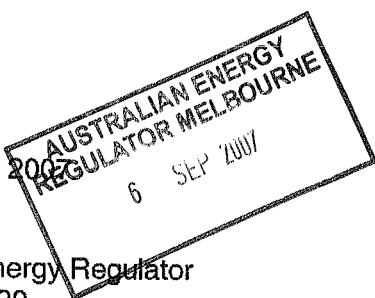




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Australian Energy Regulator  
G P O Box 520  
MELBOURNE VIC 3001

AERinquiry@aer.gov.au

97-99 Adelaide Street  
Maryborough QLD 4650  
PO Box 163  
Maryborough QLD 4650  
Telephone 13 10 46  
Facsimile 07 4123 1124  
Website www.ergon.com.au

Dear Sir/Madam

### **AER CONSULTATION – PROPOSED REGULATORY TEST V3 AND APPLICATION GUIDELINES**

Ergon Energy is pleased to provide comments in response to the AER's consultation about the proposed Regulatory Test Version 3 and the accompanying Regulatory Test Application Guidelines.

Ergon Energy's comments are provided in its capacity as a Distribution Network Service Provider (DNSP) and are focussed on the obligations that arise for DNSPs with respect to carrying out the Regulatory Test.

We note that the AER's Explanatory Statement includes recognition of other policy work that will affect the Regulatory Test regime. In particular, on page 33 the AER states:

*The AER is also cognisant of the upcoming policy work that will affect the role and operation of the test, particularly the AEMC's upcoming task to integrate the two limbs of the test as part of its work to implement new national transmission planning arrangements.*

It is Ergon Energy's view that there have been clear policy developments by the Ministerial Council on Energy that indicate its intention that the Regulatory Test be amended for DNSPs and that the National Electricity Rule changes relating to establishment of a national economic regulatory regime for DNSPs would incorporate any necessary alternative arrangements. Furthermore, the published discussions of the various parties<sup>1</sup> who currently have a role with reviewing and amending elements of the Regulatory Test have focussed on the practical application of the Regulatory Test by Transmission Network Service Providers (TNSPs) and not DNSPs.

We set out the various supporting documents to our view (that the review of the Regulatory Test's applicability to DNSPs is intended to occur as part of the current economic regime reforms) in the attached Appendix.


<sup>1</sup> AEMC, COAG, ERIG and MCE SCO

Ergon Energy is cognisant that this AER consultation cannot in itself rectify what we perceive to be the current confusing and ambiguous set of circumstances in which DNSPs find themselves. However we seek to draw this matter to the attention of all parties who are currently taking a role in development of the Regulatory Test arrangements.

It is Ergon Energy's submission that neither the Regulatory Test (in its current form), nor the associated AER Guidelines, should be applied to DNSPs. Instead if there is considered a continued need for economic analysis for network expansion projects, then, as part of the MCE's Rules changes to introduce the new economic regulatory arrangements for DNSPs (and after appropriate consultation), provisions could be introduced that are consistent with the other elements of new economic regulatory regime.

Ergon Energy would be pleased to discuss our views on this matter with the AER (and the other relevant parties).

Yours faithfully



Carmel Price  
**Manager Regulatory Affairs – Network Regulation**

Telephone: 07 4121 9545  
Postal Address: P O Box 15107  
CITY EAST QLD 4002  
Email: [carmel.price@ergon.com.au](mailto:carmel.price@ergon.com.au)

## APPENDIX

### INFORMATION TO SUPPORT ERGON ENERGY'S VIEW THAT THE CURRENT REGULATORY TEST IS INTENDED TO BE APPLIED FOR TNSPs BUT AMENDED/ABOLISHED FOR DNSPs

Ergon Energy considers it important to draw attention to the sequence of policy positions and reviews that have a bearing on the Regulatory Test, and in particular, which scope the intended future application of the Regulatory Test for DNSPs.

<sup>1st</sup> In May 2005 the MCE released the NERA and Gilbert+Tobin document "Public Consultation on a National Framework for Energy Distribution and Retail Regulation"<sup>2</sup>. This document stated that:

*"The formal application of the regulatory test for electricity distributors is an onerous requirement, given the relative size of the majority of distribution investments. Allowing the AER to take into account the extent to which the distributor has considered alternatives to network augmentation as part of the AER's assessment of the prudence of the investment, represents a more appropriate means of ensuring that non-network alternatives are considered where relevant."*<sup>3</sup>

The public consultation document also stated that the then provisions of the National Electricity Code relating to:

- The form of regulation (i.e. clauses 6.10.3 and 6.10.5) and the regulatory test (i.e. clause 5.6.2) "will be replaced with the new proposed Rules relating to the form of regulation"<sup>4</sup>; and
- The distribution network expansion rules will be revised and "will replace the regulatory test for distributors"<sup>5</sup>.

While the public consultation document did "not represent a settled view of SCO or the MCE", it is clear that it was intended to inform the early development of the framework for the new chapter 6 of the Rules.

The result of its application would be the removal of the requirement for DNSPs to comply with the requirements of the regulatory test under chapter 5 of the Rules. This would result in the Regulatory Test only applying to TNSPs in the future.

<sup>2nd</sup> In October 2005, the MCE made a Rule change application to the AEMC to implement new Regulatory Test Principles. Following public consultation, the AEMC issued a Final Determination in November 2006, which was reflected into a new Clause 5.6.5A of the Rules. This determination imposed obligations on the AER to develop a new Regulatory Test by 31 December 2007.

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<sup>2</sup>

<http://www.aemc.gov.au/pdfs/reviews/Reform%20of%20the%20Regulatory%20Test%20Principles/aemcdocs/008Final%20Rule%20Determination.pdf>

<sup>3</sup> Refer page 23

<sup>4</sup> Refer pages 23 and 24

<sup>5</sup> Refer pages 41 and 42

The AEMC did not accept the arguments put forward in the consultation to abolish the Regulatory Test for DNSPs on the basis that “the MCE has not finalised its review of distribution and retail regulation” and any action by the AEMC “would duplicate other workstreams that the MCE is currently progressing”. The AEMC stated that “The Commission notes that the most appropriate process would be for the MCE to finalise its views on distribution and retail regulation, at which point it would be appropriate to amend the relevant elements of clause 5.6.5A to take account of the MCE’s decisions”.<sup>6</sup>

It is therefore clear that the AEMC understood that the MCE intended addressing the future application of the Regulatory Test for DNSPs in the context of the development of the revised Chapter 6. Once this work has been completed, it was envisaged that consequent changes could be made to Chapter 5 of the Rules so that the Regulatory Test would in the future only apply to TNSPs and not to DNSPs.

3<sup>rd</sup> On 10 February 2006, the Energy Reform Implementation Group (ERIG) was established by the Council of Australian Governments (COAG) “to review certain elements of the operation of Australia’s energy sector and to suggest further reforms, where there is a case for them supporting more efficient energy markets”. ERIG issued its final report to COAG entitled “Energy Reform – The Way Forward for Australia” in January 2007.

Amongst other things, ERIG’s report found that:

*ERIG considers that the original role of the Regulatory Test is inconsistent with the emerging regulatory regime and both its form and function needs to be changed as a result.*

It went on to find that:

*ERIG considers that the current form of the Regulatory Test is inappropriate as:*

- *a project by project assessment cannot be expected to deliver efficient, long term development of the national network; and*
- *a two limb approach attempts to artificially identify and justify an individual project as either providing reliability or market benefits where in reality any network augmentation is part of a total network which delivers both (i.e. reliable and efficient supply).*

ERIG recommended in its report that:

*....the Regulatory Test should be replaced with a two step process to guide efficient transmission investment as follows:*

- *a National Transmission Network Development Plan should be developed which aims to deliver an integrated, national plan for the longer term efficient development of the transmission network which is consistent with the efficient development of the overall power system, and;*
- *the Plan would be designed to inform the setting of the revenue allowance provided for TNSPs for a regulatory period. Within that period, each project*

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<sup>6</sup> Refer page 90

would be subject to a Project Assessment and Consultation process prior to being constructed.<sup>7</sup>

In its discussion of the regulatory test ERIG focused exclusively on its application to TNSPs and did not refer at all to the test's application to DNSPs. Indeed, the recommendations that it made do not appear to contemplate that amending the Regulatory Test in Chapter 5 of the Rules would have any implications for DNSPs.

- 4<sup>th</sup> COAG considered ERIG's recommendations at its meeting on 13 April 2007. Its Communiqué stated that:

*COAG has also agreed to a revised network planning and consultation process, replacing the current 'Regulatory Test'. The AEMC will be tasked with advising on amalgamating the Regulatory Test criteria of reliability and market benefits and broadening the latter's definition to include national market benefits. This will allow proposed transmission projects to be assessed against meeting both local reliability standards and their ability to maximise benefits to the national market. This is intended to recognise the broader national benefits which may be achievable from investment opportunities whilst encouraging and ensuring those justified solely on reliability grounds are delivered in an efficient and timely manner.<sup>8</sup>*

On the basis of COAG's decision, the MCE wrote to the AEMC on 13 July 2007 requesting that it undertake a review of the National Transmission Planning Arrangements. This included a request to develop a revised network planning and consultation process, which would replace the current Regulatory Test. Again, this request only referred to the transmission network planning and did not reference distribution networks in any way.<sup>9</sup>

The AEMC issued a Scoping Paper in August 2007 that, amongst other things, sought interested parties' comments on alternative approaches to amalgamating the reliability and market benefits criteria under the regulatory test and broadening the definition of market benefits to include national benefits. This Scoping Paper also referred only to the Regulatory Test as it applies to TNSPs and made no reference to DNSPs. Submissions on this Scoping Paper are due on 7 September 2007 and the AEMC is required to provide its final report on National Transmission Planning Arrangements to the MCE by no later than 30 June 2008.<sup>10</sup>

- 5<sup>th</sup> On 22 August 2007, the MCE's SCO released its Bulletin 99<sup>11</sup> consulting about National Frameworks for Distribution Networks: Network Planning and Connection Arrangements. This consultation references previous and current MCE work, including the May 2005 NERA and Gilbert+Tobin document "Public Consultation on a National

<sup>7</sup> [http://www.erig.gov.au/assets/documents/erig/ERIG\\_main\\_report20070413114259.pdf](http://www.erig.gov.au/assets/documents/erig/ERIG_main_report20070413114259.pdf)

<sup>8</sup> [http://www.coag.gov.au/meetings/130407/docs/coag\\_nra\\_competition\\_reforms.pdf](http://www.coag.gov.au/meetings/130407/docs/coag_nra_competition_reforms.pdf)

<sup>9</sup> <http://www.coag.gov.au/meetings/130407/index.htm>

<sup>10</sup>

<http://www.aemc.gov.au/pdfs/reviews/National%20Transmission%20Planner/aemcdocs/000National%20Transmission%20Planning%20Arrangements%20Scoping%20Paper.pdf>

<sup>11</sup> <http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=8B431891-D7EB-8152-2A5B3CB50B590C93>

Framework for Energy Distribution and Retail Regulation”<sup>12</sup> mentioned above, as the basis upon which the consultation has been built up from.

This review and consultation specifically deals with the intended future rules for distribution network planning and expansions/extensions. The consultation closes on 28 September 2007, and will (presumably) ultimately be the final MCE policy position that is incorporated in the Rules.

Ergon Energy is therefore led to understand that it is this consultation that will lead to the outworking of the MCE’s policy intentions for the applicability of the Regulatory Test to DNSPs and that the other work currently being undertaken (by the AER, AEMC, COAG and ERIG) relates to refinements of the Regulatory Test that is to be applied by TNSPs (and not DNSPs).

## SUMMARY

It therefore appears that:

- The AER will issue Version 3 of the Regulatory Test by 31 December 2007 in order to align it with the new clause 5.6.5A of the Rules;
- The AEMC will propose a new Regulatory Test framework to the MCE by no later than 30 June 2008, with Version 4 of the Regulatory Test likely to be implemented sometime thereafter; and
- The MCE will settle its policy position with respect to the application of the Regulatory Test to DNSPs upon completion of the Bulletin 99 consultation and the Rules (Chapters 5 and 6) will be changed accordingly, but the timing is not yet known.

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12

<http://www.aemc.gov.au/pdfs/reviews/Reform%20of%20the%20Regulatory%20Test%20Principles/aemcdocs/008Final%20Rule%20Determination.pdf>