

19 August 2005



Ms Anna Brakey
Director
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Email: submissions@aemc.gov.au

Dear Ms Brakey

Review of the Electricity Transmission Revenue and Pricing Rules

Ergon Energy Pty Ltd (Ergon Energy) appreciates the opportunity to provide comment to the Australian Energy Market Commission (AEMC) on the “*Review of the Electricity Transmission Revenue and Pricing Rules*” (Scoping Paper). Ergon Energy is an electricity retailer and active participant across the National Electricity Market (NEM).

Ergon Energy supports the development of a framework for the regulation of transmission revenue and pricing that ensures the reliable and secure delivery of lower-cost energy to end-users. Timely and efficient investment in transmission is an issue of particular importance to Ergon Energy given the dispersed nature of our franchise customer base and the unique geographic characteristics of the Queensland network.

1. Process and Approach

Ergon Energy appreciates the opportunity provided by the AEMC for industry and interested parties to provide input into the development of the scope of the transmission review. However, we are concerned to ensure that:

- all transmission reform issues emanating from the Ministerial Council on Energy’s (MCE) December 2003 “*Report to the Council of Australian Governments on the Reform of Energy Markets*”, are resolved as a priority - the NEM has experienced a period of protracted reform and the range of issues raised in the Scoping Paper for possible consideration have the potential to create significant ongoing uncertainty and risk; and
- the options presented and recommendations made in the course of the review are underpinned by a detailed consideration of their impact – this analysis should include the ability to deliver required investment, as well as the mechanisms available to the market to reduce risk, manage price shocks and mitigate adverse competition outcomes and dispatch consequences. Again, if the review is cast too widely, it will be impossible for the AEMC to undertake the necessary level of analysis and consultation in the timeframes available.

Ergon Energy would encourage the AEMC to clarify the precise scope of the review early in the review process – prior to release of the Issues Papers. This would reduce the level of uncertainty regarding the forward reform agenda and allow industry and interested parties to commence consideration of the issues and the resources required to respond.

We also believe that detailed clarification is required by the AEMC on the interaction of the review with the remaining transmission items identified in the MCE's May 2005 "*Statement on NEM Electricity Transmission*" and how the AEMC sees these concurrent reforms resulting in a robust transmission framework for the NEM.

2. Economic Regulation of Electricity Transmission Revenue

Ergon Energy considers that markets exhibiting natural monopoly characteristics are most appropriately managed within a regulated framework that acknowledges the monopolistic aspects of the market and seeks to overcome these through the development of appropriate guidelines and regulatory discretions. To this end, we support the AEMC's guiding presumption in conducting the Review as to the ongoing regulation of electricity transmission revenues.

The major transmission revenue issues from Ergon Energy's perspective as a retailer are:

- **Form of Regulation** – The ability of the 'form of regulation' to deliver the NEM's transmission requirements is critical for market confidence and credibility. We believe that care should be exercised by the AEMC in any examination of alternate methodologies or mechanisms for the derivation of maximum allowable revenues.
- **Mechanisms for Establishing the Revenue Requirement** - Significant debate has occurred historically regarding the scope and content of the Statement of Regulatory Principles (SRP). For this reason, Ergon Energy is supportive of a process that involves the evolution of the current SRP in satisfaction of Schedule 1 to the National Electricity Law, rather than a broad re-opening of the SRP.
- **Incentive Mechanisms** - Ergon Energy is supportive of the development of commercial incentives for TNSPs that facilitate efficient and effective energy market competition through the free flow of electricity within and between States. These incentives need to be directed at market outcomes that benefit electricity-users and should explicitly recognise:
 - the economic cost of transmission performance borne by network users and market participants as a result of network constraints and outages;
 - that both the timing of a transmission failure and the relative importance of the particular transmission asset to the effective operation of the wider market are of critical importance;
 - the requirement for access to information and data to support both the setting and the monitoring of performance standards. On this issue, while we agree with the AEMC that an incentive regime "...can be a cost-effective alternative to more information intensive approaches to regulation", the development of an effective incentive mechanism will necessitate a significant body of work to establish a common set of data against which the TNSP's performance can be measured and periodically reported; and

- the need for symmetry in the incentive mechanism developed, such that the TNSP is exposed to financial consequences for non-performance, not just rewarded for meeting or exceeding the performance target.

Clarity should also be provided as to the level of discretion that will be afforded to the Australian Energy Regulator (AER) under the service incentive framework in carrying out its role as economic regulator and 'enforcer' of the Rules.

3. Economic Regulation of Electricity Transmission Prices

As a general comment, Ergon Energy acknowledges the complexity of the task faced by the AEMC in its examination of transmission pricing and supports the proposed release to the market of both an Issues Paper and Options Paper on this issue.

The major transmission pricing issues from Ergon Energy's perspective as a retailer are:

- **Consistency in Cost Recovery** - the principles applied in the pricing of network services by network service providers within the NEM lack consistency and stability. Whilst it is important to be mindful of the inherent business characteristics which differ between the network services businesses, a level of consistency should be sought to strengthen the pricing signal and promote more economically efficient network service expansion.
- **Price Shocks on End-users** - while increases in the revenue requirements of network service providers are expected so as to ensure the appropriate levels of transmission investment, the impact of these increases on customers should be mitigated through appropriate glide-paths. For customers in competitive markets, these price shocks can significantly diminish the gains of contestability or can incorrectly be associated with the introduction of competition, damaging its public perception.
- **Causer Pays** – an examination is required of the principles underpinning the allocation of transmission use of system charges across the NEM, to ensure they promote competitive neutrality, efficient network usage and stimulate dynamically efficient investment.

4. Conclusion

Ergon Energy would welcome the opportunity to discuss this submission with the AEMC in greater detail.

If you have any queries, please feel free to contact me on (07) 3228 8116 or alternatively, Angela Moody on (07) 3228 7536.

Yours sincerely

Darren Barlow
General Manager – Strategic Relations
Ergon Energy Pty Ltd

Telephone: 07 3228 8116
Email: darren.barlow@ergon.com.au