requirement for Metrology Coordinators to ensure that peel off⁵ will only be introduced following analysis of its costs and benefits, and consultation with industry and consumers. This would allow the flexibility to introduce peel-off if it is required. However, the proposed Victorian metrology procedures do not provide for loads to be peeled off initially from the net system load profile in Victoria. Our analysis did not support initial peel-off, principally on grounds of cost, degree of accuracy, and its lack of potential to impact on price signals.

New and replacement strategy

The Victorian/national regulatory regime will incorporate several safeguards to ensure that profiling does not become overly complicated or artificially entrenched, and to ensure a transition to interval meters occurs. The details of how a transition from profiling to interval metering would be managed are currently being examined by the Office as part of the proposed 'new and replacement' policy. The ACCC has been provided with a copy of a letter from the Office to the Department of Industry Science and Resources which provides an indication of the consideration being given by the Office to a new and replacement policy and the likely timing of consultation on and implementation of such a policy.

Energy Policy Division has been advised by the Office that it expects to seek expressions of interest for expert advice on the proposed meter roll-out in the next few weeks. The proposed timetable commences with an issues paper and consultation; implementation of the strategy is planned to commence in November 2001.

Without pre-empting the Office's final policy, Energy Policy Division understands that the Office will endeavour to ensure sufficient volume of interval meter installation so as to ensure a reduction in unit meter costs. In order to capture the benefits of interval metering any accelerated rollout would be funded by a smeared charge. The Office has expressed the view that any mandatory metering rule should be de-coupled from customers' decisions to change retailer.

The 'new and replacement' strategy for the phased introduction of interval meters is discussed in Victoria's forthcoming application for derogations from the National Electricity Code, as the strategy would be supported by the granting of a derogation. We do not however view the new and replacement strategy as an issue to be addressed through the Code. The Code is concerned with metering for the purposes of settlement of the wholesale market, and, as such, regulates second tier metering. However, as noted above, it is our view that any meter roll-out policy must apply equally

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⁵ Peel-off is a form of net-off for a subset(s) of customers for whom interval load data is not available, but who consume separately metered loads.

to first and second tier customers. We consider that jurisdictional regulators are best placed to balance the constraints associated with introducing interval meters with the resultant benefits.

While the ACCC has requested that EPD provides an update on the progress of work on the 'new and replacement' strategy, it would be preferable for the ACCC to seek a progress update directly from the Office. I am advised that Richard Bolt (ph (03) 9651 3075 and David Cornelius (ph (03) 9651 3941) are the appropriate contacts for any questions you may have about the new and replacement strategy.

Meter Ownership

We understand the ACCC is concerned about the issue of meter ownership in the context of current Code changes, as the framework created by those Code changes for the provision of second tier metering in the mass market results in complicated issues relating to meter ownership.

In its Distribution Price Determination, the Office noted the following in relation to meter provision:

Aligning responsibility for meter provision with the activities of retailers has the potential to lower costs and to enable innovation in pricing and the terms and conditions of supply. However, competitive meter provision has produced meter churn, which has created unnecessary inefficiencies and barriers to switching retailer. ***These problems may be overcome by empowering customers to contract directly with competitive metering providers. However, this is unlikely to appeal to small customers.*** (our emphasis)

In the early stages of [full retail competition], the introduction of competition in metering provision would require process changes to be implemented. In view of the limited benefits that are likely to arise, there is a case for limiting competition in metering provision until [full retail competition is established] and the process changes can be more readily made.⁶

As you noted, the question of meter ownership in Victoria is one that will not become relevant until any metering derogations have ended. In relation to the Commission's concerns about the unlikelihood of retailers bearing capital outlay on meters, EPD agrees that maturity in the market for meter provision is required otherwise it is likely to be an impediment to customer retail choice. We note that retail ownership of meters in New Zealand in the early stages of full retail competition in that country was problematic. The New Zealand Ministerial inquiry into the electricity industry concluded that:

Retail company ownership of meters has impeded the efficient switching of customers, contributing to unnecessary delays and costs that are ultimately borne by consumers. On the other hand, were the meters to have remained with the distribution companies, they would be provided by a monopoly.⁷ There are gains to be made in having meters provided in a properly functioning competitive market.

In our view, while the issue of meter ownership does need to be resolved, it is unnecessary to resolve it by 1 January 2002. While the Victorian derogation application, if approved, should address this problem in the short term, in the medium term it would be preferable for the issue of meter ownership to be addressed by jurisdictions in the light of market developments over the next few years. The New Zealand experience indicates that this issue is complex and that a transparent and manageable process is required if the disruptions experienced in that market are to be avoided.

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⁶ Office of the Regulator General Electricity Distribution Price Determination 2001 – 2005, Volume 1 Statement of Purpose and Reasons, page 72

⁷ Ministerial Inquiry into the Electricity Industry - Report to the Minister of Energy - June 2000, page 52 paragraph 229

Victoria believes that the proposed process involving the jurisdictional regulator and public consultation is an appropriate mechanism on which to base any future decision on meter ownership.

The exclusivity derogation sought by Victoria would enable FRC to commence in accordance with the current timetable, and these outstanding issues to be resolved by a process which will enable the issues to be well considered. At this stage, we believe that reverting to the LNSP as the 'default' meter provider (as would be the case upon derogation expiry) is likely to provide 'foundation' certainty for retailers, and minimise the incidence of unnecessary and costly meter churn.

With an appropriate cost recovery mechanism instituted by the Office, it is possible at this stage to envisage that there will be room for competition and innovation to develop in meter provision to the extent required by customers and their retailers.

I hope the above information is useful for the Commission to better understand Victoria's views on these issues. I would appreciate if you could confirm my understanding that a draft determination will be made by the end of March 2001. Please do not hesitate to call Peter Clements (03) 9412 4981 (from 26 March, (03) 9637 8249) or Fiona Walker (03) 9412 4832 (from 26 March, (03) 9637 8818) if you have any questions.

Yours sincerely

John Robinson
Executive Director
Energy Policy Division