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14 May 2008

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Australian Energy Regulator
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Dear Mr Pattas

Explanatory Statement: Proposed Efficiency Benefit Sharing Scheme for Electricity Distribution Network Service Providers

Ergon Energy Corporation Limited (Ergon Energy) appreciates the opportunity provided by the Australian Energy Regulator (AER) to comment on the development of an Efficiency Benefit Sharing Scheme to support the transition to a nationally consistent framework for the economic regulation of electricity distribution networks.

The attached submission represents Ergon Energy response to the AER's proposed Efficiency Benefit Sharing Scheme and the accompanying Explanatory Statement.

Ergon Energy would welcome the opportunity to discuss this submission or provide further detail regarding the issues that it has raised should the AER require.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Tony Pfeiffer', written over a circular stamp or seal.

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c.c.: Carmel Price, Manager Regulatory Affairs – Network Regulation

Ergon Energy Corporation Limited

**Proposed Electricity Distribution Network
Service Providers Efficiency Benefit Sharing
Scheme – Submission**

Australian Energy Regulator

14 May 2008

**Proposed Electricity Distribution Network Service
Providers Efficiency Benefit Sharing Scheme –
Submission**

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Overview

Ergon Energy Corporation Limited (Ergon Energy) welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its consultation:

“Explanatory Statement - Proposed electricity distribution network service providers efficiency benefit sharing scheme” (April 2008) (Explanatory Statement); and

“Proposed electricity distribution network service providers efficiency benefit sharing scheme” (April 2008) (Guidelines).

This submission is provided by Ergon Energy, in its capacity as an electricity distribution network service provider (DNSP) in Queensland.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues that it has raised should the AER require.

General Comment

Schedule 6.1.3(3) of the National Electricity Rules (Rules) requires a DNSP’s building block proposal to contain a description, including relevant explanatory material, of how the DNSP proposes the efficiency benefit sharing scheme (Scheme) should apply for the relevant regulatory control period. Ergon Energy believes that the level of detail required for a DNSP to develop a Scheme for inclusion in its Regulatory Proposal is currently absent from both the Guidelines and accompanying Explanatory Statement.

As a general principle, Ergon Energy believes that all substantive provisions related to the preparation and application of a DNSP’s Scheme should be detailed in the Guidelines. Ergon Energy is concerned that, as currently drafted, the Guidelines will rely heavily on the use of regulatory information instruments to provide the level of detail that DNSPs will require to effectively develop and apply the Scheme.

This issue applies equally to all the guidelines that have been released by the AER for comment and is a matter of particular concern for those DNSPs who are currently in the process of preparing their Regulatory Proposals.

Ergon Energy believes that in the interests of transparency and regulatory certainty, all substantive issues should be addressed in the guidelines and that regulatory information instruments should only be used in circumstances where there are specific issues related to an individual DNSP, or a class of DNSPs, that are required to be addressed outside the guidelines.

Ergon Energy does not believe that the National Electricity Law (Law) or Rules envisage the use of regulatory information instruments for matters of general application to all DNSPs. This interpretation is supported by:

- The basis upon which the AER is permitted to issue a regulatory information instrument under Part 3, Division 4 of the Law. For example:
 - Section 28C of the Law, which provides that the AER may issue a regulatory information order to “each regulated network service provider of a specific class, or each related provider of a specified class...”; and

- Section 28D of the Law, which provides that the AER may issue a regulatory information notice to “the regulated network service provider, or related provider, named in the notice...”;
- The degree of transparency supporting the development of a regulatory information instrument being lower than that supporting the development of a guideline. In particular:
 - Section 6.16 of the Rules requires the AER to comply with the ‘distribution consultation procedures’ in making, developing, or amending any guidelines, models or schemes, or in reviewing any values or method. This provides for a two-stage process of public consultation involving the release of a draft document, explanatory statement, a summary of responses to issues raised, and a final decision; and
 - Section 28F of the Law permits the AER to serve a regulatory information notice or make a general regulatory information order in circumstances where it considers this reasonably necessary in the performance of its functions or powers:
 - Section 28J of the Law only requires the impacted party to be provided with an opportunity to be heard (including provision of a draft), prior to service of a regulatory information notice; and
 - Section 28H of the Law only provides a general requirement for public consultation, prior to making a general regulatory information order.
- The ‘status’ of the regulatory information instruments and the guidelines differ, impacting the degree of flexibility in their application that is afforded to both the AER and the impacted DNSP (or related party). In particular:
 - Section 6.2.8(c) of the Rules state that the guidelines are not mandatory and hence do not bind the AER or any other party; and
 - Sections 28N and 28O of the Law require a party receiving a regulatory information notice or general regulatory information order, to comply with the notice or order. As these instruments are binding in nature, they should be used with discretion.

Ergon Energy suggests that the guidelines should contain a greater level of specification than currently proposed and that the use of regulatory information instruments should be minimised.

In those circumstances where regulatory information instruments are required, these should be released by the AER as a matter of priority.

1 Introduction

Clause 6.8.1(b) of the Rules indicates that the AER's framework and approach paper for a forthcoming distribution determination should set out the AER's likely approach to the application of an efficiency benefit sharing scheme to the DNSP.

Ergon Energy seeks clarification of the issues the AER proposes to address in its framework and approach paper and, in particular, any issues likely to be addressed in the framework and approach paper that have not been addressed in the Explanatory Statement or Guidelines.

2 Rule requirements

No comment.

3 Reasons for the efficiency benefit sharing scheme

No comment.

4 Issues raised in submissions and the AER response

4.1 Consistency with EBSS for transmission

The Explanatory Statement indicates that efficiency gains should be measured as the difference between forecast and actual expenditure, subject to adjustments designed to remove the impacts of agreed uncontrollable costs, non-network alternative opex and recognised pass through events, and changes in capitalisation policies, demand growth and regulatory responsibilities.

Ergon Energy suggests that adjustments may also be required to accommodate changes to service classifications between regulatory control periods. Since the Scheme applies to standard control services, a reclassification of services from standard control services to alternative control or negotiated services is likely to require an adjustment to carry-over amounts between regulatory control periods.

Ergon Energy suggests that the AER include a provision in the Guidelines that allows for a re-examination of carry-over amounts between regulatory control periods in the event that there is a change in the service classifications.

The Explanatory Statement seeks to address the requirements of clause 6.5.8(c) of the Rules in developing the EBSS. To this end, the Explanatory Statement concludes that it is desirable to apply negative carry-overs.

Ergon Energy notes that clause 11.16.4(b) of the Rules requires that, in developing and implementing the Scheme, the AER must also have regard to the continuing obligations on Ergon Energy throughout the regulatory control period to implement the recommendations from the Electricity Distribution and Service Delivery (EDSD) Review adopted by the Queensland Government.

Ergon Energy is concerned that the decision to implement negative carry-overs, in combination with the requirements placed on Ergon Energy by the EDSD review, overly penalises Ergon Energy.

The EDSD Review provided a clear indication to Ergon Energy that its opex should not be constrained by the “building blocks” expenditure approved by the regulator, and encouraged Ergon Energy to incur additional opex to the extent that needs were identified. Ergon Energy is concerned that, in adhering to the principles of the EDSD Review, it will be overly penalised. Specifically, where Ergon Energy incurs opex above the “building block” allowance (in order to meet customer requirements) it will be firstly be penalised within the regulatory period (by not receiving an allowance for the additional expenditure). The application of negative carry-overs in the Scheme means that Ergon Energy will be further penalised (for the same over expenditure) in subsequent regulatory periods.

Ergon Energy suggests that the Guidelines make reference to additional obligations concerning the Scheme as referred to in Chapter 11 of the Rules. Ergon Energy also seeks clarification from the AER as to how obligations such as those proposed by the EDSD Review will be accommodated within the Scheme.

4.2 Inclusion of capex in the EBSS

Ergon Energy supports the AER’s decision not to apply the Scheme to capex.

4.3 Incentives to defer capex

No comment is provided.

4.4 Impact on non-network alternatives

Ergon Energy supports the AER’s exclusion of non-network alternatives costs from the Scheme.

4.5 Treatment of distributions losses

Ergon Energy supports the AER’s decision not to apply the Scheme to distribution losses.

4.6 Linkages with information requirements

The Explanatory Statement sets out the information requirements required in a DNSP’s regulatory proposal.

Ergon Energy notes that schedule 6.1.3(3) of the Rules requires a DNSP’s building block proposal to contain a description, including relevant explanatory material, of how the DNSP proposes the Scheme should apply for the relevant regulatory control period.

Ergon Energy requests that the AER provide details in the Guidelines or accompanying Explanatory Statement outlining the precise nature of the Scheme information required to be incorporated in a DNSP’s building block proposal.

In addition, Ergon Energy seeks to confirm whether the information required by this section of the Guidelines and by Appendix D constitutes “financial information” as set out in the AER’s proposed Cost Allocation Guidelines. If so, the associated audit requirements will need to be known with sufficient time and certainty to ensure that a complying audit can be performed prior to, and accompany, Ergon Energy’s Regulatory Proposal.

Ergon Energy proposes that the Guidelines be amended to detail any audit requirements associated with the Scheme information.

4.7 Sharing of efficiency gains

No comment is provided.

5 AER preliminary positions

Ergon Energy provides the following comments regarding Appendix E: Proposed efficiency benefit sharing scheme.

5.1 The expenditure allowance for the following regulatory control (Section 2.2)

The AER indicates that, in assessing forecasts for the following regulatory control period, the AER will place significant weight on the actual expenditure in the penultimate year of the regulatory control period during which the EBSS has been applied. The AER suggests that it is reasonable to expect the actual opex in the penultimate year of a regulatory control period to be the best indicator of the efficient level of opex available when determining forecast opex for the following regulatory control period.

While the AER acknowledges the requirements of Chapter 6 of the Rules in assessing a DNSP’s opex forecasts, the above statement indicates that the AER “...will place significant weight on the actual expenditure in the penultimate year”. This suggests that the AER intends to adopt a “baseline and scope change” approach to the assessment of forecast opex (with the baseline defined by expenditure in the penultimate year of a regulatory control period).

It is not clear to Ergon Energy that the AER’s emphasis on the penultimate year’s expenditure is consistent with Chapter 6 of the Rules. Accordingly, Ergon Energy seeks an explanation from the AER as to how its proposed approach is consistent and compatible with the various opex assessment criteria set out in clause 6.5.6 of the Rules.