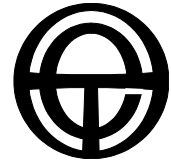


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27 February 2009

John Tamblyn
Australian Energy Market Commission
submissions@aemc.gov.au

Dear Mr Tamblyn,

Re: Total Factor Productivity Review – Issues paper

Total Environment Centre (TEC) became interested in the effects on demand management (DM) of various features of economic regulation of the National Electricity Market (NEM). We undertook a research project to investigate some of these, including total factor productivity (TFP). As part of the project, Bob Lim and Headberry Partners produced a report titled, *Does current electricity network regulation actively minimise demand side responsiveness in the NEM?* We have sent the report through to the AEMC previously, but I have attached it here as it raises matters that are relevant to this AEMC review.

Headberry and Lim reviewed the building block, revenue cap, price cap and TFP approaches against the goal of optimising DM within the NEM. They also looked at a selection of overseas DM programs, with particular regard to the Californian example.

Their main findings regarding the TFP were, in summary (p 3):

A total factor productivity (TFP) approach has the potential to be neutral in relation to DM, but as it requires the use of a price cap approach (which incentivises greater demand and consumption) it also encourages consumption and demand. A TFP program also has a number of other disadvantages that need to be assessed in light of the overall goals of encouraging DM. In particular, it is not a tool which provides transparency and therefore might not provide the necessary transparency required to encourage DM options (and energy efficiency).

They noted that essential features for a TFP approach to be successful include (p 50):

- Accurate and detailed data over a reasonable length of time to provide confidence in the data set.
- Certainty that the starting point tariffs are correct, both from a fundamental value basis and that they are cost reflective.
- Sufficient numbers of participants to ensure that collusion (passive and active) is not possible.
- Similarity between the NSPs being regulated to ensure that no one NSP might be treated inappropriately.

Appendix 4 of the report provides a discussion of the TFP approach; and Appendix 5 also raises matters relevant in this Review.

We hope that the report will provide useful information and assist towards proper consideration of solutions for optimising DM within the TFP review.

Yours faithfully,

Glyn Mather
NEM Advocate
Total Environment Centre