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BY EMAIL: aerinquiry@aer.gov.au

Mr. Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

Dear Chris

AER's Framework and Approach Paper – Regulatory control period commencing 1 January 2011

1. Introduction

United Energy Distribution (UED) welcomes this opportunity to comment on the AER's preliminary position paper on the framework and approach ("position paper") for CitiPower, Powercor, Jemena, SP AusNet and UED in anticipation of the 2011-2015 distribution determination. As a general observation, UED is pleased that the position paper is a carefully considered and well-presented document that diligently follows the process envisaged by the Rules.

UED notes that the AER assumed responsibility for the economic regulation of the Victorian DNSPs on 1 January 2009. The forthcoming regulatory control period, commencing on 1 January 2011, will be the first distribution determination conducted in Victoria under the National Electricity Rules (the Rules). UED strongly supports and welcomes the new national regime for energy network regulation, and the company looks forward to developing a positive and constructive relationship with the AER as the review progresses.

Given that the forthcoming review is the first Victorian distribution review under the new regime, UED notes that at this very early stage of the process it would be unrealistic to expect to anticipate all of the transitional issues that may arise in the course of the review. In addition, UED notes that the Rules explain that the framework and approach paper is not binding on the AER or DNSPs, with the exception that the control mechanisms specified in the framework and approach paper must be adopted by the DNSP.

In light of these observations, UED encourages the AER to adopt a flexible approach during the review so that transitional issues can be resolved effectively as and when they arise. UED will similarly aim to respond in a flexible manner if regulatory approaches established at an early stage of the review process subsequently need to be modified.

The remainder of this submission follows the structure of the position paper:

- Section 2 comments on the classification of distribution services
- Section 3 discusses the application of price caps to alternative control services.
- Section 4 addresses the AER's service target performance incentive scheme; the efficiency benefit sharing scheme, and the demand management incentive scheme.
- Section 5 comments on the application of the Victorian Cost Allocation Guidelines that were issued by the AER in June 2008.
- Appendix A provides details challenging the AER's classification of services

2. Classification of distribution services

The AER summarises its proposed approach to the classification of distribution services in the following table.

Table 2.5 – AER's preliminary position – classification of Victorian DNSPs' distribution services

Service grouping	Negotiated distribution services	Direct control Services - standard control services	Direct control services - alternative control services
Network services		All "standard" network services	
Connection services	Connection and augmentation works for new customer connections		Connection - energisation
Metering services			Metering services provided to existing first tier customers with annual consumption greater than 160 MWh that have either type 5 manually read interval meters or type 6 manually read accumulation meters Metering services for unmetered supplies
Public lighting services	New public lighting		Operation, repair, replacement and maintenance of DNSP's public lighting assets Alteration and relocation of existing DNSP public lighting assets
Fee based services			All fee based services
Quoted services			All quoted services

Source: AER analysis

Further detailed descriptions of the types of activities that fall within each proposed service group is provided in Appendix 1 to the position paper, although the AER notes that it does not provide a complete listing of the services provided by each distributor.

When classifying distribution services as either direct control services or negotiated distribution services, the AER must have regard to the four factors in clause 6.2.1(c) of the NER. These factors include:

- a consideration of the characteristics of the service and particularly the extent to which prices may be subject to competitive pressures;
- the regulatory approach previously applied;
- the need for consistency; and
- any other factors.

For direct control services, further factors are assessed to determine the form of control – whether it is a building block regime (standard control services) or a more light handed regime (alternative control services).

UED believes that the position paper has in the main properly examined the relevant factors for each of the service categories. In particular, UED believes that in most cases the AER has appropriately balanced its analysis of the characteristics of the particular services (and the extent to which they are subject to competition) against the need for consistency with previous and current regulatory practice. Appendix A provides details where UED believes that the AER has incorrectly classified services.

3. Application of price caps to alternative control services

Whilst UED generally concurs with the AER's approach and conclusions regarding the classification of distribution services, there is one matter in the position paper that is unclear. The AER correctly comments on page 59 of the position paper that:

> "Under the EDPR, in the absence of submitting the above information [which relates to the costs of providing these services], "the charges for excluded services will not be subject to automatic indexation". The AER understands that the prices for these services have not, to date, been automatically indexed. The exception to this has been the operation, maintenance and replacement charge for public lighting, which has been adjusted annually since 2008 at the request of DNSPs."

UED agrees with this statement as a description of the current arrangement. UED notes that it would be normal commercial practice to subject prices to indexation, and this would be regarded by customers as a reasonable approach for updating prices during the regulatory control period. The current regulatory process for reviewing these prices has proved to be deficient – as noted by the AER the charges have been substantially unchanged since 1999 – and it is therefore appropriate to implement a common-sense approach to updating these prices that has low administrative costs. On this basis UED strongly supports the AER's conclusion on page 69 of the position paper that:

> "For the remaining years of the regulatory control period the AER proposes to establish a price path, such as CPI-X, or some other escalation mechanism to be contained in each DNSP's distribution determination."

As a practical matter applying CPI to the approved prices is strongly preferred as it has low administrative costs and reflects standard commercial practice and expectations.

4. Incentive schemes

The position paper discusses three incentive schemes:

- the service target performance incentive scheme (STPIS) and guaranteed service levels (GSLs);
- the efficiency benefit sharing scheme (EBSS); and
- the demand management incentive scheme (DMIS).

As a general observation, UED supports the application of each of these schemes. By the commencement of the forthcoming regulatory period, UED will have been subject to an S-factor scheme and an efficiency carryover scheme for more than 10 years. UED notes that the AER has released a further consultation paper proposing amendments to the current S-factor scheme. Responses to this consultation are due on 19 March 2009. UED will provide more substantive comments at that stage.

4.1 Service target performance incentive scheme

The S-factor scheme that presently applies in Victoria was subject to material changes at the commencement of the current regulatory period. One of these changes related to the exclusion regime for extreme weather events. Whilst these changes were well-intentioned, the application of the new arrangements has raised unanticipated definitional issues. UED will want to ensure that the AER's STPIS scheme consistently applies exclusion criteria to historic data (which form the basis of performance targets) so that future performance is measured on a like-for-like basis. UED notes the AER's consultation paper appears to adequately address this issue.

Another one of these material changes is the increase in incentive rates. An increase in rates exposes UED to increased risk. For example if UED improves its performance in the current period it will be rewarded at the current rates. In the case that it deteriorates in the new scheme it will be penalised at three times the rate of the reward. As overall reliability levels improve, the marginal cost to achieve further improvements can be expected to increase.

UED would argue that distributor's incentives for improvements should be greater than penalties - in particular where those improvements were paid at a lower rate than the new rates.

4.2 EBSS

The AER is required to calculate the revenue building blocks for the 2011 – 2015 period based on the current scheme. Whilst the new scheme comes into effect from 1 January 2010 it has no revenue impact until 2016. The proposed scheme is not materially different to the current scheme. On this basis UED has no substantive comments to make regarding the application of the scheme. UED has not recently reviewed any alternatives to the scheme.

Prior to the 30 November 2009 submission, UED will review any alternatives to the scheme and will contact the AER prior to applying any alternative scheme in the company's submission.

4.3 Demand Management Incentive Scheme

The AER has taken a deliberate "small scale" approach to introducing a DMIS scheme in Victoria. The approach is based on schemes elsewhere and involves:

- An allowance of $400,000 per annum (for UED) to carry-out a number of small scale demand management projects; and

- A mechanism whereby any shortfall in tariff revenue as a result of demand management schemes will be reimbursed

UED supports this approach to DMIS at this stage. Arguably the scheme is one that simply keeps business whole rather than one that provides genuine incentives. Given the nature of the interval meter roll-out in Victoria any other demand management initiatives may be limited in nature until information from interval meters can be analyzed conclusively. For this reason the approach adopted by the AER in this review is adequate in the short-term.

4.4 Concluding comments

UED notes that the arrangements for STPIS and DMIS are not yet settled as both schemes are subject to further consultation. In advance of these matters being settled it is noted that:

- in relation to STPIS, the AER is currently investigating potential perverse incentives that may occur under the STPIS when the cap on revenue at risk is invoked. The AER envisages that any amendments to the STPIS will be proposed and finalised before the publication of the final framework and approach paper for Victorian DNSPs in May 2009; and

- in relation to DMIS, consultation on a DMIS suitable for consistent application across the NEM has not yet commenced. UED will contribute more substantively to the consultation process of any National scheme. UED hopes that the AER does not simply introduce a national scheme by "stealth" by rolling out individual, but the same, state based scheme as they determine pricing over the next five years. In addition the AER is conducting a parallel consultation exercise to develop its proposed approach to the application of DMIS to the Victorian DNSPs.

UED will engage with the AER on these separate consultation processes and looks forward to the finalisation of these schemes.

5. Victorian Cost Allocation Guidelines

The position paper correctly describes the Rules requirements in relation to the cost allocation arrangements. In light of these requirements, the AER proposes that:

- the Victorian DNSPs prepare and submit a Cost Allocation Method to the AER in accordance with the NER and section 3 of the AER's Victorian Cost Allocation Guidelines;

- it will approve, or reject, a Victorian DNSP's proposed Cost Allocation Method in accordance with section 4 of the Victorian Cost Allocation Guidelines, and

- the Victorian DNSPs apply their approved Cost Allocation Method in accordance with section 5 of the Victorian Cost Allocation Guidelines.

UED concurs with the AER's description of the Rules and supports the AER's proposed approach. UED will endeavour to consult with the AER prior to the 30 November 2009 submission with the intent of having an approved Cost Allocation Method already approved by the AER at the time the company makes its pricing proposal.

As noted at the outset, UED considers that the position paper is a well-presented document that diligently follows the process envisaged by the Rules. The company strongly supports and welcomes the new national regime for energy network regulation, and the company looks forward to developing a positive and constructive relationship with the AER as the review progresses.

Should you have any queries regarding this submission, please contact me on (03) 8540 7818.

Yours sincerely

Andrew Schille
Regulatory Manager, UED

Attachment A: Comments on AER's proposed service groups and classifications

The table below is an extract from the AER's Framework and Approach paper. For convenience only those matters with specific comments are included in the table.

AER service group	ESCV current classification	AER proposed classification	Service / Activity	Comments
Public lighting services - Alteration and relocation of existing DNSP public lighting assets	Excluded distribution service	Alternative control service	Alteration and relocation of existing DNSP public lighting assets (included under 'quoted services' below)	The alteration and relocation of public lighting is currently not price capped by unit cost. Each job/project is quoted on an individual basis based on the specific nature of the works. This does vary on a case by case basis. Given the nature of the current arrangements UED proposes that this service be classified as "***negotiated distribution service".*** This is consistent with the current provision of this activity and Guideline 14.
Quoted services	Excluded distribution service	Alternative control service	Rearrangement of network assets at customer request, including alteration and relocation of existing public lighting assets	UED supports the AER's classification of these works. It is practical to apply a price cap to a labour rate however it is not practical to apply a price cap for each item of works. For example materials, traffic control and other costs will vary between jobs and should be passed through at UED's costs rather than be subject to a price cap.
Quoted services	Excluded distribution service	Alternative control service	Supply enhancement at customer request	UED supports the AER's classification of these works. It is practical to apply a price cap to a labour rate however it is not practical to apply a price cap for each item of works. For example materials, traffic control and other costs will vary between jobs and should be passed through at UED's costs rather than be subject to a price cap.
Quoted services	Excluded distribution	Alternative control	Emergency recoverable works	UED supports the AER's classification of these works. It is practical to apply a price cap to a labour rate

	service	service		however it is not practical to apply a price cap for each item of works. For example materials, traffic control and other costs will vary between jobs and should be passed through at UED's costs rather than be subject to a price cap.
Quoted services	Excluded distribution service	Alternative control service	Watchman lights — installation	UED believes that this is a contestable service and should therefore be classified as an ***unregulated service***. This service is not regulated currently - customers have the choice of installing their own security light within their property.
Fee Based Services	Excluded distribution service	Alternative control service	Elective underground service where an existing overhead service exists	UED believes that this service be classified as ***negotiated distribution service***. Elective undergrounding is in essence a connection service and should not be treated any differently to the other connection services, which the AER has proposed to classify as negotiated distribution services. Individual elective undergrounding can vary significantly based on terrain, length etc.
Fee Based Services	Excluded distribution service	Alternative control service	Supply abolishment	This item requires clarification and disaggregation. This ***fee based service*** should be limited to small service supply abolishment and the scope of this service should be defined in the Price Review. There are other more complex supply abolishment projects (involving substations etc) that should be classified as ***quoted service***.
Fee Based Services	Excluded distribution service	Alternative control service	High load escorts — lifting overhead lines	UED supports the AER's classification of these works however it should be treated as a ***quoted service***. It is practical to apply a price cap to a labour rate however it is not practical to apply a price cap for each item of works. For example materials, traffic control and other costs will vary between jobs and should be passed through at UED's costs rather than be subject to a

				price cap.
Fee Based Services	Excluded distribution service	Alternative control service	Watchman lights — maintenance	UED believes that this service be classified as ***an unregulated service.*** UED currently charges a maximum uniform tariff which has not changed since pre retail contestability in Victoria.

This appendix proved by the AER in the Framework and Approach paper does not make reference to a number of excluded distribution services currently offered by UED. These are:

- Field officer visits;
- Meter equipment tests; and
- Switching service;

UED offers the following discussion on each of these services: For the reasons listed below, it is proposed UED not seek to have these services included in the schedule of services listed in Appendix A

- Field officer visits - UED provides a range of field officer visit services to customers. They include they include re-energisation and de-energisation for non payment; fuse removal and insertion at the request of electrical contractor; fuse removal and insertion at the request of retailers, time switch adjustments etc. Whilst most of these services are listed as fee based services in the AER appendix, ***special meter reads; meter equipment test*** and ***time switch adjustment*** services are not included in the appendix. UED proposes that the AER include these services in appendix A as an ***alternative control service***.
- Switching service should be included as part of a negotiated connection service.

Finally, the AER has not classified customer initiated alteration and relocation of existing DNSP network assets. UED proposes this service activity to be listed in the service group list in appendix 1 and propose the classification to be ***negotiated distribution service*** for the same reason given for public lighting assets.