AUSTRALIAN ENERGY REGULATOR

GPO Box 520
Melbourne Vic 3001

Telephone: 03 9290 1444
Facsimile: 03 9290 1457

www.aer.gov.au

Contact Officer: Moston Neck
Contact Phone: (07) 3212 6001

12 February 2010

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear John

I refer to the Commission's consultation paper regarding the proposed amendment to the National Electricity Rules (NER) by ETSA Utilities to accommodate payments under feed-in schemes and climate change funds.

ETSA Utilities' proposal offers an opportunity to consider, in the broader context, any government initiative that imposes on regulated business an obligation to provide a service that is not directly related to the provision of distribution services. From the AER's perspective, it is important that there is a satisfactory regulatory mechanism for the treatment of these initiatives under the NER.

ETSA Utilities' proposal has the benefit of more transparently delineating costs associated with the provision of distributions services from the costs of certain types of regulatory obligations, like feed-in tariffs. In doing so, such regulatory obligations would be removed from the AER's assessment of efficient network operating and capital allowances under chapter 6 of the NER and would instead be incorporated in the annual pricing approvals process. Under such an arrangement, the AER would have more of an audit function than that of determining the efficiency of program delivery.

I note that ETSA Utilities considers any assessment of efficiency in regard to feed-in tariff schemes as being needless. While this may be true in regard to the tariff payment, the administrative costs of such a scheme would be controllable by a regulated business and would give rise to efficiency considerations. It would not be possible for the AER to make a proper assessment of the efficiency of these types of costs in the annual pricing approval process. If these types of costs are to be assessed in accordance with efficiency criteria, they need to be considered as part of the building block assessment under chapter 6 of the NER.

In regard to the climate change fund, in the absence of more detail about the program it is unclear whether the approach proposed by ETSA Utilities is appropriate or not. The initiative may not be as simple as the straightforward pass through of a cost over which a DNSP as no control.

Distribution businesses recovering the costs of these types of initiatives through their chapter 6 determination is currently problematic. It is uncertain whether a number of these initiatives would fit within the definition of a distribution service for the purposes of chapter 6 of the NER. If the costs (or some of the costs) of these initiatives are to be recovered through the chapter 6 building block determination process, it is vital that the National Electricity Law and the NER clearly allow for this and the limitations in the current regime be addressed.

I note that ETSA Utilities considers the proposed amendment to be non-controversial and is seeking to expedite the rule change. The AER considers this should not be considered as a non-controversial rule change. As outlined above, the rule change proposal gives rise to broader issues with the regime that need to be resolved. The proposed rule change could form the basis on which current and future schemes, like the feed-in tariff scheme, would be funded by policy makers. Given, there are some significant issues to be resolved in how these schemes should operate and their relationship with the NER, I do not consider the rule change should be expedited as non-controversial.

Attached are number of more detailed comments on the proposed rule change. If you have any questions in relation to this matter please contact Moston Neck on (07) 3212 6001.

Yours sincerely

Steve Edwell
Chairman

Comments on AEMC Consultation paper: National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule 2010

AER approach to feed-in tariff schemes

At present, the AER approach to feed-in tariff schemes is to treat these costs as opex costs to be forecast by a DNSP. However, in consideration of the variability of these costs, the AER has permitted an annual adjustment to account for any differences between forecast and actual costs by way of a cost pass through. The cost pass through adjustment is likely to be a temporary mechanism while the costs of the schemes are highly uncertain due to take up rates and energy produced growing rapidly from a very low base.

The current approach of the AER has two main disadvantages. First, the approach tends to hide rather than promote transparency of the cost of the schemes. The AER would support, in principle, a rule change that made clear to customers the costs of regulatory obligations, such as feed-in tariff schemes, particularly where the services are not associated with the provision of distribution services.

Second, the approach embodies in the DUOS tariffs the costs of a scheme that is not a standard control service. The operating expenditure objectives referred to in chapter 6 of the NER refer to standard control services. ETSA Utilities proposed approach, could remove (potentially) the need for an assessment of the efficiency of these schemes under the chapter 6 provisions of the NER.

Is an efficiency assessment required?

In its proposal to the AEMC, ETSA Utilities indicated that an opex assessment of a feed-in tariff is needless. This is true to an extent. The actual amount of the tariff to be collected through DUOS tariffs and passed onto customers via a retailer is an uncontrollable cost to the DNSP. However, costs associated with the administration of the scheme are controllable and should presumably be subject to a consideration of efficiency.

Notably, in its revised regulatory proposal to the AER in January this year, Energex has proposed that the administrative costs of managing feed-in tariff payments to retailers be considered as part of the total cost of the scheme, not just the tariff payment. Energex estimated that eight staff (full time equivalent) will be required each year of the next regulatory control period to administer this scheme.

The AER is at present assessing the efficiency of these administrative costs against the operating expenditure objectives of the NER. In the context of any rule change, a solution would need to address the uncontrollable and controllable cost elements of feed-in tariffs and any associated administration. This issue is not raised by ETSA Utilities in its proposal.

Cost allocation

The feed-in tariff schemes to date have not indicated how the costs of the scheme should be recovered from customers. The pricing principles and the regulatory obligations on the DNSPs to do not state which tariff classes should be targeted for the allocation of cost. While it is possible to make certain assumptions, it would be preferable if there was an explicit statement made in either the NER or in the regulatory obligations imposed on the DNSPs as to how the costs should be recovered.

Potential for administrative savings

ETSA Utilities suggests on page seven of its proposal the current approach to the recovery of feed-in tariffs costs would involve a number of tasks, including the need to forecast expected feed-in tariff costs and assess the efficiency of these costs. As a result, according to ETSA Utilities, DNPS would have to carry the risk of forecast errors and be subject to a process for the assessment of any cost pass through amounts. ETSA Utilities considers its proposal obviates the need for these tasks to be undertaken.

However, it is unclear to the AER whether any of these tasks would be avoided under the proposed rule change. Forecasts would still be required for the year ahead, as noted on page eight of ETSA Utilities' proposal. An efficiency assessment would (presumably) still be needed in terms of any controllable costs. In addition, forecast errors would still occur and an adjustment would still be required.