



Level 9, 299 Elizabeth Street
Sydney NSW 2000
Australia
DX 643 Sydney
Tel: +61 2 8898 6500
Fax: +61 2 8898 6555
E-mail: piac@piac.asn.au
ABN 77 002 773 524

Our Ref:

Dr John Tamblyn
Chair
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

By email: submissions@aemc.gov.au

26 September, 2006

Dear Dr Tamblyn

Transmission Pricing Rule Proposal

The Public Interest Advocacy Centre (PIAC) thanks the Commission for the opportunity to comment on the Rule Proposal around pricing for prescribed transmission services. We also acknowledge the care taken by the Commission and its staff in considering the views of stakeholders such as ourselves as expressed in previous submissions.

However, in making a response to the Rule Proposal we believe it is useful for us to build on comments made in earlier submissions to the Commission. In particular, PIAC has argued that it is important that proponents of changes to the regulatory arrangements for energy networks demonstrate how such changes will lead to benefits for end-users. That is, we believe the test of meeting the *long-term interests of consumers* requires more than simple assertions about gains in efficiency or changes in the investment environment.

The Commission has made the point that there is no need for substantive change to the way in which prices are set for transmission network services. Yet, in our view the proposed change to the method for setting network prices is, at least, a significant change. The costs of network services overall can contribute around 50% of final bills for residential consumers of electricity. We understand that changes being proposed for regulation of transmission services can be expected to be reflected subsequently in the regulation of distribution networks.

The proposed move to the pricing of network services being undertaken according to guidelines set by the regulator should be supported by a detailed argument to show how it is that consumers will be better off as a result. The absence of such a case leads to the concern that the Rule Proposal will result in a weakening of regulatory protections for end-users.

The Commission has suggested that the existing provisions of the *National Electricity Rules* contain excessively detailed requirements around the implementation of pricing methodologies. It is implied that this level of detail is, of itself, evidence of the need for reform. However, as we understand it, the proposed change to the Rules will not, in fact, reduce the complexity of the pricing methodology as it is undertaken by the TNSPs. At the very least the monopoly network businesses would continue to rely on this complicated cost allocation methodology if only for the purposes of internal decision making around customer prices.

Furthermore, the Australian Energy Regulator (AER) will continue to have an obligation to satisfy itself that the pricing practices of the TNSPs are undertaken in a manner that complies with its pricing guidelines. So the regulator, too, will continue to apply the existing complex and detailed criteria in assessing the prices set by the network businesses.

It seems to PIAC, then, that the major consequence of the proposed change to pricing methodology will be to make it easier for the TNSPs to justify those decisions to the regulator. It is far from clear how consumers will benefit from this change.

The Commission has suggested that the change it proposes will lead to more ‘innovative’ pricing on the part of the networks. Unfortunately, at this stage PIAC can only guess at the nature and benefit of such innovation in relation to prices charged by monopoly network businesses. However, this assertion appears to ignore the reality that the current CRNP and modified CRNP models for setting prices provide considerable room for the TNSPs to make decisions which are subjective or tailored to the needs of different groups of customers.

PIAC understands the value to regulators of incorporating Baumol-Willig conditions into pricing methodologies. To a large extent this reflects the difficulty in making definitive cost allocation decisions – a difficulty confronted almost to the same extent by the regulated businesses. On the other hand, it should be recognised that the ‘subsidy free’ zone bounded by the limits of the Baumol-Willig conditions is a very wide area, indeed, for the exercise of discretion in cost allocation and price setting.

We believe this exercise of discretion can be illustrated readily by observation of the operation of any of the cost allocation models currently used by regulated energy network businesses in Australia. It is important that the Commission take account of the degree of discretion inherent in the cost allocation models and the sensitivity of customer prices to individual decisions made within them.

For end-users, the central problem stemming from reliance on Baumol-Willig principles is that prices for these monopoly services tend to lack transparency and certainty. Many consumers, particularly household users, do not understand the size or the design of the prices they face for electricity network services. The more important point, however, is that even the most price conscious and active consumers may find that the assumptions lying behind those prices and the subjective decisions about how to allocate costs between end-user groups are not always readily understood.

The principles embedded in the existing CRNP model, and proposed to be retained in the new pricing guidelines, include that consumers should be treated with equity – that prices should reflect no more or less than the totality of costs incurred on behalf of consumers (the ‘causer

pays' principle). Yet, as noted above, the Baumol-Willig subsidy-free zone is a broad one. PIAC believes it is so wide as to carry an inherent challenge to the 'causer pays' principle. This follows because not all end-users have the same motivation or opportunity to understand or challenge the pricing decision made by the TNSPs (or, for that matter the distribution entities).

It is important to see the current CRNP and modified CRNP models as embodying a regulatory compromise. On the one hand, this approach obviates the need for regulators to replicate the expertise of electricity network operators in matching costs to appropriate prices. On the other hand, it recognises, as the Commission has explained, the necessity of some controls over those pricing decisions.

Moving the content of the CRNP models to incorporation in new regulatory guidelines would result in a significant change in the nature of this compromise. The weaker oversight implied by the use of guidelines does not appear to be matched by any gain in consumer benefit.

PIAC has sought to focus on the long-term interests of consumers because we believe there is a need for the regulatory arrangements to balance properly the interests of network businesses and those of various categories of end-users. We remain to be convinced that a move to a weaker form of oversight of price setting by the TNSPs can preserve this balance.

Yours sincerely
Public Interest Advocacy Centre Ltd

A handwritten signature in black ink, appearing to be 'JW', with a long horizontal flourish extending to the right.

Jim Wellsmore
Senior Policy Officer

e-mail: jwellsmore@piac.asn.au