



Submission to the Australian Energy Regulator

**Gas and Electricity Distribution
Regulatory Guidelines**

Response to Scoping Paper

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1. Overview

The Energy Networks Association (ENA) welcomes the opportunity to comment on the *Gas and Electricity Distribution Regulatory Guidelines Scoping Paper* (Scoping Paper) released by the Australian Energy Regulator (AER) in March 2006.

The ENA considers that the preparation of guideline development for energy transmission and distribution should not proceed until the Ministerial Council on Energy (MCE) has had an opportunity to respond to the reviews outlined by the AER, such as the Expert Panel Review and until the energy policy framework has been developed further. The ENA recommends that the commencement of guideline development should be postponed for 6 months.

The AER has referred to several reviews and the development of the energy policy framework as its main reference points in developing energy policy guidelines. The ENA considers the list of reviews which consist of - AEMC Chapter 6 Review, the Gilbert and Tobin/NERA review, the Expert Panel review, to be insufficient. Several other reviews should be taken into account, including: PM Taskforce Report, the Productivity Commission *Review of Gas Access Regime* and the Report of the Taskforce on Reducing Regulatory Burdens on Business – Rethinking Regulation. If in the alternate, the AER rejects consideration of these additional reviews, then for consistency, it should also not consider its listed reviews. Instead, the AER should take guidance from MCE and AEMC policy responses as well as the developments of the gas and electricity law and regulations.

In response to the issue of whether the guidelines should consist of gas and electricity guidelines, the ENA views gas and electricity guidelines to have a level of consistency where there are common areas, but recognises that there will be differences between the two. The ENA recommends that the gas and electricity distribution guidelines be completed within the same period.

The AER has stated that the regulation of transmission will be particularly instructive for the regulation of distribution. The ENA considers that due to the draft stage of the AEMC Review of Chapter 6 of the National Electricity Rules, and the differences between transmission and distribution, it is inappropriate for transmission regulation to influence distribution regulation and guidelines to such a significant degree as described by the AER.

The AER's indicative timetable for the development of electricity distribution guidelines within the Scoping Paper has two additional suggested matters in comparison to the Draft Rules Proposal. The ENA recommends that the two additional matters proposed by the AER to be included within the electricity distribution guidelines be deleted.

2. Background

This submission responds to the *Gas and Electricity Distribution Regulatory Guidelines Scoping Paper* released by the Australian Energy Regulator in March 2006.

The Energy Networks Association is the national representative body for gas and electricity distribution network businesses. The members of the ENA include:

- ActewAGL
- AGL Energy Networks
- AlintaGas Networks
- Aurora Energy
- Citipower
- Country Energy
- ENERGEX
- EnergyAustralia
- Envestra
- Ergon Energy
- ETSA Utilities
- Integral Energy
- Multinet Gas
- NT Power and Water Corporation
- Powercor
- SP AusNet
- United Energy Distribution
- Western Power

Energy network businesses deliver electricity and gas to over 12 million customer connections across Australia through approximately 800 000 kilometres of electricity lines and 75 000 kilometres of gas distribution pipelines. These distribution networks are valued at more than \$35 billion, and each year energy network businesses undertake investment of around than \$5 billion in network operation, reinforcement, expansions and greenfields extensions.

3. Scoping Paper and the developing policy framework

A significant challenge identified in the Scoping Paper is that regulatory arrangements in electricity and gas distribution are currently undergoing significant reforms led by the Ministerial Council on Energy. This poses difficulties for any detailed development work on the shape and form of operational regulatory arrangements, such as development of the types of guidelines outlined in the Scoping Paper.

A threshold issue to be considered is whether there is sufficient certainty about likely future arrangements in energy distribution to make significant steps towards the development of detailed guidelines relating to the AER's conduct of distribution regulation.

At this time ENA considers that sufficient certainty does *not* exist to guide to the AER on how it should proceed in developing energy guidelines for the distribution sector.

The Scoping Paper states the AER's intention to be guided by the AEMC Chapter 6 Review, the Gilbert and Tobin/NERA review, the MCE Expert Panel on Energy Access pricing and the development and amendments to the NGL/NEL and NGR/NER.

The ENA has concerns about whether the outcomes of these particular policy review processes are sufficiently clear to enable meaningful guidance to be drawn from them by the AER.

AEMC Review of Electricity Transmission Revenue and Pricing Rules

This review is identified by the Scoping Paper as a primary source of guidance on the future shape of distribution regulatory arrangements. In this review, however, the AEMC has emphasised that the particular regulatory arrangements proposed are a result of the particular market circumstances and characteristics of electricity transmission infrastructure. In addition, electricity transmission businesses have been regulated at a national level for some time against the existing provisions of Chapter 6 of the Electricity Rules. Electricity distribution regulatory arrangements, by contrast, have developed on a State-based model (with a number of jurisdictions derogating away from the then Electricity Code). Distribution businesses have different characteristics and face different market circumstances than electricity transmission businesses. These considerations mean that it cannot be assumed that future AEMC rule-making relating to energy distribution regulation will closely follow that put in place for transmission.

Another difficulty with the reliance on a presumption that energy distribution rules will follow those suggested by the AEMC for transmission is that the AEMC rule-making process for transmission revenue regulation is only in its initial stages. The AEMC has not yet responded to the first round consultation process, which include significant proposals for alterations to the exposure draft rules (including from the AER and energy market participants). This uncertainty over the likely outcomes of the AEMC process is unlikely to be resolved quickly given the announced delay to the AEMC Chapter 6 review. A formal draft decision on revenue rules is now likely in June 2006.

Gilbert and Tobin/NERA review paper

This options paper provides a proposal for a nationally legislated framework for distribution and retail regulation rules.

The MCE retained consultants Gilbert and Tobin and NERA to prepare this initial options paper for public consultation. In response, in January 2006, 39 public submissions were provided to the MCE. The MCE has not responded to either the Gilbert and Tobin/NERA paper or the submissions to date, and it is understood that no formal response is pending. The ENA considers it is not appropriate for the AER to base critical assumptions regarding the future development of distribution regulation on an options paper which lacks any response from the MCE. The only formal statement the MCE has made in releasing the paper for comment is that it should *not* be taken to represent the settled view of MCE.¹

MCE Expert Panel on Energy Access Pricing

The Expert Panel report has been prepared by a panel of specially appointed consultants and is a report to the MCE. The ENA considers that it cannot be assumed that the Panel's findings and recommendations will be accepted by the MCE, particularly as the MCE has formally advised that the Expert Panel final report should not be taken to represent the views of MCE on the matters covered in the report. As

¹ MCE Bulletin, Number 50, 13 October 2005

with the Gilbert and Tobin and NERA paper, the ENA understands no formal response is intended to this document.

Timing implications of uncertainty over policy framework for regulatory guidelines

The AER has proposed developing all detailed regulatory guidelines which it views as necessary to carry out distribution regulation 12 months prior to the expected commencement of the first electricity distribution reviews in mid 2008.

In view of the lack of clear indications from the above review, and the fact that the MCE has yet to make significant policy decisions on the nature of energy distribution regulatory arrangements, there is substantial risk that development of detailed regulatory guidelines will pre-empt policy and rule-making due over the next six months.

In addition, a significant risk exists that the outcome of the AER developing the gas and electricity distribution guidelines prior to the further development of the law and regulations could result in the guidelines influencing the outcome of legislative and regulatory development. The ENA is concerned that the AER's role of regulatory enforcement and rule-making will be perceived to have been blurred.

To reduce this risk, the ENA strongly recommends that the AER to postpone its commencement of guideline development for 6 months. This will allow time for further development of the energy distribution and transmission rules and therefore increase certainty regarding the future shape of energy distribution arrangements. Recognising that further delays are possible in MCE's policy development processes, this 6 month period would enable a new decision to be made after the expiry of this period. If the likely policy environment is still substantially unclear after this period, it may be that it is appropriate for some detailed steps to be taken by ENA and the AER to further develop regulatory guidelines, to allow for their timely completion prior to the AER's initial distribution network reviews.

4. Sources for AER guidance on policy framework

The AER has stated that it has in particular sought guidance from the:

- AEMC Review of Chapter 6 of the NER
- MCE expert panel review
- Gilbert & Tobin/NERA paper
- development of, and amendments to the NGL/NEL and NGR/NER.

A number of the above papers are consultation papers and do not have any MCE policy response associated with them. In light of this, there are other papers that should be considered by the AER, there is no reason why the AER should only consider the above consultation paper without also taking into account other consultation papers such as the:

- Prime Minister's Infrastructure Taskforce Report

- the Productivity Commission *Review of Gas Access Regime*
- the Productivity Commission Report *Reducing Regulatory Burdens on Business – Rethinking Regulation*.

If the AER chooses to not consider the above consultation papers, then it would also seem reasonable that it *only* considers MCE policy response's to relevant consultation papers and the developments and amendments to the NGL/NEL and NGR/NER. Specific energy policy relating to distribution regulation is developed by the MCE, and rules are made by the AEMC, not by the selected consultation papers that the AER has outlined.

5. Energy guidelines

In light of some of the differences between gas and electricity, the AER has raised the issue as to whether there should be a single set of uniform guidelines or separate sets of guidelines for the regulation of gas and electricity distribution.

The ENA considers there to be some areas between gas and electricity distribution, these common areas should result in common energy guidelines. The areas which do require differentiation need to be recognised and drafted appropriately. The actual guidelines can be separate, but with common sections in both the gas and electricity guidelines as appropriate.

In light of the above, the ENA recommends that both gas and electricity distribution guidelines be developed at the same time. This will allow for the comparison of the guidelines to determine which parts can be similar, and which parts need to be treated differently.

6. Consistency of approach for transmission and distribution

The AER has stated in its paper that it has sought guidance from the three reviews discussed above, and in particular the AEMC Review of Chapter 6 of the NER. In the AER's view, this provides the clearest indication of the regulatory framework likely to be adopted for distribution regulation. The AER has stated that the regulation of transmission will be particularly instructive for the regulation of distribution. The AER Scoping Paper raises the prospect of developing joint, or very similar 'transmission/distribution' guidelines.

The AEMC Review of Chapter 6 of the NER has still not reached a Draft Decision phase of the rule making process - it is at least questionable whether it will be the clearest indication of the regulatory framework for distribution regulation. Not only due to the AEMC review being at its draft stage, but also due to the differences between transmission and distribution. The ENA does not consider it appropriate that transmission should be 'particularly instructive' on distribution guidelines.

7. Additional guidelines proposed by AER

The draft rules proposal requires the AER to develop, by 31 December 2006 and finalise by mid June 2006, guidelines on the following matters:

- Information guidelines
- Cost allocation guidelines
- Service performance target incentive scheme
- Efficiency benefit scheme
- Post tax revenue model
- Roll forward of regulatory asset base model.

Within AER’s indicative timetable for the development of electricity distribution regulatory guidelines, the AER has suggested guidelines on the following matters:

- PTRM
- Roll forward model
- Incentive mechanism for opex
- Cost allocation methodology
- Information requirements
- **Connection and capital contribution (no transmission equivalent)**
- Service standards
- **Tariff setting (no transmission equivalent)**
- Ring fencing

The ENA is concerned at the potential for ‘regulatory creep’ and a lack of consistency between future policy and rule making decisions and AER practice in the AER proposing the matters to be covered within the electricity distribution regulatory guidelines.

The two matters that appear to be going beyond the original proposed scope within the rules are connection and capital contribution and tariff setting. The ENA considers that it is highly speculative to seek to predict how and to what degree of prescription future distribution regulatory arrangement will treat these specific issues. The ENA recommends that these two matters be deleted from the AER’s indicative timetable.

8. Market circumstances of energy distribution sector

The AER has provided an ‘Industry Overview’ section within the Scoping Paper.

This overview provides an economically focused description of the role of distribution networks in competitive energy markets.

Overall, however, the section seems an incomplete summary of the full market circumstances of distribution networks. The ENA considers the following important additional issues should be recognised.

Competition within the energy industry

It needs to be recognised that there is competition in the following sections of the industry: contestability of network works; emerging contestability in asset management; between energy sources; electricity and gas distribution networks do compete in some applications/circumstances, for example electricity, wood, LPG, heating oil and solar are typically strong competitors facing new gas networks; inter-network competition recognised by Australian Competition Tribunal and by decisions to not regulate small regional gas networks; and the national gas transmission grid is evolving and increasingly offering different supply choice to customers.

Market circumstances relevant to distribution regulation

Other important issues that the energy industry faces include:

- shifting consumer expectations on matters such as reliability, customer service and visual amenity
- new challenges for energy and especially electricity grids (such as increasing potential for networks to be requested to provide dedicated services to embedded generators and wind farms)
- the high proportion of non-discretionary investment in network sector to meet safety and reliability requirements, and to serve new customers
- increases in peak load through greater penetration of energy appliances
- ageing infrastructure profile of network assets – with most electricity networks increasingly relying heavily on infrastructure up to 20-30 years of age

The Energy Networks Association
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