TECHNICAL SHEET

SECOND GENERATION SMART METERING SYSTEMS:
RECOGNITION OF LOW VOLTAGE ELECTRICITY METERING COSTS AND COMMISSIONING PROVISIONS.
CHANGES TO THE "TIME" CONSOLIDATED TEXT

646/2016/R/EEL (*)

With Resolution 646/2016/R/EEL, the Regulatory Authority for Electricity, Gas and Water approves the pricing rules for the recognition of low voltage electricity metering costs and sets the provisions for commissioning second generation (2G) smart metering systems.

The measure, which comes after an extensive consultation process (consultation documents 267/2016/R/EEL and 457/2016/R/EEL), establishes the criteria for the recognition of capital costs for smart metering systems that meet the functional requirements and performance levels defined in Resolution 87/2016/R/EEL, which is fully confirmed after the standstill period provided by the EU.

For distribution companies that serve more than 100,000 withdrawal points (for those with fewer withdrawal points, see the parametric system in the process of being defined), Resolution 646/2016/R/EEL spells out the criteria for the recognition of the capital costs for the 2G smart metering systems for low voltage electricity metering based on incentivising regulation schemes. For the three-year period 2017-2019 these schemes will be applied only to capital expenditures, whereas from 2020 the recognition of these costs will be total expenditure based (Totex).

The Resolution provides for the adoption of a conventional installation profile for 2G meters for the recognition of costs defined on the basis of the accounting profile, thereby optimizing the plans for commissioning 2G meters and excluding cost recognition overlaps between 1G and 2G meters.

For the start-up phase of the new regulatory framework, the Resolution defines two recognition systems for metering service capital costs:

- ✓ "specific system" for companies that start the commissioning plan for 2G smart metering systems approved by the Regulatory Authority;
- ✓ "transitional system" for companies that have not yet started the commissioning plan for a 2G smart metering system.

The transitional system will be fully effective starting from 2018 and based on parametric logic, whereas for 2017 the existing provisions are confirmed based on the revalued historical cost criterion with application of an upper limit on the unitary expenditure admissible in the way of tariffs (equal to 105% of the gross investment value per meter for investments that became operational in 2015).

The specific system provided for companies that start the commissioning of 2G smart metering systems (compliant with requirements and performances set by resolution 87/2016/R/EEL) is based on analyses of expenditure forecasts, efficiency incentive schemes and ex-post checks on progress, spending and performance. In this context, the first step of the cost recognition process provides that companies should prepare a detailed commissioning plan, publish it and submit it to the Regulatory Authority's approval.

Annex A of Resolution 646/2016/R/eel defines in point by point detail the minimum content of the commissioning plan (i.e. the essential elements that should be reported, including information on the features of current smart metering systems, the issues that came up and the positive impacts expected from the substitution plan, among other things), the expected progress of the replacement process and of the next "user management" phase and the expenditure planned. The triennial update schedules for commissioning plans of 2G smart metering systems are also defined, which have a 15-year horizon, as well as a transparent and participatory public process of publishing on the distribution company's website not only the plan but also the observations of the various 2G infrastructure development stakeholders.

For distributors who want to start their own commissioning plan by the year 2017, the plan should be submitted to the Regulatory Authority by 31 January 2017, whereas plans expected to start in 2018 are to be submitted on 30 September 2017. Subsequently, the commissioning plans shall be submitted by the 15 May preceding the year the commissioning is started.

An explanatory report reserved to the Regulatory Authority should be added to the commissioning plan, defining estimated expenditure breakdown details - with requirements of reporting any extraordinary revenues from the exploitation of decommissioned 1G assets and the measures taken to ensure compliance with accounting unbundling requirements - to guarantee the correct allocation of costs and revenues and in order to handle correctly possible synergies with other activities.

The plan shall be supported by a detailed programme for the massive phase, with a half-year horizon (and updated at least twice a year), which will identify the installation areas and a commissioning timetable for them.

Next, the measure regulates the analysis procedure for the approval of the plan by the Regulatory Authority, which can occur on a fast track basis with a quick decision (within 90 days) in the case where the total capital expenditure planned by the company for the 15-year horizon of the plan is lower than the reference expenditure defined by the Regulatory Authority based on the counterfactual hypothesis of commissioning 1G systems; essentially, companies that provide for an expenditure such that it will guarantee a substantial invariance of the low voltage electricity metering service tariffs can get on the fast track. Failing this requirement, the plan is reviewed through an ordinary process, which is longer and more analytical.

As for cost recognition mechanisms, the Resolution introduces a marked innovation in the regulation, by initiating the adoption of incentivising schemes, focused only on capital expenditures through 2019, continuing in the same period the incentivising treatment of operating expenses established by Resolution 654/2015/R/eel, and based on the IQI incentive matrix.

The IQI matrix, which may be subject to subsequent revisions, accounting also for technological innovation, defines the value of the incentives to be recognized to companies for the various actual expenditure combinations incurred by the distributor and the expenditure provided by the Regulator. This matrix combines an efficiency incentive, geared toward rewarding (or vice versa penalizing) businesses in the case of lower actual expenditure (or, respectively, higher) than expected (*sharing*), and a mechanism geared toward inducing businesses to provide a truthful expenditure forecast of true spending (*additional income*).

The new cost-recognition logic is coordinated with current tariff regulations, providing that the capital expenditure recognized for each year will increase the level of invested capital for regulatory purposes and contribute to the determination of the tariff components covering the capital costs of the reference tariff. As stated in the consultation, covering capital costs is provided according to a deferred fixed-rate mortgage (considering a time horizon consistent with the regulatory useful life of the meters, equivalent to 15 years).

One of the general principles of the measure is that the provided remuneration criteria entail compliance with the features of 2G meters, the expected performance levels of 2G smart metering systems and the schedule set for them to become fully operational, as defined by the Regulatory Authority with Annex B of resolution 87/2016/R/eel. To this end, the measure provides that distributors shall systematically make available specific information in order to check the plan's progress and compliance with expected performances.

Lastly, the measure introduces mechanisms to check on the progress of the plans made by the companies, providing mechanisms for the curtailment of tariff awards if they fail to achieve at least 95% of the progress target they set for themselves.

(*) This sheet is for disclosure purposes only; it is not a measure.