

20 March 2009

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Pattas

Proposed Amendment to AER's Service Target Performance Incentive Scheme

I refer to the AER's Explanatory Statement of February 2009 on the proposed amendments to the Service Target Performance Incentive Scheme (STPIS).

Integral Energy notes that while the proposed amendments do not fundamentally alter the overall operation of the STPIS, the changes will result in some material adjustments to the way the s-factor is determined. It is also noted that Integral Energy will not be subject to any financial penalty or reward in the next regulatory period as a result of the operation of the STPIS.

S-factor component

Integral Energy notes that the reliability performance targets are to be based on the average performance over the past five years adjusted for any planned reliability improvements and having regard to any instance where the cap on revenue at risk has been breached in the previous regulatory period.

Integral Energy has concerns with the proposal for the AER to set additional performance targets. The NSW Design, Reliability and Performance (DRP) Licence Conditions set specific reliability standards based on feeder type eg urban, long rural, short rural etc. These reliability standards are set at both the average level and also the individual feeder level. At each regulatory reset the AER is required to provide the efficient costs of meeting these Licence Condition standards.

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The NSW DRP Licence Conditions standards, which formed the basis of Integral Energy's 2009 to 2014 Regulatory Proposal, have been set by the NSW Minister for Energy and represent the level of reliability that strikes an appropriate balance between what is achievable by the businesses and the costs to NSW consumers. For the AER to set additional reliability targets, presumably lower than the NSW DRP Licence Conditions standards, introduces potential inconsistencies in targeted performance and reporting of results.

If the AER were to set additional reliability targets above or below the NSW DRP Licence Condition standards, then this could result in perverse outcomes for either the business or for customers. For example, if the AER were to set a target below the NSW DRP Licence Condition standard and the actual performance achieved lies between the AER's target and the Licence Condition standard, then the business would be penalised under the STPIS even though it has met the NSW DRP Licence Condition. The reliability experienced by the customers would be the same, but the outcomes for the business could be quite different if the AER has allowed expenditures and set revenues that permit the business to satisfy the NSW DRP Licence Conditions but then penalises the business for not achieving a reliability target it has set.

For the STPIS to operate in a meaningful manner, Integral Energy recommends that the AER use the NSW DRP Licence Conditions standards as the targets for the STPIS, to do otherwise would undermine the intent of the Licence Conditions standards.

Revenue at risk

Integral Energy notes that, under its arrangements for the 2009-14 regulatory control period, no revenue will be placed at risk.

Integral Energy does not believe there is any justification for the AER to increase the amount of revenue at risk under the STPIS from 3 per cent to 5 per cent. The AER has argued that the increase is required to maintain the power of the incentive after the removal of the carry forward mechanism. Based on the AER's NSW Draft Distribution Determination, 3 per cent of Integral Energy's revenue would equate to approximately \$24 million in the first year alone. Due to uncertainty over how the STPIS will operate when introduced for the first time in 2014, Integral Energy considers that a maximum revenue at risk of 3% is appropriate.

Major event day definition

Integral Energy supports the changes the AER has proposed to the major event day definition and notes that the revised approach more closely aligns with the Institute of Electrical and Electronics Engineers (IEEE) standard 1366-2003, IEEE Guide for Electric Power Distribution Reliability Indices.

Integral Energy, however, does not support the AER's adoption of different exclusion clauses and feeder definitions to those currently defined in the NSW DRP Licence Conditions.

The AER's proposed methodology stipulates that five years of daily unplanned SAIDI data is to be used whereas the NSW DRP Licence Conditions reporting methodology requires the

use of five years of daily planned and unplanned SAIDI data. As a result, the threshold for exclusion of events from the reported SAIDI will differ depending upon whether the AER's methodology or the NSW DRP Licence Conditions Methodology is used regarding planned SAIDI. This will lead to different reliability outcomes being reported which will lead to uncertainty and confusion amongst customers and other interested stakeholders.

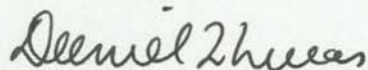
The AER's proposal also has a different definition for CBD feeders than that used for the NSW DRP Licence Conditions. Under the NSW DRP Licence Conditions Integral Energy does not have any CBD feeders. However, under the AER's proposal it is possible that some of the Integral Energy feeders could be classified as CBD feeders for reliability reporting purposes. This will effectively mean that some feeders will have two classifications depending upon which reporting framework is being used. Again this will lead to uncertainty and confusion amongst customers and other interested stakeholders.

Integral Energy is concerned that these differences will require separate reporting for the NSW DRP Licence Conditions and for the AER's STPIS and will also lead to different outcomes being reported. While this will not only be confusing for customers and other stakeholders it is also inefficient to require the businesses to establish two different reporting regimes for reporting the reliability outcomes for a single network.

Integral Energy proposes that the reporting framework for the STPIS align to Integral Energy's obligations as set in the NSW DRP Licence Conditions so that only one reporting regime is required, thereby reducing the confusion for customers and other key stakeholders and avoiding unnecessary additional compliance costs.

Should you have any questions or require further information on any of the matters discussed above please contact our Manager Regulatory & Pricing, Mike Martinson, on 02 9853 4375.

Yours faithfully



Daniel Lucas

**General Manager
Regulatory and Corporate Affairs**