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Mr John Pierce
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Our Ref:

Dear Mr Pierce

SUBMISSION ON AEMC DIRECTIONS PAPER – ECONOMIC REGULATION OF NETWORK SERVICES

The Victorian Department of Primary Industries (DPI) as the portfolio agency responsible for energy market development in Victoria is pleased to make this submission in response to the Australian Energy Market Commission's March 2012 Directions Paper on the economic regulation of network service providers.

Any queries in relation to this submission should be directed to Mr John Krbaleski, Director, Network Policy by email at john.krbaleski@dpi.vic.gov.au or on telephone (03) 9658 4436.

Yours sincerely

16/4/12

Mark Feather
Acting Executive Director
Energy sector Development Division

SUBMISSION TO THE AEMC'S DIRECTIONS PAPER (ERC0134)

National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012

National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012

The Victorian Department of Primary Industries (DPI) welcomes the opportunity to make a submission to the Australian Energy Market Commission's (the Commission's) Directions Paper on the rule change requests received from:

- the Australian Energy Regulator (AER) in relation to the economic regulation of network services
- the Energy Users Rule Change Committee in relation to the methodology for the calculation of the return on debt component.

In this submission, we have provided comment on:

- the capital expenditure (capex) and operating expenditure (opex) allowances
- capex incentives
- actual or forecast depreciation
- related party margins
- the regulatory determination process
- other issues – customer involvement and AER resourcing.

Capex and opex allowances

Operation of the existing framework

Question 3: Would it be appropriate for the wording of the National Electricity Rules (NER) to be clarified to better reflect the policy intent?

The Directions Paper states that¹:

Most [Network Service Providers] NSPs strongly suggest that there is no evidence from the AER's regulatory determinations that it has been constrained in the way it has suggested. ... The fact that the AER applies the same approach in Chapter 6A, where there are not the same constraints as in Chapter 6, in the opinion of some NSPs, shows that the problem is not with the NER itself but the way the AER applies the NER.

The Commission appears to support this view based on its review of many of the AER's regulatory determinations.²

¹ Australian Energy Market Commission, *Directions Paper; National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012; National Gas Amendment (Price and revenue Regulation of Gas Services) Rule 2012*, 2 March 2012, page 19

As indicated in the Victorian Minister for Energy and Resources' submission to the Commission's Consultation Paper, to the extent that there is legal uncertainty regarding the extent of the AER's discretion, it is preferable that the rule changes are approved so as to put the matter beyond doubt and to reduce the potential for future legal challenge before the Australian Competition Tribunal.

Comparisons with Ofgem

The AEMC's Directions Paper makes a number of comparisons to the approach to regulation undertaken by Ofgem in Great Britain. The AEMC's Directions Paper notes that the AER has suggested that Ofgem has much broader discretion when compared with the AER. The AEMC Directions Paper then notes that while Ofgem appears to have more discretion, this is heavily constrained by the ability of NSPs to reject price control proposals and initiate a wide ranging appeals process.

DPI notes that the AER is not only constrained by its limited discretion but also by the merits review framework. The merits review framework encourages cherry picking by NSPs, with limited downside risk, and does not provide a "wide ranging appeals process". This is in contrast with the appeals arrangements that have operated in Great Britain which have historically constrained incentives on NSPs to appeal by creating the potential for downside risk. Arguably, therefore, the appeals regime under which the AER operates in fact creates a greater constraint on its discretion than that which Ofgem has faced in Great Britain.

The AEMC also notes in its paper that "it appears to the Commission that there may not in fact be such a significant difference between the policy intent of the AEMC in developing the Chapter 6A rules for transmission and the actual practice of Ofgem". Whether this is the case or not does not address the fundamental issue raised by the AER that there is significant legal uncertainty regarding the extent of this discretion under the Australian arrangements and that this uncertainty should be removed.

Comments on Professor Yarrow analysis

The paper prepared by Professor Yarrow also raises a number of concerns that "a regulator with unconstrained discretion to set price controls will be tempted to opportunism and that the temptation will be particularly great in circumstances of rate shock". The concern expressed is that regulatory discretion may lead to biases in periods of sharply rising costs as rate setting becomes more politicised and the independence of regulators "tends to come under most threat".

It is important to note in this context that there is no suggestion in the AER rule change proposal that it will have unconstrained discretion. In this context, it is important to recognise that the AER is obligated to take into account the Revenue and Pricing Principles set out in section 7A of the National Electricity Law (NEL) and must perform its functions in a manner that will or is likely to contribute to the National Electricity Objective (see section 16 of the NEL).

In addition, Professor Yarrow's paper also indicates that in order to provide for appropriate checks and balances, regulatory discretion is usually accompanied by great degrees of ex post supervision (i.e. by courts and tribunals). Professor Yarrow notes that "if the rules are a partial (ex ante)

² Ibid, page 23

substitute for (ex post) judicial supervision of regulatory decisions, then a rebalancing away from prescription will likely 'crowd in' greater judicial supervision". In particular, a rebalancing might give rise to adaptation in other parts of the legal and political system.

It is also important to note that under the regulatory framework in which the AER operates, it is both constrained by significant prescription in its decision making, as well as being constrained by a high level of judicial supervision, under which most of its regulatory determinations are appealed to the Australian Competition Tribunal. This suggests that the degree of "balance" referred to in Professor Yarrow's paper is absent in the Australian regulatory framework.

Other issues

Question 5: Would it be appropriate for the capital expenditure incentives to be clarified to better reflect jurisdictional reliability standards?

The Commission has suggested in the Directions Paper that the capex objectives could be amended to clarify that:

... the level of capex described by the objectives should only be enough for the relevant jurisdictional reliability standard, and any other statutory standards covered by the objectives to be met and not exceeded

The reliability of the Victorian electricity distribution networks are driven by the Service Target Performance Incentive Scheme rather than jurisdictional reliability standards. Victoria considers that service levels are an integral component of the economic regulatory regime – customers pay for a specific level of service. If the required level of service changes, then so too will the amount that customers pay.

The Essential Services Commission (ESC) amended the service incentive scheme that applied to the Victorian distribution NSPs (DNSPs) for the 2006-10 regulatory period, with the target effectively the performance in the previous year and the incentive rates based on the value of customer reliability. Under this scheme, the DNSPs had an incentive to deliver a level of service that is valued by customers. The level of service will vary over time as the cost of reliability improvements and the value of customer reliability vary.

The design of the AER's Service Target Performance Incentive Scheme is similar and achieves the same outcomes.

Under this approach, and together with Guaranteed Service Level payments for those receiving the worst level of service and reporting requirements, the jurisdictional reliability standards are superfluous. Victoria therefore does not have jurisdictional reliability standards.

The capex objectives can therefore not be stated by reference to jurisdictional reliability standards.

Capex incentives (and related issues)

Capex incentives

Question 8: What is the best option for dealing with the capex incentive issues identified in the paper?

The Victorian Government strongly supports the Commission's views that³:

... the price and service outcomes experienced by consumers are a function of three drivers:

- *the legal and regulatory framework;*
- *the application of that framework by the regulator; and*
- *the corporate governance of NSPs and gas service providers.*

Given the capex efficiency incentives implicit in the incentive-based regulatory framework, and the role of the corporate governance in ensuring these incentives are effective, the Victorian Government is not convinced that the inclusion of an additional capex incentive scheme within the legal and regulatory framework will necessarily benefit the long term interests of consumers.

The ESC previously had an efficiency carryover mechanism, which was similar to the AER's EBSS, that applied to capex. It was discontinued from 2006 for the following reasons⁴:

Reductions in capital expenditure below forecast can be the result of any, or a combination, of: efficiency gains, the deferral of capital expenditure projects between regulatory periods; changes in external expenditure drivers (for example, lower than anticipated peak demand); or overstatement of expenditure requirements when the 2001-05 forecasts were set.

In light of these various sources of spending below forecast, it is difficult to isolate whether or not the efficiency carryover mechanism has provided any greater efficiency incentive than that already provided within the five year regulatory review cycle.

...

However, where capital expenditure underspends arise from unsustainable rates of investment deferral (or inaccurate forecasts), customers are at risk of potentially funding efficiency carryover rewards on efficiencies that are not sustainable (or not genuine efficiencies). Where efficiencies are not sustainable (or have not occurred in the first place) customers will not benefit from lower prices arising from the sharing of efficiency benefits through the efficiency carryover mechanism and regulatory review. This differs from operating and maintenance expenditure where the incremental calculation of the efficiency carryover amounts and the clear translation of revealed costs into the next period forecasts

³ Australian Energy Market Commission, *Directions Paper; National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012; National Gas Amendment (Price and revenue Regulation of Gas Services) Rule 2012*, 2 March 2012, page 21

⁴ Essential Services Commission, *Electricity Distribution Price Review 2006-10; Final Decision Volume 1, Statement of Purpose and Reasons*, October 2005, pages 431-432

ensure that customers only reward sustained efficiencies and that customers share in efficiency benefits via lower prices.

Deferral of capital expenditure can be efficient, in which case customers benefit through a lower regulatory asset base which reduces the return required to be funded through prices over time. However, in contrast to operating expenditure, the benefits to customers are not as readily realisable. For example, where capital expenditure is included in the expenditure forecasts, but deferred to the next period, customers benefit through a reduced regulatory asset base but may pay for that benefit more than once where they also pay for a reward under the efficiency carryover.

Further, where expenditure is less likely to be recurrent as is the case with many types of capital expenditure, the relationship between revealed expenditure and future capital expenditure is more difficult to establish. Therefore the additional value that the efficiency carryover mechanism provides in estimating efficient future expenditures is less tangible. This reduces the benefit to customers from the application of the mechanism.

These concerns would need to be addressed if a capex EBSS were to be introduced.

The Commission has also raised the option of ex post reviews of the prudence and efficiency of capex. The Victorian Government is of the view that there is merit in further considering the use of ex post reviews.

The evidentiary burden that the regulator must satisfy before it could disallow investment should be high so as not to overly contribute to investment uncertainty. However the threat that the regulator could disallow investment will provide a greater incentive to ensure that investment is prudent and efficient.

The Economic Regulatory Authority (ERA) is required under the *Electricity Networks Access Code 2004* (Access Code) to undertake an ex post review of the prudence and efficiency of capex incurred by Western Australian NSPs. As part of the review of Western Power's access arrangement for the 2009/10 – 2011/12 period (the second access arrangement period), the ERA disallowed around \$260 million (in June 2009 dollars) of investment due to⁵:

- inefficiencies in cost estimation and overcharging by contractors
- deficiencies in demand forecast and analysis of options
- delayed or cancelled projects or amounts that should have been recovered from contributions.

Western Power made a number of changes to its corporate governance arrangements in response to the disallowance of the investment. In its proposed revisions to the access arrangement for the 2012/13 – 2016/17 period, Western Power indicated that⁶:

In response to the Authority's criticisms and the funding uncertainty, we sharpened our focus on initiatives to improve strategic, planning, delivery and compliance processes. This is part

⁵ Economic Regulatory Authority, *Final Decision on Proposed Revisions to the Access Arrangement for the South West Interconnected Network*, 4 December 2009, page 202

⁶ Western Power, *Access Arrangement Information for 1 July 2012 to 30 June 2017*, September 2011, page 62

of our objective to accelerate the transition of the organisation's culture from one that is highly technical and engineering-based to one that is commercially astute with more focus on efficiency and customer service.

We continue to implement governance improvements to be able to ensure and provide assurance that we make good commercial decisions and invest efficiently.

ERA's technical adviser considered that⁷:

.. the implementation of Western Power's governance processes during the second access arrangement period were generally good and that the management of capital expenditure had improved as a result.

In its Draft Decision on the access arrangement for the 2012/13 – 2016/17 period, the ERA has disallowed investment of \$21.2 million (in June 2012 dollars), a significant reduction on the amount disallowed during the previous period.

This example is not to suggest that the ex post review framework as provided for in the Access Code is appropriate for the NER. Rather, it is to illustrate that capex efficiency incentives are a function of corporate governance as well as the legal and regulatory framework, and that the threat of an ex post review can provide an incentive to improve corporate governance arrangements.

Actual or forecast depreciation

Question 9: How does using actual or forecast depreciation to determine the RAB affect a NSP's behaviour?

The Commission has provided a worked example of the impact on the NSPs of using actual or forecast depreciation when there is a capex overspend relative to forecast and a capex underspend relative to forecast. It concludes from this worked example that⁸:

Where forecast depreciation is used, the amount of depreciation coming off a NSPs RAB will be the same whether it overspends or underspends compared to its allowance (e.g. \$50 million in the above scenarios). This means that there is no additional incentive for an NSP to underspend or not overspend using forecast depreciation.

Under actual depreciation, a NSPs RAB is lower if it overspends compared to if forecast depreciation is used (RAB + 60 compared to RAB + 70 in the above scenarios), and higher if it underspends compared to if forecast depreciation is used (RAB + 40 compared to RAB + 30 in the above scenarios). This means that actual depreciation creates a greater incentive not to overspend and a greater incentive to underspend against the allowed expenditure.

⁷ Economic Regulatory Authority, *Draft Decision on Proposed Revisions to the Access Arrangement for the Western Power Network*, 29 March 2012, page 102

⁸ Australian Energy Market Commission, *Directions Paper; National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012; National Gas Amendment (Price and revenue Regulation of Gas Services) Rule 2012*, 2 March 2012, page 49

The Victorian Government agrees in principle with the worked example that has been provided. However, the Victorian Government is not convinced by this example that the actual depreciation regime protects the interests of consumers more than the forecast depreciation regime.

The Victorian DNSPs have historically underspent relative to forecast capex more frequently than they have overspent relative to forecast capex, as illustrated in the table below. The underspends have occurred within a regulatory framework in which forecast depreciation has been historically used. This would indicate that factors other than the form of depreciation have provided a strong capex efficiency incentive.

Year	CitiPower	Powercor	Jemena	United Energy	SP AusNet
1996-2000	+	+	+	-	-
2001	+	+	-	-	-
2002	-	-	-	-	-
2003	-	-	-	-	-
2004	-	-	-	-	+
2005	+	-	-	-	+
2006	-	+	-	-	-
2007	-	-	+	-	-
2008	-	-	+	-	+
2009	-	-	+	+	+

Sources: Australian Energy Regulator, *Victorian Electricity Distribution Businesses, Comparative Performance Report for Calendar Year 2009*, December 2010, Tables B.1 – B.6; Essential Services Commission, *Electricity Distribution Businesses, Comparative Performance Report 2006*, October 2007, Table B.1

Note: + overspend, - underspend

The prevalence of underspends rather than overspends indicates that the Victorian DNSPs would benefit (and Victorian electricity customers would pay more) from a higher RAB if actual depreciation were used.

The Victoria Government is concerned that any capital expenditure incentive benefits associated with applying actual depreciation are likely to be more than offset by the privately-owned Victorian businesses over-forecasting their capital expenditure requirements for the next regulatory control period and obtaining higher regulatory allowances (such as allowed costs of financing the higher forecast capex).

The AER is subject to significant information asymmetries in evaluating the NSPs' capex forecasts. The ESC commented on the information asymmetries in the 2006-10 electricity distribution price determination⁹:

The balance between overcompensating and undercompensating the distributors for their expenditure requirements is made more complex for the regulator given the information asymmetry that exists between the regulator and the distributors. Investment in the distribution network involves a large number of relatively small projects. This contrasts with investment in the transmission network which involves a small number of relatively large projects, which may more readily be assessed on a project-by-project basis.

⁹ Essential Services Commission, *Electricity Distribution Price Review 2006-10; Final Decision Volume 1, Statement of Purpose and Reasons*, October 2005, page 268

As demonstrated in this price review, when requested to provide supporting information, the distributors are able to produce a large amount of material to support individual projects. However, this material does not constitute a commitment to execute those projects nor an assessment of their capacity to execute them within the regulatory period. This requires that the distributors' proposals for future expenditure must be subject to careful scrutiny.

However, the Commission does not have the information necessary to develop the counterfactual at this project by project level.

The privately owned Victorian businesses have strong incentives to over-forecast capex to secure higher regulatory allowances. The higher the forecast capex, the higher the forecast depreciation and the return on assets. They then have an incentive to profit from this behavior by underspending – thus negating the impact of any capital expenditure efficiency incentives provided through the use of actual depreciation.

This is illustrated in the following extension to the Commission's worked example in which the actual expenditure is the same under the two scenarios but the forecast capex is higher under the actual depreciation scenario than under the regulatory depreciation scenario.

Regulatory depreciation scenario

Forecast capex = \$100m
Forecast depreciation = \$10m/year

Actual life = 10 years
Actual capex = \$100m
Actual depreciation = \$10m/year

Revenue in period from depreciation = $10 \times 5 = 50$
Closing RAB: $RAB + 100 - 10 = RAB + 90$

Actual depreciation scenario

Forecast capex = \$120m
Forecast depreciation = \$12m/year

Actual life = 10 years
Actual capex = \$100m
Actual depreciation = \$10m/year

Revenue in period from depreciation = $12 \times 5 = 60$
Revenue in period from return on assets higher than under regulatory depreciation scenario
Closing RAB: $RAB + 100 - 10 = RAB + 90$

Note:

- Scenarios assume expenditure occurs on the first day of the regulatory control period

In this example, the closing RAB at the end of the regulatory control period is the same under both scenarios, but the revenue earned by the NSP (or amount paid by customers) in the current regulatory control period is higher under the actual depreciation scenario than under the regulatory depreciation scenario.

Regulatory depreciation has a disincentive effect on over-forecasting capex. If capex is consistently over-forecast under a regulatory depreciation regime, the RAB will be written down more quickly than indicated by the physical assets. At its extreme, the RAB could be written down to a very low value which would decrease the business's building block revenue (the return on assets and

depreciation would be based on a smaller asset base) and could therefore have an impact on the business's cash flow position.

Actual depreciation does not have an equivalent disincentive effect on over forecasting.

The Commission's worked example illustrates that the RAB will be written down more quickly with regulatory depreciation than actual depreciation when there are underspends.

The Victorian Government strongly supports the use of forecast depreciation for the Victorian DNSPs to appropriately balance the capex efficiency incentives and the incentive to not over-forecast capex as part of the regulatory determination process. However, the Victorian Government recognizes that actual depreciation may be more appropriate with the circumstances that apply in other jurisdictions. The AER therefore requires the discretion to use either forecast depreciation or actual depreciation, depending on the circumstances.

Related party margins

Question 13: How, and to what extent, does the incentive for a NSP to overspend or underspend vary depending on whether it uses a related party or not having regard to the other incentives for efficient capex, including the scope for the AER to determine efficient capex at the regulatory determination?

As indicated in the Victorian Minister for Energy and Resources' submission to the Commission's Consultation Paper, Victoria is very concerned with the recent decision by the AER, which was upheld by the Australian Competition Tribunal, that allows the NSPs to roll margins on related party contracts into their RABs. As recognised by the AER¹⁰:

... there is a perverse incentive in the RAB roll forward which is not in the long term interests of consumers. This also arguably undermines the incentive-based regulatory regime in Chapter 6.

This issue was considered extensively as part of the ESC's 2006-10 electricity distribution price review.

The entry by distributors into outsourcing arrangements, particularly where these outsourcing arrangements have not or are not capable of being appropriately market-tested, and the regulatory treatment of such outsourcing arrangements, is an issue that has been the subject of much consideration by the Commission. In this, the Commission is not alone – regulators in other industries and jurisdictions face similar challenges. However, it is critical to the integrity of the regulatory framework that regulators are able to investigate these arrangements and ensure that their existence does not prejudice the delivery of the benefits to customers under the regulatory framework.¹¹

¹⁰ Australian Energy Regulator, *Victorian electricity distribution network service providers, Distribution determination 2011-2015: Final decision*, October 2005, page 457

¹¹ Essential Services Commission, *Electricity Distribution Price Review 2006-10; Final Decision Volume 1, Statement of Purpose and Reasons*, October 2005, page 13

The ESC identified that related party contracts¹²:

... have the potential to allow for a greater than intended portion of the benefits of any efficiency gains to be retained within the corporate group that includes the regulated business and the related service provider. If inflated charges paid to the related party are accepted as representing the costs of providing the services, not only are the efficiency gains made in the provision of services by the related service provider not returned to customers, but customers will actually pay more for the services than otherwise would be the case.

This issue was also recognised during the transition of the economic regulatory framework from the state-based to the national regime, including during the development of Chapter 6 of the NER. Enhanced information gathering powers were provided to the AER to ensure that it was better placed than the ESC to gather the information necessary to make adjustments for related party margins. As stated in the second reading speech for the National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Bill:

The Bill introduces substantial amendments to the Australian Energy Regulator's information gathering powers under the National Electricity Law, designed to address ongoing issues of information asymmetry between regulated businesses and the regulator recognised by the Expert Panel.

The amendments enable the Australian Energy Regulator to obtain adequate information from industry to set efficient prices for energy services without placing an unnecessarily heavy administrative burden on industry whilst supporting competition in the energy market place and protecting commercially sensitive information.

Information on costs incurred in supplying network services is a critical input into the regulatory process and is an essential starting point for determining regulated prices for services supplied in such a market.

...

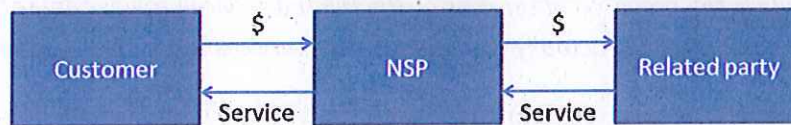
A key component of these reforms is to extend the Australian Energy Regulator's information gathering powers to parties related to the service provider. This mechanism is designed to ensure that the Australian Energy Regulator has sufficient information to perform its functions and to discourage service providers from using corporate structures to avoid disclosure of information to the regulator ...

Despite providing these enhanced information gathering powers, the AER has not been able to effectively utilise these powers to ensure that customers only pay for the costs associated with providing distribution services.

A stylistic example of the incentives on the NSPs as a result of the AER's decision to roll all related party margins into the RAB is illustrated below. For simplicity, the example considers capex in a single year and ignores the effect of depreciation.

¹² Essential Services Commission, *Electricity Distribution Price Review 2006-10; Final Decision Volume 1, Statement of Purpose and Reasons*, October 2005, page 169

	Forecast	Actual as incurred by NSP	Actual as incurred by related party
Opening asset base	2000	2000	2000
Capex	250	350	230
Closing asset base	2250	2350	2230



	NSP	Related party
Revenue	250	350
Cost	350	230
Profit	(100)	120

In this example, it is assumed that:

- the opening asset base is 2000 units and the forecast capex is 250 units
- as the NSP can roll in the actual value of a contract with a related party contract, it chooses to enter into a contract with the related party to undertake its works program for a value of 350 units, noting that the NSP has an incentive to increase the value of this contract more than used in this example
- the related party undertakes the work program more efficiently than originally forecast by the NSP, at a cost of 230 units.

Under this example:

- the customer will pay a return on and of an asset base with an opening value of 2,350 units in the next period
- the NSP will pay 100 units more than forecast for the works program to be undertaken by the related party
- the related party makes a profit of 120 units which offsets the additional cost incurred by the NSP.

If the works program had been undertaken by the NSP, or if the actual costs incurred by the related party were rolled into the RAB, then:

- the customer would pay a return on and of an asset base with an opening value of 2,230 units in the next period
- if the NSP is subject to some form of capex efficiency incentive scheme, it would expect to keep a proportion of the efficiency gain (20 units) for a period of time (generally 5 years). This is considerably less than retaining the efficiency gain (as well as the excess rent) for the life of the asset.

This example illustrates that the related party has a capex efficiency incentive to maximise profitability, however there is no means to pass through any efficiency gains to the customer, and the NSP has an incentive to enter into a contract for as high a value as it chooses.

A practical example of this type of practice was revealed as part of the 2006-10 electricity distribution price review. AGL indicated to the ESC that the arrangements between AGL and its related party at that time (Agility) were based on the forecast expenditure as provided in the previous price determination.¹³

This example demonstrates that allowing excess related party margins to be rolled into a NSP's RAB is thus not in the long term interests of customers and undermines the incentive-based economic regulatory regime.

Regulatory determination process

The Commission's Directions Paper states that¹⁴:

The Victorian DPI proposes amending the timeframe for the regulatory determination process to allow for the introduction of an AER issues paper early in the process which may reduce the volume of information from the NSPs.

The Commission has mischaracterised the submission made by the Victorian Minister for Energy and Resources. The inclusion of an issues paper in the regulatory determination process will not reduce the volume of information from the NSPs.

Rather, the objective of an issues paper is to summarise and synthesise the information provided in the NSPs' regulatory proposals and to identify the key issues that need to be considered during the regulatory determination process.

As a result, the volume of material that needs to be considered by stakeholders as part of the process is reduced. Assuming that the issues paper provides extensive referencing to the source material, stakeholders will be able to identify where further information on a particular issue is located and access the relevant portions of the voluminous material on an as required basis.

The Minister's submission indicated that the timeframe for the regulatory determination process may need to be amended to more effectively allow for the issues paper. However, a comparison of the dates for the key milestones under the ESC's 2006-10 electricity distribution determination and the AER's 2011-15 electricity distribution determination, which is summarised in the table below, indicates that if any extension to the timeframe is required, it will be short. The table demonstrates that:

¹³ Essential Services Commission, *Electricity Distribution Price Review 2006-10; Final Decision Volume 1, Statement of Purpose and Reasons*, October 2005, page 178

¹⁴ Australian Energy Market Commission, *Directions Paper; National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012; National Gas Amendment (Price and revenue Regulation of Gas Services) Rule 2012*, 2 March 2012, page 128

- the ESC's process commenced later than the AER's process with the release of the consultation paper on the framework and approach by the ESC in March 2004 as compared to the AER in December 2008
- the time between the receipt of the regulatory proposals and the final determination was 12 months for the ESC and 11 months for the AER, with the ESC releasing an Issues Paper during this period (as well as a Summary Paper and Position Paper) while the AER did not.

It should be noted that the target date for the release of the ESC's final determination was originally September 2005, that is, 11 months after receipt of the regulatory proposals, consistent with the AER's process. However the final determination was delayed as a result of an appeal that was lodged prior to the Final Determination.

Key milestone	ESC's process	AER's process
Framework and Approach – Consultation paper	March 2004	December 2008
Final Framework and Approach	June 2004	May 2009
Regulatory Proposals	October 2004	November 2009
Summary Paper	November 2004	
Issues Paper	December 2004	
Position Paper	March 2005	
Draft Decision	June 2005	June 2010
Final Determination	October 2005	October 2010

Note: ESC's Final Determination delayed due to an appeal lodged by United Energy following the release of the Draft Decision

Other issues

Customer involvement

In November 2005, the Ministerial Council on Energy agreed to strengthen the arrangements for consumer advocacy in the energy sector with a particular focus on small to medium end users.¹⁵

The Consumer Advocacy Panel was subsequently established.

A review of the Consumer Advocacy Panel's 2010/11 Annual Report indicates that a relatively small proportion of the \$2.2 million funding for 2010/11 was directed towards NSPs' revenue determinations:

- Street Lighting Group – appeal of the Victorian distribution determination and a report on lessons learned (\$49k)
- Major Energy Users Group – Victorian distribution price review, rule change on network investment, AEMC review of value of customer reliability, generator market power AEMC rule change, SA gas distribution price review, AEMC electricity transmission frameworks review, AER review of Darwin Amadeus gas pipeline access arrangement, Reliability Panel review of Reliability and Emergency Reserve Trader, AEMC review on scale efficient network extensions, strategic directions and inter-regional transmission charging (\$206k)

¹⁵ MCE Communique, 4 November 2005

If consumers are to engage more in the regulatory determination process, either a larger share of the Consumer Advocacy Panel's funding needs to be directed towards regulatory determinations or additional funding needs to be provided to the Consumer Advocacy Panel.

AER resources

A number of submissions to the Commission's Consultation Paper raised concerns in relation to the capacity and capability of the AER's resources. The Commission has not evaluated these comments as it is of the view that the AER resourcing is a matter for the AER Board and the Commonwealth Treasury.

The Victorian Government is concerned about the lack of transparency on the resourcing of the AER.

Section 44AAJ of the *Competition and Consumer Act 2010* states that:

- (1) The AER must, within 60 days after the end of each year ending on 30 June, give the Minister a report on its operations during that year, for presentation to the Parliament.
- (2) The Minister must give a copy of the report to the relevant Minister of each of the States, the Australian Capital Territory and the Northern Territory.

There is no separate report on AER's operations – it is incorporated in the ACCC's Annual Report. As such, there is no transparency as to the resourcing of the AER.

