29 January 2008

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Buckley,

Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 preliminary positions paper

Thank you for the opportunity to comment on the AER's preliminary positions paper concerning matters relevant to the distribution determinations for ACT and NSW DNSPs for 2009-2014. Integral Energy is broadly supportive of the AER's preliminary positions on the issues discussed in the paper. A number of specific comments are provided below.

Demand management incentive scheme (DMIS)

Need for effective long-term framework

Integral Energy supports the AER's preliminary position to retain IPART's D-factor incentive scheme and to introduce a learning by doing fund trial for the upcoming regulatory period. These are appropriate interim mechanisms for encouraging both constraint-based and broader demand management activity.

It will be important that the AER also ensures that the regulatory framework beyond the 2009-2014 periods provides for the sustainable adoption of demand side approaches including the need to provide investment certainty for DNSPs. To develop an effective framework, the AER will need to take into consideration developments in relation to a number of broader policy issues including retail price regulation, the provision of advanced metering, energy efficiency and greenhouse initiatives. Given the complexity of these matters, Integral Energy encourages the AER to commence that development process sooner rather than later.

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Learning by doing funding level

While welcoming the introduction of a learning by doing fund, Integral Energy submits that the proposed $600,000 allowance over the five year regulatory period runs the risk of encouraging only limited investment. Given the nature of the likely projects (for example, energy efficiency education and information programs which require a sustained effort over time to generate outcomes), a higher level of funding would increase the likelihood of realising material demand management savings. By way of comparison, the South Australian regulator provided $20m to ETSA Utilities for the 2005-2010 regulatory period to support the development and implementation of a range of demand management initiatives[1].

In this regard, it would be inappropriate to base funding on the relative size of NSW DNSP regulated revenues as proposed by the AER. The objective of the exercise is to support the development of a viable demand management supply industry. Each of the DNSPs should be in a position to contribute to that development irrespective of the size of its revenues or customer base[2]. On this basis alone, Integral Energy submits that, as a minimum, its learning by doing fund allowance should be raised to the $1m level as that provisionally allocated to EnergyAustralia.

Integral Energy considers that the best practice way forward in terms of determining a suitable fund allowance for the NSW and ACT DNSPs would be to follow the process undertaken by ESCOSA. This would involve the AER, in consultation with the DNSPs:

- developing the funding criteria;
- reviewing the potential range of projects that could be delivered within the upcoming regulatory period; and then
- setting fund allowances based on the results of that consultation.

Section 6.6.3(g) of the Transitional Rules provides that, on the basis that the AER considers it appropriate to impose a DMIS for the 2009-2014 regulatory period, it must develop and publish that scheme by 1 March 2008. Noting this time constraint, Integral Energy submits that the AER should determine a base level of funding for the period and include the process outlined above in the guidelines for the scheme. The process could then take place during the period when the AER reviews the DNSPs' regulatory proposals. A decision as to any funding allowance in addition to the base could then be made as part of the AER's regulatory proposal decisions.

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1 ESCOSA, *2005-2010 electricity distribution price determination, Part A – statement of reasons*, p 60.

2 Were a relative size basis to be used, Integral Energy notes that it has a similar number of customers to ETSA Utilities.

This course would provide the opportunity to establish a more meaningful learning by doing fund allowance and ensure a wider opportunity to generate demand management activities without imposing undue costs on customers.

Other DMIS matters

Integral Energy supports the adoption of the IPART D-factor scheme guidelines and looks forward to the release for consultation of the guidelines for application of the learning by doing fund. It also endorses the AER's focus on maximising the benefits to be obtained from the learning by doing fund by keeping the associated administrative processes simple.

Integral Energy submits that the scheme guidelines should include transitional arrangements to ensure recovery of allowances for demand management projects made during the later years of the 2009-2014 regulatory period should there be a decision not to continue the scheme into the subsequent regulatory period. Any lack of certainty in this regard would be likely to impact on investment.

Finally, Integral Energy notes that the interaction between the DMIS and other incentive schemes (such as the Efficiency Benefit Sharing Scheme) needs to be clearly articulated in order to preserve the DMIS's intended incentive effects.

Control mechanisms for alternative control services

Integral Energy supports the AER's proposed form of control for alternative control services in NSW (namely, public streetlighting services), being a schedule of fixed prices in the first year of the regulatory period and a price path based on revealed efficient costs for the remaining years. In principle, this should generate an appropriate balance of certainty and efficiency.

Integral Energy also endorses the AER's view that achieving those outcomes depends upon there being an appropriately light-handed review process and welcomes the opportunity for the DNSPs to use simplifying assumptions in their proposals to assist in achieving that end. This is particularly the case given the 1 March 2008 date prescribed by the Transitional Rules for the AER's decision on this matter is only three months in advance of the 2 June 2008 submission date for a five year price path.

Approach to determining materiality for possible pass through events

Subject to two points of clarification, Integral Energy accepts the AER's proposed pass through event thresholds, namely, than an event is material if:

- the revenue impact in any one year exceeds one per cent of the respective DNSP's annual revenue requirement for the first year of the regulatory period; or

- the proposed capex exceeds five per cent of the annual revenue requirement in the first year of the regulatory period.

The points of clarification are that:

- the capex limb refers to the cumulative value of the required expenditure with the term "cumulative" understood to mean aggregation both *through* time (total capex over the project life) and of like projects (smaller projects related to a single pass through event) — to interpret it as either a year by year measure or to treat such projects separately would be likely to put material expenditure at risk; and
- the term "annual revenue requirement" is preferred to the "AARR" used by the AER in its paper — strictly speaking, "AARR" is used in the Rules as a reference to transmission revenues only.

Should you wish to discuss any aspect of this submission, please contact Michael Martinson on (02) 9853 4375.

Yours faithfully

R. Powis

Richard Powis
Chief Executive Officer