

Electricity Distribution Regulatory Guidelines

Statement of Approach

September 2006



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Glossary

ACT	Australian Capital Territory
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ENA	Energy Networks Association
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NER	National Electricity Rules
NGL	National Gas Law
NGR	National Gas Rules
NSW	New South Wales
PC	Productivity Commission
PIAC	Public Interest Advocacy Centre
PTRM	Post tax revenue model

1 Summary

This paper presents the Australian Energy Regulator's (AER) statement of approach for the development of its regulatory guidelines for electricity distribution. It follows the release of a Scoping Paper by the AER in March 2006, which discussed the likely content and consultation process for the development of such guidelines. The AER received public comment on its proposals through submissions by interested parties and engaged in discussions with distribution businesses both directly and indirectly through the working group established in consultation with the Energy Networks Association (ENA). The AER's approach to developing distribution regulatory guidelines reflects the outcomes of these consultations and is explained in this document.

The AER is preparing for the transfer of responsibility for distribution regulation to a national regime, scheduled to take effect in 2007. Through this preparation, the AER aims to ensure that all stakeholders are aware of how the AER intends to fulfil its responsibilities and exercise its discretion under the law and the market rules. This is particularly important for electricity distribution businesses in the Australian Capital Territory (ACT) and New South Wales (NSW), which will be the first to be regulated under the new national regime. The AER believes it is necessary to commence consultation and publish its final guidelines to provide businesses in these jurisdictions sufficient time to prepare their reset applications in accordance with the AER's requirements.

The AER recognises that the legislative framework for energy regulation is currently subject to review and that this situation is not ideal for the development of subsidiary guidelines. The AER believes, however, that recent events have indicated the future regulatory framework for distribution with a sufficient degree of certainty to allow the AER to commence consultation on its guidelines. As the policy framework becomes clearer, the AER will adapt its work to align with these developments. The AER will time its draft and final decisions on the guidelines to coincide with the progression and finalisation of current legislative reviews. Views expressed in public consultation on the Scoping Paper have further informed the AER's considerations on its timing and scope.

This statement of approach also provides an update on review processes, in particular the Australian Energy Market Commission's (AEMC) Draft Determination on its review of transmission revenue rules and recent communications from the Ministerial Council on Energy (MCE) regarding the 2006 energy legislative package. This statement explains how these events provide additional certainty on the future legislative framework and the potential role and scope for AER guidelines.

In summary, this document outlines the AER's intention to:

- develop electricity distribution guidelines as a separate process from gas distribution and from electricity transmission

- continue to base its expectations of the future regulatory framework on certain legislative and policy review reports, particularly those of the MCE Expert Panel and of the AEMC
- ultimately adopt a flexible approach in order to ensure that its decisions and guidelines comply with the relevant laws and rules as they develop
- consult on the guidelines according to the timeframes as per the table below.

Table 1: Timing and scope for consultation

	Discussion Paper	Draft Decision	Final Decision
Stage 1			
Scoping paper and statement of approach	15 March 2006	N/a	September 2006
Stage 2			
Revenue modelling	Fourth Quarter 2006	Second quarter 2007	Fourth quarter 2007
Asset roll-forward modelling			
Cost allocation guidelines			
Cost reporting templates			
Stage 3			
Connection and Capital contributions	First half 2007	Third quarter 2007	Early 2008
Tariff setting			
Ring-fencing			
Incentive mechanisms for:			
— Opex			
— Capex			
— Service standards			

This paper is structured as follows:

- chapter 2 discusses recent developments affecting the legal and policy framework for the regulation of energy networks
- chapter 3 outlines and addresses the views put forward in public consultation on the Scoping Paper
- chapter 4 presents the AER's process and scope for the development of its electricity distribution regulatory guidelines.

2 Legislative and policy considerations

This chapter provides a summary of the developing policy and legislative frameworks governing energy network regulation, and discusses the AER's expectations of how these affect the need and scope of guidelines for distribution regulation.

2.1 AER Scoping Paper

The Scoping Paper provided an overview of the current status and operation of gas and electricity distribution regulation, including key legislative instruments, roles and responsibilities of regulators and pricing principles.

It also discussed the outcomes of the following reviews and their relevance to distribution regulatory guidelines:

- the options paper prepared by NERA Economic Consulting and Gilbert+Tobin, which suggested that the AER issue 'Statements of Requirements' covering ring-fencing, regulatory accounts, connection and capital contributions and other reporting requirements
- the AEMC's review of electricity transmission revenue regulation, with initial rules prescribing AER guidelines on:
 - information requirements
 - cost allocation methodologies
 - service performance target incentive scheme
 - opex efficiency benefit scheme
 - post-tax revenue model (PTRM)
 - roll forward of regulatory assets model
- the draft report of the MCE Expert Panel on Energy Access Pricing.

The Scoping Paper expressed the AER's view that these reviews provided less certainty about the future regulatory framework for gas distribution. The AER therefore proposed deferring the consideration of regulatory guidelines for gas distribution.

In relation to electricity, the AER noted that the AEMC's Draft Rule Proposal for transmission elevated much of the AER's Statement of Regulatory Principles into the National Electricity Rules (NER) and proposed a number of AER guidelines to complement the regulatory framework. The AER presumed that the rules for distribution regulation would be influenced by the Gilbert+Tobin/NERA options paper, the Expert Panel's draft report and the AEMC's Draft Rule Proposal for electricity transmission.

In the Scoping Paper, the AER recognised that there were likely to be differences between the final regulatory frameworks for electricity distribution and transmission. It also recognised the draft or unofficial status of the AEMC's Draft Rule Proposal, the Expert Panel's draft report and the Gilbert+Tobin/NERA options paper.

The AER acknowledged the need to reconsider the scope of its guidelines should the AEMC's Final Determination for transmission revenue regulation differ significantly from its draft rules.

2.2 Subsequent developments

The following major developments regarding the legislative framework for energy regulation have occurred since the publication of the AER's Scoping Paper:

- MCE communications regarding the release of a legislative package for gas and electricity regulation
- the AEMC's Draft Determination for the review of Chapter Six of the NER
- the MCE's response to the review of the Gas Access Regime by the Productivity Commission (PC)
- release of the final report of the MCE Expert Panel.

Each of these developments is discussed in turn below.

2.2.1 2006 Legislative Package

On 31 July 2006, the MCE released a 'Statement of Scope' for the revised NER and National Electricity Law (NEL), the new National Gas Law (NGL) and the National Gas Rules (NGR).¹ This legislative package will incorporate provisions to:

- transfer economic regulatory functions for distribution to the AER and AEMC, as envisaged under the Australian Energy Market Agreement (AEMA)
- implement the MCE's response to the PC review of the Gas Access Regime
- incorporate the MCE's response to the Expert Panel review, adopting recommendations on pricing principles and a 'fit-for-purpose' decision making framework
- implement a limited merits review model for both gas and electricity
- implement the MCE's November 2005 decision to establish a long-term consumer advocacy funding model for both gas and electricity advocacy.

¹ MCE Standing Committee of Officials, *Statement of Scope, A National Legislative Framework for Gas and Electricity*, 31 July 2006.

The MCE stated that amendments to the NER as part of the 2006 legislative package would cover items 1 to 3 of Annexure 2 of the AEMA (part of which is reproduced below), dealing with economic regulatory functions, service performance incentives and information disclosure.² The current NER provisions relating to customer connections and network expansion will also be carried over with these amendments.³ The remaining national distribution and retail functions listed in Annexure 2 are expected to transfer to the AEMC and AER by way of a second round of amendments to take effect from 2008.

2.2.2 AEMC Chapter Six Draft Determination

On 26 July 2006, the AEMC released its Draft Determination for its review of the transmission revenue elements of Chapter Six of the NER. In adopting the ‘fit-for-purpose’ approach recommended by the Expert Panel, the AEMC’s proposed rules prescribe:

- ‘locked in’ asset values and treatment of related roll forward elements including inflation, capital expenditure (capex) and depreciation
- parameters for the cost of capital and processes for periodic review by the AER
- a post-tax revenue framework
- provisions for the pass-through of unexpected costs.

The AEMC deemed that certain elements of the framework under the discretion of the AER would require the publication of guidelines to clarify the use of this discretion. The Draft Determination therefore requires the AER to publish guidelines on:

- information requirements
- reset submission requirements
- cost allocation methods
- efficiency benefit sharing scheme
- service performance target incentive scheme
- PTRM
- asset roll-forward modelling
- ring-fencing.

² *ibid.*, p. 10.

³ *ibid.*

**ANNEXURE 2
DISTRIBUTION AND RETAIL FUNCTIONAL ALLOCATION**

National Functions

This list sets out the activities which will form part of the national distribution and retail regulatory framework for electricity and gas, which is to be developed by the MCE in accordance with this agreement. The regulatory framework will be regulated through the AEMC and the AER.

- 1. Distribution economic regulation**—services to be regulated, the form of regulation and tariff setting.
- 2. Service performance incentive scheme**—for network service performance standards (as set by the jurisdiction where elected), and customer service performance standards, linked to economic regulation.
- 3. Information disclosure**—information requirements for the AER to undertake its regulatory functions.
- 4. Connection and capital contribution requirements**—new connections charges and capital works contributions.
- 5. Distribution network expansion**—determining when extensions are part of a regulated service and how charges are levied.
- 6. Distributor connection service obligations**—provision of connection and related services to users and the contractual relationship with retailer and customer.
- 7. Distributor small customer disconnection/reconnection**—allowable disconnections or reconnections of small customers including those arranged by retailers.
- 8. Distributor interface with other market participants**—determining the nature of distributor-retailer and distributor-embedded generator relationships including use of system.
- 9. Metering**—obligations to install, maintain and read meters.
- 10. Retailer obligation to supply to small customers**—obligation on retailers to supply customers at a default tariff with minimum terms and conditions.
- 11. Retailer failure arrangements**—arrangements to ensure customer supply continuity and wholesale market financial integrity.
- 12. Retailer - small customer market contracts**—minimum contract terms and conditions.
- 13. Retailer - small customer marketing**—marketing conduct obligations.
- 14. Balancing regime, settlements, customer transfer**—balancing, settlement and contestable customer churn arrangements to ensure accurate financial reconciliation would be retained by independent market administrators.
- 15. Distributor and retailer general business authorisations**—where necessary for matters other than technical capability and safety.

2.2.3 MCE response to the review of the Gas Access Regime

On 9 May 2006, the MCE released its response to the PC's 2004 review of the Gas Access Regime.⁴ In this response, the MCE endorsed recommendations to:

- insert an objects clause in the form suggested by the Expert Panel
- amend the NGL coverage test to ensure regulation is only applied where it is expected to promote a material increase in competition in related markets
- retain the National Competition Council as the coverage recommendation body, with coverage provisions to be included in the NGL
- introduce a 'light-handed' regulatory option ('monitoring' supported by dispute resolution)
- allow proponents of greenfields networks to apply for 15 year coverage exemptions, and for 15 year price regulation exemptions for new pipelines that originate in other countries.

The MCE noted that implementing some of the PC's recommendations would not achieve the policy objective of implementing a national approach to energy access regulation. In this context, it noted that its responses to some of these recommendations would be dealt with following other processes, in particular the consideration of the Expert Panel's recommendations.

2.2.4 MCE Expert Panel on Energy Access Pricing

The final report of the Expert Panel was released on 19 April 2006. In its release, the MCE emphasised that the report was 'an input to the MCE's deliberations and no part of it should be considered as representing the MCE's position on any of the matters the report considers'.⁵ The report recommended, inter alia, that the NGL and NEL contain the following elements:

- a common objects clause
- scope of regulation—with defined coverage for electricity and coverage tests for gas infrastructure
- form of regulation—provision for market rules specifying the different forms and selection criteria for particular services
- regulatory procedures—procedural requirements in pricing determinations, with details to be determined in rules
- pricing principles—principles guiding the AEMC and AER in their functions, and rules for the use of building blocks, total factor productivity, incentive mechanisms,

⁴ MCE Standing Committee of Officials, *Energy Market Reform Bulletin No. 61*, 9 May 2006.

⁵ MCE Standing Committee of Officials, *Energy Market Reform Bulletin No. 60*, 19 April 2006.

asset valuation and consideration of the risks of under- and over-investment and asset utilisation

- information disclosure—provisions defining the AER’s powers and guidance for the AEMC in making rules regarding the format and scope of reporting requirements
- review of decision making—appeals and review processes as determined by the MCE.

In relation to information disclosure, the Panel recommended that the framework provide for guidelines to be issued by the AER, in accordance with the NER, which specify the format requirements and timelines for regular reports.⁶

The majority of the Panel’s recommendations regarding the regulatory framework involved legislative guidance for the making of the market rules. The Panel recommended that legislation should not specify the level of prescription and discretion in the market rules,⁷ and that the various bodies involved in rule making and regulation (such as the AEMC and the AER) be responsible for certain broad areas.

The Panel recommended that guidelines be made by the AER or special purpose committees with the delegated authority of the AEMC under the rules. It specified that the content of guidelines should cover detailed technical matters that rely substantially on operational information or knowledge and matters limited to industry segments or likely to be subject to exceptions.⁸

2.3 Implications of recent framework developments

The recent developments described above have reinforced the AER’s expectations of the likely framework for electricity distribution regulation and the role of regulatory guidelines. There is less guidance on the role of the AER in relation to gas distribution regulation.

The AER expects to have responsibility (either directly or delegated under the market rules) for economic regulatory functions regarding distribution services from mid 2007 and other functions from 2008. Although the list of functions in schedule 2 of the AEMA provide considerable guidance on the potential scope of the AER’s specific responsibilities for distribution, similar guidance is not provided in relation to the relative degrees of prescription for each responsibility.

The AEMC’s Draft Determination provides additional clarity on the likely elements of the regulatory framework that will be subject to prescription under the NER. The role of guidelines in the Draft Determination coincide with the Expert Panel’s comments that guidelines may be issued on matters that are of a technical nature, limited to industry segments or likely to be subject to exceptions. The AER’s reliance on transmission rules as an indication of the regulatory approach for distribution stems

⁶ Expert Panel on energy Access Pricing, *Report to the Ministerial Council on Energy*, April 2006, p. 132.

⁷ *ibid.*, p. 29.

⁸ *ibid.*, p. 23.

from the assumption that the MCE will achieve its policy goal of an appropriate level of consistency between the regulation of electricity transmission and distribution. In achieving this consistency, the AER expects that the initial rules implemented by the MCE will be less prescriptive in areas that require the accommodation of specific existing jurisdictional arrangements.⁹ The AER has been further informed through its consultation with the ENA of the major issues faced by distribution businesses in each jurisdiction that will require the AER's attention during the transition to the new national regime.

⁹ MCE Standing Committee of Officials, *Statement of Scope, A National Legislative Framework for Gas and Electricity*, 31 July 2006, p. 31.

3 Views Raised in Submissions

This chapter discusses comments from interested parties on issues raised in the Scoping Paper, grouped as follows:

- the separate development of guidelines for electricity distribution
- the AER's expectations for distribution regulation, drawn from expert reports and current reviews
- the proposed contents of the guidelines for electricity distribution
- the proposed timeframes for consultation
- general transitional issues.

3.1 Separate regulatory guidelines for electricity distribution

The AER's Scoping Paper indicated a preference to provide consistency between its regulatory guidelines for gas and electricity. However, given the particular timeframes relating to electricity distribution price resets in NSW and the ACT and the uncertainties regarding gas regulation, the AER indicated a preference to commence the development of electricity distribution regulatory guidelines and delay similar processes for gas and for electricity transmission.

3.1.1 Stakeholder comments

Most stakeholders were supportive of these proposals. Several stakeholders¹⁰ expressed the desirability of achieving consistency between gas and electricity guidelines, while others¹¹ agreed with the AER's reasoning relating to the relative uncertainties for the gas regime.

EnergyAustralia submitted that, in the context of the possible combination of reviews for its transmission and distribution businesses, there would be long-term benefits in ensuring consistent regulation through the simultaneous development of guidelines for each type of energy network. As part of its main recommendation to defer commencement of the general guideline process, the ENA recommended that gas and electricity distribution guidelines be developed together. Integral Energy considered it practical to develop guidelines for electricity transmission and distribution simultaneously but through separate processes. The Public Interest Advocacy Centre (PIAC) believed that consistency in the regulation of gas and electricity distribution should not be precluded by conducting separate processes for each.

¹⁰ See submissions from CitiPower & Powercor, Country Energy, ENA and SP AusNet.

¹¹ See submissions from United Energy & Multinet, EnergyAustralia, Ergon Energy and CUAC.

3.1.2 AER response

The AER has decided to develop electricity distribution guidelines as a separate process from the development of regulatory guidelines for gas networks and for electricity transmission.

Although the AER agrees that it is preferable to develop regulatory guidelines for all energy networks through a single uniform process, the AER notes that there are practical impediments to this approach. The AER is currently preparing the development of various transmission guidelines that are required under the AEMC's Draft Determination. The AER therefore expects that the development of guidelines for electricity transmission and distribution will overlap although the different timing priorities for transmission require there to be separate processes.

The AER believes it would not be prudent to commence the development of gas regulatory guidelines given the current uncertainty regarding gas legislation.

The AER believes that consistency between the guidelines for different networks can be achieved over time even if they are developed through separate processes. The particular sequence of consultation for each type of network service also need not indicate that the approach for electricity will be used as a template for gas. Overall, the AER will seek to implement a consistent regulatory approach for all networks where it is appropriate to do so and is allowed or directed to under the legislation.

3.2 AER's reference to review reports

The AER previously indicated that its expectations for electricity distribution regulation were based on the analysis and conclusions of the following reviews, on the assumption that these reviews would impact the prospective legislative framework:

- the Gilbert+Tobin/NERA consultation paper
- the AEMC Draft Rule Proposal for electricity transmission revenue regulation
- reports of the MCE Expert Panel.

3.2.1 Stakeholder comments

United Energy Distribution & Multinet Gas Distribution (United Energy & Multinet), the ENA, ActewAGL and AGL believed that the AER should not base its proposals on the Gilbert+Tobin/NERA consultation paper and the Expert Panel reports as these reports have no official status as policy or legislative instruments.

United Energy & Multinet and the ENA questioned the AER's selection of references, stating that it had not considered other relevant expert reports, including the PC's review of the Gas Access Regime and the Prime Minister's Export Infrastructure Taskforce review.

United Energy & Multinet, ENA, ActewAGL CitiPower & Powercor and SP AusNet cautioned the AER against relying on the AEMC's Draft Rule Proposal because of the

differences between electricity transmission and distribution, and also because of their draft status.

3.2.2 AER response

The AER has decided to continue to base its expectations of the future regulatory framework on the reports listed in the Scoping Paper, particularly those of the Expert Panel and of the AEMC.

Since the publication of the AER's Scoping Paper, the AEMC has released its Draft Determination and the Expert Panel has released its final report. In relation to the scope of the AER's responsibilities for distribution regulation, and the role of regulatory guidelines in general, these recent developments have been consistent with the AER's expectations and continue to provide the best available indication of the AER's future responsibilities and discretion for distribution regulation.

The AER has sought to account for the differences between electricity distribution and transmission services in forming its expectations on distribution guidelines. As noted above, the AER believes that the initial distribution rules will provide more discretion to the AER, potentially increasing the scope of these guidelines.

The AER's approach in relation to the development of the legislative framework will be to conduct a two-stage consultation process. Those issues that have been identified with a higher degree of certainty in the current reviews (such as information requirements and revenue modelling) will be consulted on first. Following this, the AER will consult on issues that are likely to be transitioned to the national regulatory regime although are still subject to uncertainty regarding the AER's specific role (such as connection and capital contributions and service standard incentives).

The AER's responses to specific comments regarding certain review reports are discussed below.

Status of expert reports for distribution

The AER believes that the findings in the Expert Panel's final report have had an influence on energy policy and related legislation even though the report does not constitute an official policy decision.

The MCE has indicated in its response to the review of the Gas Access Regime and in other separate policy statements that it would implement changes to the regulatory framework that are consistent with the findings and conclusions of the Expert Panel, namely:

- the existence and specific wording of objects clauses in the NGL and NEL
- a light handed regulatory option for certain gas services
- limited merits review
- access holidays for greenfield investments

- specific criteria for coverage test provisions.

The MCE has also strongly relied on the Expert Panel's findings to determine the scope of its energy legislative package and in the common structure and objectives of the NGL and NEL.

While the majority of the Expert Panel's findings provide a good indication of the key elements of the legislative framework to be adopted, most of its key recommendations relate to the AEMC developing rules. In isolation, these recommendations provide limited guidance on the scope of the AER's regulatory guidelines.

Similarly, the issues paper by Gilbert+Tobin/NERA has only provided an indication of the potential role of guidelines rather than their scope. Accordingly, the AER has not relied upon the Gilbert+Tobin/NERA issues paper heavily in its considerations.

Consideration of expert reports for gas and other infrastructure

In proposing guidelines for electricity distribution regulation, the AER has decided not to draw heavily on the recommendations of the Prime Minister's Export Infrastructure Taskforce and the PC's review of the Gas Access Regime.

Of all recent reviews of access issues relating to essential infrastructure, the AER expects that the outcomes of the AEMC's review of Chapter Six of the NER for transmission regulation and the findings of the Expert Panel provide a better indication of the future legislative framework for electricity distribution.

The review outcomes regarding gas and export infrastructure do provide some guidance in the abstract, for example, regarding regulatory principles and policy issues. The findings from these reviews that could be relevant to the AER's decisions have, however, been developed in the context of other types of infrastructure and therefore have not been relied upon in the presence of more applicable alternatives.

Applicability of the draft Chapter Six rules

The AER has now considered the AEMC's Draft Determination in deciding its approach to distribution guidelines. The AER again acknowledges that these rules are still in draft form and made for a different class of electricity network services.

The AER believes, however, that the AEMC's Draft Determination, when combined with other framework developments discussed above, provides sufficient guidance for the AER's work plans for electricity distribution. Moreover, in relation to the scope of AER guidelines, the AEMC's Draft Determination does not differ significantly from its original Draft Rule Proposal. On this basis, the AER expects that the guideline provisions in the Final Determination will not differ substantially from the Draft Determination. In any case, in the event the AEMC's Final Determination provides for a different approach to regulatory guidelines (and more applicable rules for distribution have not been published by this time) the AER will be able to accommodate these changes in its discussion papers and draft decisions.

3.3 Contents of electricity distribution guidelines

The AER's Scoping Paper indicated that the distribution guidelines would address elements similar to those set out in the initial Draft Rule Proposal for transmission regulation. In particular, this includes:

- a post-tax revenue model
- asset roll-forward model
- cost allocation methodology
- opex incentive mechanism
- information requirements
- service standards incentive design
- tariff setting
- connection and capital contribution
- ring-fencing.

On the basis of outcomes of reviews to date, the AER expects that an incentive-based regulatory framework in the form of a CPI-X building block approach will be adopted for distribution regulation. Based on this expectation, the AER stated that it would not consult on the treatment of building block elements for electricity distribution, given the presumption that the Draft Rule Proposal for transmission (used as an indication for distribution) would provide sufficient detail without regulator issued guidelines. For example, asset values and the methodologies and parameters for the setting of a regulated return on capital would be specified with sufficient detail.

3.3.1 Stakeholder comments

Several stakeholders¹² raised concerns over the addition of ring-fencing, connection and capital contributions and tariff setting guidelines to the list of existing guidelines in the Draft Rule Proposal for Chapter Six. SP AusNet indicated that the Chapter Six provisions relating to service standards and the form of regulation may warrant a different regulatory approach for distribution.

Integral Energy stated that it may be possible to develop guidelines for revenue and asset modelling, tariff setting and opex incentives, while acknowledging that these elements were interrelated. It also noted that the AER should have no role in setting service standards, and that any guidelines for service standard incentives should only be developed following clear guidance from the jurisdictions with reference to the NEL and NER. United Energy & Multinet expressed a similar view for all of the proposed

¹² See submissions from ActewAGL, AGL, ENA, Citipower & Powercor.

guidelines, expressing a concern over duplicating the existing guidelines and powers of jurisdictional regulators.

ActewAGL requested the AER's view on whether the scope of its guidelines was consistent with that of the Expert Panel, namely that guidelines would regard technical matters and have the delegated authority of the AEMC under rules.

Ergon Energy generally supported the proposed scope of the guidelines, although expressed reservations regarding cost allocation and information requirements, stating that the AEMC's Draft Rule Proposal for Chapter Six sufficiently prescribed how these elements would be regulated in the absence of guidelines.

3.3.2 AER response

In response to uncertainties over the scope of its guidelines, the AER has decided to sequence the consultation and release of its guidelines in two stages, with the first stage encompassing elements that are more likely to involve a greater degree of discretion under the NER. In making this decision, the AER has been mindful of those matters in the AEMC's Draft Determination that are likely to be sufficiently prescribed in the future in the absence of guidelines, namely asset valuation methods and WACC parameters.

The AER expects that rules for electricity distribution will be different to those currently proposed for transmission in regard to:

- the requirement to set revenue caps—the specific relationships between costs, revenues and changes in demand for distribution services are likely to justify consideration of alternate forms of control, such as price caps
- the explicit inclusion of tax liabilities into the modelling of building blocks—the differences between jurisdictions and the potential transitional implications of prescribing either a pre- or post tax regime are likely to justify less prescription in the rules
- specifics of the service standards incentive regime—similar to the treatment of tax, the differences in service standard regimes across jurisdictions are likely to require more detailed or flexible rules regarding associated incentive frameworks.

To account for the possibility of price caps and the significant role that pricing plays in distribution network service provision, the AER expects to have more responsibility in the approval of tariffs and associated pricing issues.

The AER does not expect to be involved in setting service standards for electricity distribution in the short term although is likely to be responsible for the setting of related incentives as part of its economic regulatory functions.

The AEMC's Draft Determination envisages the development of ring-fencing guidelines for transmission. In performing its economic regulatory functions, the AER will also require assurances of adequate separation of electricity distribution services from upstream and downstream business units. Connections and customer contributions

are listed in the AEMA as a function to be transferred to the national regulatory framework.

The AER expects that the legal status of its distribution guidelines will be specified in the rules or in law, and notes that the AEMC's Draft Determination envisages mandatory guidelines. The AER believes the development or content of its distribution guidelines should not be affected by their legal status provided they are consistent with relevant provisions in the legislation.

The AER is sympathetic to concerns over the possible duplication of regulatory obligations in the transition to a national regime and aims to ensure that its guidelines do not overlap with other requirements. The AER will also seek to adopt the existing approaches of jurisdictional regulators where they represent best practice regulation and it is possible to do so.

3.4 Timeframes for consultation

The AER's Scoping Paper stated that it would establish guidelines for electricity distribution through a staged consultation process. The AER's intention was to publish guidelines for items critical to reset applications (revenue and asset modelling, information requirements, cost allocation methodology and incentives for opex) by mid-2007. This was intended to provide distribution businesses in the ACT and NSW with twelve months to prepare their reset applications under the new guidelines.

3.4.1 Stakeholder comments

Three submissions¹³ supported the proposed timeframes. Stakeholders also commented on:

- the timing of consultation to coincide with the commencement of price resets in NSW and the ACT
- the recommendation to delay the process and allow the legislative framework to develop further
- concerns over the AER pre-empting and influencing the legislative framework.

NSW and ACT price resets

Submissions indicated that businesses took a long-term perspective on the development of guidelines. A preference was expressed for the AER to devote more time to analyse and consult on the guidelines even if this reduced the amount of time available to businesses in NSW and the ACT to prepare reset applications under the new guidelines.

Integral Energy and EnergyAustralia expressed a view that the AER could delay the publication of the major elements of its guidelines up until the end of 2007.

¹³ See submissions from CUAC, PIAC and SP AusNet.

Regarding the ‘core’ elements of reset applications, businesses indicated that those requiring the most clarity included how the AER would set building block elements, while those of lesser importance included tariff setting, ring-fencing and incentive mechanisms.

In its submission on the Scoping Paper, ActewAGL agreed with the AER that information regarding the necessary elements of its regulatory regime should be provided to businesses involved in the first round of price reviews at least twelve months prior to the submission of their applications.

Delay consultation

EnergyAustralia, the ENA and ActewAGL believed that the current regulatory framework was too uncertain, and recommended that the AER delay the development of guidelines by six months to allow the development of the framework.

Energex suggested that the AER postpone the development of guidelines following the AEMC’s revisions of the NER and NGR, and other reform processes stemming from the Expert Panel and Gilbert+Tobin/NERA reports. Similarly, Country Energy suggested that the AER commence consultation on its guidelines in line with the outcomes of the Expert Panel and AEMC’s review of Chapter Six.

Pre-empting and influencing policy and legislation

Integral Energy indicated that the development of guidelines prior to the setting of the regulatory framework would overstep the AER’s role as the regulator and result in inconsistencies with the market rules. It recommended that the AER not release any statements or decisions until after the regulatory framework had been finalised by the MCE and the AEMC. Moreover, CitiPower & Powercor noted that it would not be possible to finalise the guidelines until rules were finalised.

Country Energy noted the risk that the guidelines may pre-empt the outcomes of MCE and AEMC reviews. Ergon Energy accepted the necessity for the AER to continue with the development of guidelines least likely to be affected by rule changes, and that it may need to reconsider the scope of its guidelines should they be affected by such changes.

EnergyAustralia and the ENA believed that the AER’s proposals could be interpreted as an attempt to actually influence legislative and regulatory outcomes.

AGL expressed the view that legislative provisions empowering the AER to issue binding guidelines would be inconsistent with the intent of the MCE, and the AER’s proposals to exercise such power would compromise this intent. AGL also noted that many public submissions to the AEMC’s Draft Rule Proposal for Chapter Six highlighted the problems that the ability of the AER to make binding guidelines would blur its distinction between rule maker and regulator. It suggested that the AER’s guidelines be non-binding or restricted to low-level technical or procedural issues.

3.4.2 AER response

The AER has decided on timeframes for consultation and publication of its guidelines to give distribution businesses in NSW and the ACT sufficient time to consider these guidelines prior to the submission of their reset applications. The AER has also decided to delay the consultation process by several months, with the release of a discussion paper expected in the fourth quarter of 2006 instead of the third quarter as proposed in the Scoping Paper. These decisions and responses to other stakeholder comments are discussed below.

NSW and ACT price resets

The AER believes that it will be able to properly consult and develop guidelines on those regulatory elements requiring more considered analysis by distribution businesses twelve months prior to the commencement of the next price resets. Other elements will be published closer to the commencement of these resets.

Delay consultation

The AER is mindful of the current uncertainties regarding the regulatory framework. It agrees with stakeholder comments that delaying the process for the development of guidelines by six months may be beneficial in allowing the framework to become more stable.

The AER delayed releasing this statement of approach on the scope and timetable for consultation to allow for the publication of the AEMC's Draft Determination and further indications of the MCE's 2006 legislative package. The AER has also decided to delay consultation by several months with respect to the timeframes proposed in the Scoping Paper. The AER will deal with any changes to the legislative framework should they arise throughout the guideline consultation process. As noted previously, the AER believes that review outcomes and policy statements to date provide sufficient indication of the likely scope of the AER's functions and discretions to allow consultation to commence later this year.

The final form of the legislative framework is expected to become clearer in the next few months with the release of exposure drafts of legislation and progression of the AEMC's review of transmission pricing rules. The AER expects that final legislation and rules will be delivered prior to the release of draft versions of its guidelines in 2007.

Pre-empting and influencing policy and legislation

The AER disagrees that the commencement of consultation on its regulatory guidelines will influence legislative or policy outcomes. The AER will make the appropriate adjustments to its processes and work programs should they prove to be inconsistent with the new legislation. This will involve consideration of the relative degree of prescription and discretion as well as the scope of the AER's activities. As discussed above, the AER has already considered these issues in making the decisions in this document.

3.5 General transitional issues

3.5.1 Stakeholder comments

AGL indicated that the AER should seek to build on the experience of existing frameworks rather than commence with a ‘clean sheet’ as implied by the need for regulatory guidelines. AGL also suggested that the AER:¹⁴

- establish working relationships with regulators, particularly IPART and the ICRC
- commence developing expertise to deal with distribution regulation
- determine elements of previous regulatory approaches that can be used in the national framework, and other jurisdictional specific regulations
- consider if non-binding guidelines are required
- prioritise the AER work program towards the transition to national regulation and the development of knowledge to assist in each price review.

Energex and SP AusNet also noted that the AER’s work programs should build on the strengths of existing arrangements.

The ENA and ActewAGL commented on the analysis in the Scoping Paper of network industries, indicating that additional characteristics (such as the expectations of customers and the degree of competition) need to be identified and accounted for in the transition to a national regime. CUAC commented on the need to consider regional and remote energy supply issues.

3.5.2 AER response

The AER has established working groups with the ENA and jurisdictional regulators to manage the transition of distribution regulatory functions to a national regime. The AER is also working to establish similar mechanisms with user groups. The AER will gather information through these mechanisms and build on its existing expertise in distribution regulation.

The AER is liaising closely with IPART and the ICRC as well as businesses in NSW and the ACT to manage the forthcoming price resets in these jurisdictions.

¹⁴ See AGL submission, p. 2.

4 Scope and Process for consultation

4.1 Consultation process

The AER has decided to develop its guidelines in three stages:

- stage one—consider the process for guideline development (now completed with this statement of approach)
- stage two—to commence with the release of a discussion paper in the fourth quarter of 2006, with publication of certain guidelines in the fourth quarter of 2007
- stage three—to commence in early 2007, with guidelines published in early 2008.

Table 2: Timing and scope for consultation

	Discussion Paper	Draft Decision	Final Decision
Stage 1			
Scoping paper and statement of approach	15 March 2006	N/a	September 2006
Stage 2			
Revenue modelling			
Asset roll-forward modelling	Fourth Quarter 2006	Second quarter 2007	Fourth quarter 2007
Cost allocation guidelines			
Cost reporting templates			
Stage 3			
Connection and Capital contributions			
Tariff setting			
Ring-fencing	First half 2007	Third quarter 2007	Early 2008
Incentive mechanisms for:			
— Opex			
— Capex			
— Service standards			

The timeframes for consultation set out here allow the AER to commence consultation on several elements of its guidelines while providing sufficient flexibility to consider the inter-relationships between various elements as consultation progresses. The choice of timing and content of each stage is in recognition of those elements that have been determined with less controversy in the current reviews of the regulatory framework. That is, the issues in stage two represent the elements of the framework more likely to

require guidelines, while the issues in stage three are expected to be resolved with the release of the relevant legislation prior in the next few months.

For each guideline, the AER proposes to release and invite public submissions on the discussion papers and draft decisions prior to releasing its final guidelines. The AER will engage in informal discussions on these issues through its working groups with businesses, jurisdictional regulators and user groups.

4.2 Specific guidelines

The second stage of the consultation process will cover:

- revenue modelling—for the setting of annual aggregate revenue requirements used in the setting regulatory caps, including the issue of pre- and post-tax frameworks
- asset base roll-forward model—the AER proposes to develop a roll forward model to be applied to distribution regulation
- cost allocation methodology—the AER will develop guidelines relating to the allocation of costs between regulated and unregulated distribution network services
- cost reporting templates—the AER intends to develop information reporting templates for the analysis of expenditure forecasts.

The third stage of the consultation process will cover:

- connection and capital contribution—the AER will develop guidelines to deal with issues associated with connection and capital contributions
- tariff setting—consultation on this issue will relate to the implications of price setting for distribution network services
- ring-fencing—consultation on this issue will regard the methods and principles of separating regulated electricity distribution functions from other market segments
- incentive mechanisms—the AER will develop incentive frameworks covering capex, opex, and service standards.

4.3 Next steps

The AER expects to release a discussion paper on stage two issues identified above in the fourth quarter of 2006. This discussion paper will be available on the AER's website at <www.aer.gov.au>.

Appendix A: Submissions

The following interested parties provided submissions prior to this decision.

Organisation	Date Received
ActewAGL	8 May 2006
AGL	5 May 2006
AGL (supplementary submission)	13 July 2006
Citipower and Powercor	9 May 2006
Country Energy	5 May 2006
Consumer Utilities Advocacy Centre	9 May 2006
Energy Networks Association	5 May 2006
Energex	18 May 2006
EnergyAustralia	29 May 2006
Ergon Energy	8 May 2006
Integral Energy	22 May 2006
SP AusNet	5 May 2006
Public Interest Advocacy Centre	5 May 2006
United Energy Distribution and Multinet Gas	8 May 2006