

Mr Sebastian Roberts  
General Manager South  
Australian Energy Regulator  
GPO Box 560J  
Melbourne VIC 3001

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15 May 2006

Dear Mr Roberts

### **Gas and Electricity Distribution Regulatory Guidelines - Scoping Paper**

Integral Energy welcomes the opportunity to provide a submission to the above Scoping Paper.

Integral Energy is supportive of a national approach to energy regulation and the initiative of the AER in developing guidelines to carry out distribution regulation in time to undertake the electricity distribution reviews, expected to begin in mid 2008.

However, Integral Energy notes that the release of the Scoping Paper is occurring at a time when the Ministerial Council on Energy (MCE) is currently conducting a number of policy reviews on the regulatory framework for energy. Consequently, Integral Energy recommends that the AER amend the indicative timetable provided in the Scoping Paper to ensure the guidelines are developed in line with the timing of the regulatory framework developed by the MCE and the AEMC.

Please do not hesitate to contact Mr Frank Nevill on telephone number (02) 9853 6598 if you have any questions on the submission.

Yours faithfully



Karen Waldman  
**General Manager Regulatory and Corporate Affairs**



*The power is in your hands*

# **Gas and Electricity Distribution Regulatory Guidelines Response to Scoping Paper**

**15 May 2006**

## Contents

	Page No
<b>1 Overview .....</b>	<b>2</b>
<b>2 Structure .....</b>	<b>3</b>
<b>3 Background and context.....</b>	<b>4</b>
<b>4 Distribution regulatory guidelines.....</b>	<b>5</b>
4.1 National Approach.....	5
4.2 Role of AER .....	5
4.3 Issues for Consideration.....	6

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# 1 Overview

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In March 2006, the Australian Energy Regulator (AER) released a scoping paper titled "Gas and Electricity Distribution Regulatory Guidelines" (Scoping Paper) seeking comments from interested parties on the AER's proposed process and specific issues for the development of distribution regulatory guidelines for electricity and gas distribution.

Integral Energy is supportive of a national approach to energy regulation and of the initiative of the AER in developing guidelines to carry out distribution regulation in time to undertake the electricity distribution reviews, expected to begin in mid 2008.

However, Integral Energy notes that the release of the Scoping Paper is occurring at a time when the Ministerial Council on Energy (MCE) is currently conducting a number of policy reviews on the regulatory framework for energy. Consequently, Integral Energy recommends that the AER amend the indicative timetable provided in the Scoping Paper to ensure the guidelines are developed in line with the timing of the regulatory framework developed by the MCE and the AEMC.

Consistent with the MCE's objective of achieving a common approach to revenue and network pricing across the energy market, Integral Energy recommends that the AER's guidelines process allows for the development of certain gas and electricity guidelines simultaneously, so that a convergence of electricity and gas regulation can be achieved, where it is possible and appropriate to do so.

The AER has proposed developing guidelines for electricity distribution and transmission guidelines simultaneously. However, the development of the regulatory framework for transmission is significantly further advanced than that of distribution. Consequently, Integral Energy recommends that the AER initially conduct a process for the development of guidelines for electricity transmission but at the same time begin a consultation process on the development of guidelines for electricity distribution.

Integral Energy considers that is inappropriate for the AER to develop guidelines with respect to service standards for electricity distribution. The AER is an economic regulator and has an enforcement role under the NEL, and it would be inconsistent with this role for the AER to set service standards or advise on service standards.

## 2 Structure

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The structure of this Submission is as follows:

- Background and context to the Scoping Paper (Section 3);
- National approach to the development of regulatory framework for distribution (Section 4.1);
- Role of the AER in developing guidelines within the regulatory framework (section 4.2);
- Gas and electricity guidelines (Section 4.3.1);
- Electricity distribution guidelines (Section 4.3.2);
- Service standards (Section 4.3.3).

### 3 Background and context

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This submission is Integral Energy's response to the Gas and Electricity Distribution Regulatory Guidelines Scoping Paper released by the Australian Energy Regulator (AER) in March 2006. The purpose of the Scoping Paper was to set out the AER's proposed process and scope for the development of distribution regulatory guidelines for electricity and gas distribution.

As identified in the Scoping Paper, the legislative scheme for electricity market regulation came into operation in December 1998. However there are a number of reviews currently being conducted which will impact on the regulatory framework for gas and electricity. These include:

- The MCE Expert Panel on Energy Access Pricing;
- The AEMC Review of Electricity Transmission Revenue and Pricing Rules;
- The Gilbert & Tobin/NERA Review Paper; and
- The development and amendments to the NGL/NEL and NGR/NER.

Gas and electricity distribution regulation is to be transferred to the AER from 1 January 2007. The above reviews will provide valuable input into the regulatory framework being currently developed by the MCE. Finalisation of the regulatory framework for distribution is expected to be completed by December 2006. Given this timeframe, and the timing of the next round of regulatory distribution reviews, the AER believes that there is a need for the development of various guidelines in order to provide regulated network businesses with sufficient information of how the AER intends to carry out its regulatory responsibilities.

The Scoping Paper also recognises the current differences which exist between the frameworks for regulating gas and electricity and between transmission and distribution. These differences have generally arisen from the different approaches adopted by the various State based regulators in applying the relevant requirements of various legislative and regulatory regimes, and will mean a number of transition issues will need to be addressed in the shift to the national regulatory framework.

## **4 Distribution regulatory guidelines**

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### **4.1 National Approach**

Integral Energy has consistently advocated the need for national consistency in the energy market. A key element of this approach is that a national energy market requires a national energy framework to assist in reducing regulatory costs and uncertainty to regulated businesses and investors, as regulation would then be developed within a consistent national regulatory framework.

Therefore, wherever possible a national approach should be adopted in the development of the regulatory framework for the energy industry. Within this context, it is desirable to achieve a convergence of electricity and gas regulation. However, it is also appropriate to recognise that specific differences arise as a result of the nature of the energy products and their delivery, and that total convergence of electricity and gas regulation may not always be appropriate.

Integral Energy believes a national approach will allow for improvements to regulatory practice as it will reduce duplication, particularly in the areas of licensing and economic regulation. Accordingly, Integral Energy expects that the adoption of a national approach to the economic regulation of distribution networks will reduce the administrative burden placed on distribution businesses.

### **4.2 Role of AER**

The powers and functions of the AER are set out in the National Electricity Law (NEL). However, draft amendments to the NEL accommodating the national distribution framework are currently being prepared and are not expected to be released until later this month. More prescriptive details on the economic regulation role of the AER with respect to distribution will be contained in amendments to the National Electricity Rules (Rules) due to be in place by 31 December 2006.

Integral Energy believes that it is important for the AER to work in alignment with the policy makers who are developing the regulatory framework for distribution. Any distribution guidelines proposed by the AER before the national framework is in place may not only be inconsistent with the AER's role as an economic regulator but may also be inconsistent with the approach adopted by the AEMC in its review of transmission revenue and pricing arrangements..

To guard against this, Integral Energy recommends that the AER not release any decisions (in draft or final form) or statements of preferred view on the possible distribution guidelines until after the regulatory framework for distribution has been put in place by the MCE and the AEMC.

This position does not preclude consultation on the possible guidelines occurring so that work can be advanced. However, it is prudent and reasonable to recognise that the policy reviews currently being undertaken by the MCE will impact on the regulatory process to be followed by the AER and will need to be reflected in the guidelines.

Integral Energy recognises the need for consultation and would encourage the AER to engage with stakeholders in a constructive way prior to the release of the regulatory framework. This consultation process should not in any way be seen to be pre-empting the outcomes of the MCE process.

Accordingly, however Integral Energy believes that the AER should amend the indicative timetable provided in the Scoping Paper, in order to accommodate the development of the regulatory framework by the MCE and the AEMC, while progressing stakeholder and industry consultation.

### **4.3 Issues for Consideration**

This section responds to some of the specific questions or issues raised in the Scoping Paper.

#### **4.3.1 Gas and Electricity Guidelines**

*The AER's preliminary view is to develop electricity distribution regulatory guidelines and conduct a separate process for the development of guidelines for gas. The AER seeks comments from interested parties on whether such an approach is appropriate.*

The MCE established the Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market. The Expert Panel released its Final Report in April 2006 recommending, among other things, that the NEL and National Gas Law (NGL) contain common provisions that:

- authorise the making of Rules for the regulation of access pricing of transmission and distribution facilities<sup>1</sup>; and
- require the AEMC in making Rules that apply the available forms of regulation to network services to have regard to certain factors<sup>2</sup>.

The MCE has advised that it will address the Expert Panel's Final Report in the explanatory material that will accompany the release of an exposure draft of the NEL and NGL, scheduled for late May 2006.

Accordingly, Integral Energy recommends that the AER's guidelines process allows for the development of certain gas and electricity guidelines simultaneously, so that a convergence of electricity and gas regulation can be achieved, where it is possible and appropriate to do so.

In Integral Energy's view it should be possible to develop guidelines on the revenue model, the roll forward model, tariff setting and the incentive mechanism for opex for both gas and electricity, acknowledging also that some of these matters are linked and approaches adopted for one guideline may influence the outcome in another.

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<sup>1</sup> Expert Panel on Energy Access Pricing, *Report to the Ministerial Council on Energy*, April 2006, p56.

<sup>2</sup> Expert Panel on Energy Access Pricing, *Op. Cit.*, pp. 56-57.



Therefore, to support convergence it would be important for the development of the guidelines for both electricity and gas to proceed together. The development of gas and electricity guidelines simultaneously would allow for a consistent approach, however, where areas of differentiation exist these will need to be recognised and appropriate drafting included in the guidelines.

#### **4.3.2 Electricity distribution guidelines**

*The AER presumes that the economic regulatory framework, in particular the detailed elements of the building block approach outlined in the draft Chapter 6 Rules for transmission, are largely applicable to electricity distribution, with the exception of service standards incentive regime and the form of regulation.*

*The AER, at this stage, does not intend to set out the economic regulatory framework that is, the treatment of the building block elements for electricity distribution.*

*The AER's preliminary view is that electricity distribution guidelines should be developed.*

*At this stage, the AER proposes conducting a separate process for the development of regulatory guidelines for both electricity and transmission.*

*The AER seeks comments from interested parties on whether such an approach is appropriate.*

Integral Energy agrees with the AER's preliminary view, based on the outcomes of the reviews to date, that an incentive economic regulatory framework, in the form of CPI-X building block approach is likely to be adopted for distribution regulation. Given that this model is the most developed model of regulation and has been adopted by the majority of regulators to date, Integral Energy believes that it is appropriate to use this model for the first round of regulatory determinations conducted by the AER. Alternative models such as a TFP approach require further development and detailed consultations with stakeholders before any proper consideration of their implementation can be made.

Integral Energy also agrees with the AER that there are a number of advantages to developing the electricity distribution and transmission guidelines simultaneously. However, recognising the different stages of development of the two regulatory frameworks and the timetables for finalising those frameworks, Integral Energy considers that the most practicable way forward would be for the AER to initially conduct a separate process for the development of guidelines for electricity transmission but at the same time begin a consultation process on the development of guidelines for electricity distribution.

#### **4.3.3 Service standards**

*The AER proposes to develop guidelines relating to service standards for electricity distribution. The AER considers that the issue of service standards is likely to be a significant issue during the review process given the differences across the jurisdictions schemes.*

A primary reason for the differences in regulation across the NEM jurisdictions is that they reflect different service standards adopted by the various jurisdictions. It is appropriate for NEM jurisdictions to retain the power to set standards of service in their jurisdiction.

Integral Energy does not believe that is appropriate for the AER to develop guidelines with respect to service standards for electricity distribution. These service standards have been set by the jurisdictions as a reflection of the various policies that have been put in place in the jurisdictions.

The AER is an economic regulator and has an enforcement role, however, it does not and should not have a role in setting electricity distribution service standards or advising on service standards (unlike the Reliability Panel for example).

If the AER proposes to develop guidelines for a service standards incentive scheme (and therefore would need to have regard to service standards), it should only do so after having been given clear guidance by the jurisdictions and after its functions and powers in the process are reflected in the NEL and Rules.