



Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

19 August 2005

Dear Sir

**The Australian Energy Market Commission Review of the Electricity
Transmission Revenue and Pricing Rules – Scoping paper July 2005**

Please find attached the national generators Forum (NGF) response to the above consultation.

The NGF supports the general thrust of the review and agrees that the electricity transmission network is fundamental to the efficient, reliable and safe operation of the NEM.

From a generator perspective the transmission network is crucial for us to be able to deliver energy to our customers. Therefore generators are seeking a transmission network that:

- Provides a high level of confidence that generators will be able to access their regional reference node and deliver their product to market.
- Does not distort the effective operation of the energy and ancillary services markets.
- Responds with appropriate investment to ensure that this level of access is maintained.

Therefore it is important that the regulatory environment for Transmission Network Service Providers (TNSPs) be clear, transparent and predictable to ensure that they and other market participants can predict regulatory outcomes with some confidence. This will create the necessary level of regulatory certainty to ensure that market participants can predict the expected investment behaviour of TNSPs.

Unfortunately to date the regulatory environment for TNSPs has not provided this certainty. This is as a consequence of:

- The failure of Chapter 6 of the National Electricity Code to provide sufficient clarity for both TNSPs and the regulator in undertaking revenue determinations.

- The ACCC has been both rule maker and rule applier for TNSP revenue regulation both in relation to the ACCC Statement of Regulatory Principles (SRP) which has been subject to change entirely at the discretion of the ACCC and its role in authorising changes to the Code and in then seeking to apply the Code.

The MCE has recognised that this is an unsatisfactory regulatory design model and this has put in place the current regulatory arrangements where the rule-making role of the AEMC has been clearly separated from the enforcement and rule application role of the AER.

The NGF supports this arrangement and the need to clarify the revenue regulation environment for TNSPs given the important role played by transmission in the market.

However, at a time when there is a focus on whether the current market will deliver sufficient generation investment, the AEMC should be very cognisant of the increased regulatory risk and consequent deterioration in investment climate that comes from a wide-ranging review.

The NGF considers that the two most important considerations for the AEMC undertaking this review are:

- Maximising regulatory certainty both for TNSPs and the market as a whole.
- Limiting the scope of the review to only dealing with issues where there is a clearly identified problem and a real prospect of making improvements.

The NGF is pleased to be able to contribute to the process at this stage and would like to make an active and ongoing contribution to the review.

The NGF thanks you for the opportunity to provide input into the scope of the review and attached to this letter is a document containing responses to each of the issues raised by the AEMC in the Scoping Paper.

Please contact the undersigned if you have any questions in relation to the contents of this response.

Yours faithfully

John Boshier

Executive Director

The Australian Energy Market Commission Review of the Electricity Transmission Revenue and Pricing Rules

NGF Response to Scoping Paper July 2005

The NGF considers that this review should be limited to those areas where there are demonstrated problems and a real prospect of making improvements and provides the following comments to assist in determining the important issues.

The NEL requirements

Transitional arrangements

The NGF is not aware of any issues that may need to be dealt with under the savings and transitional arrangements

Issues relevant to the development of the electricity transmission revenue and pricing Rules

Chapter 5 Issues

The NEL requires the Rules to provide a reasonable opportunity for a TNSP to recover the efficient cost of complying with a regulatory obligation. A “*regulatory obligation*” has a range of specific definitions in the NEL but also includes “*legislation ...that materially affects the provision, by a regulated transmission system operator, of services that are the subject of a transmission determination*”

Clearly the NEL will require the AEMC to ensure that both specific “*regulatory obligations*”, such as those identified in Chapter 5 of the Rules and any future “*regulatory obligations*” that may emerge are considered in developing the new Rules.

It would be a mistake to focus only on the current specific “*regulatory obligations*” that are currently specified in the Rules and in other legislation. If the transmission revenue regulation Rules are only based on the currently known “*regulatory obligations*” this will create the requirement for any new “*regulatory obligations*” that may emerge to be dealt with by further Rule changes.

A much preferred approach would be to draft the new Rules in such a way that all current and potential future “*regulatory obligations*” will appropriately taken into account in determining a TNSP’s allowable revenue.

This will improve regulatory certainty for both TNPSs and the market as intended by the review of transmission revenue Rules. Without this certainty TNPSs may constrain their future investments to the detriment of the market.

Market Network Service Providers

Given the intention of the owners of the current MNSP owners to convert their assets to regulated assets, and the removal by the MCE of the bias in favour of MNSPs it is unlikely that any MNSPs will emerge in the foreseeable future.

Therefore the Rules related to MNSPs are not a relevant issue for consideration by the AEMC with regard to this review.

Economic regulation of electricity transmission revenue

Form of regulation

It is important that the form of TNSP revenue regulation be as effective as possible and takes into account developments in the application of regulation to this sometimes difficult area. The debate that occurs and proposals for alternative approaches are noted.

However the most important objective is a stable, clear and predictable form of regulation and it may be much better to deal with the inadequacies of a well proven form that is currently in use than use this review as an opportunity to experiment with a new and untried form of regulation.

Only if there is compelling evidence that a change in the form of regulation is required and that the proposed new form would clearly provide a much more effective regime should this be considered. The NGF would be surprised if the evidence existed to support a move away from the building block approach at this stage.

Mechanism for establishing the revenue requirement

In addition to responding to the requirements for this review as specified in the NEL the AEMC has raised some other potential issues for consideration including:

- Relative merits of ex ante and ex post approaches to revenue determination
- A wider debate regarding the role of transmission that may lead to the requirement for TNSPs to provide some form of firm access
- Role of the Regulatory Test
- Valuation of assets

The AEMC has also sought comments on any other issues that may need to be taken into consideration.

From a generator perspective there are two issues that are important for consideration are:

- The changes to the processes for adjusting regional boundaries being proposed by the MCE should be considered as part of this review. The use of economic criteria for adjustments to regional boundaries imply that the economic benefits of transmission investment to remove network congestion should be considered on the same basis as an alternative to a potential regional boundary adjustment. This makes it important that the Rules for transmission revenue determination and the Rules for regional boundary adjustment are developed in a consistent manner.
- The need to ensure that the regulatory test in a form similar to that being used currently continues to be applied to investments that are being justified on a market benefits basis. This particularly applies to interconnection upgrades and development.

Given the urgency of the review it may be prudent for the AEMC to focus on the known issues and important issues rather than seeking to expand the number of issues being considered.

Depreciation, return on investment and operating expenditure

The AEMC has sought comment of whether there are costs additional to those identified in the scoping paper.

The NGF is unaware of any omissions but again this is an issue for the TNSPs.

Incentive mechanisms

The NGF supports the need for an appropriate incentive regime to ensure that TNSPs make efficient operating decisions. The incentive regime should be targeted at ensuring that the TNSP is incentivised to maximise the transfer capacity of the transmission network, particularly at times of high market need. It is not clear how an incentive regime would assist with long-term investment decisions.

In developing an incentive regime for TNSPs it is important that the regime should create incentives for them to align the performance of their networks to market requirements. However it is also important that this regime does not create an incentive for the TNSPs to intervene in the market, in order to protect their commercial position, using their monopoly position with potentially counter-productive outcomes.

Non-transmission alternatives

The NGF considers that non-transmission alternatives to network investment should always be considered as part of the TNSP's investment decision-making process.

Economic regulation of electricity transmission prices

The NGF accepts that there is a need to review the economic regulation of electricity transmission revenue. However it is not at all clear as to whether any substantial changes are required to the rules on transmission pricing.

Transmission revenue regulation focuses on regulating the costs of a TNSP whereas the pricing rules determine how these costs are allocated amongst market participants.

There are clearly significant economic efficiency issues associated with transmission revenue regulation but the only economic efficiency issue associated with pricing rules is to ensure that the pricing rules do not create distortionary incentives for market participants. It is not apparent that these distortions are occurring, therefore the primary effect of any pricing rule changes is likely to be, potentially, quite large wealth transfers.

Therefore the AEMC should be cautious before proposing any rule changes in this area.

Transmission pricing rule changes should only be proposed if:

1. There is a clear demonstration based on empirical analysis that there is an economic efficiency problem associated with the current pricing rules.
2. That this problem is of a magnitude significant enough to warrant the substantial disruption to the market that any change will create.

3. There is clear empirical evidence that demonstrates that a change to the pricing rules will be net beneficial.

Therefore the NGF would propose that before considering any other issues that the AEMC undertake a thorough review of the operation of the current pricing rules to identify if there is an economic efficiency problem of any significant magnitude.

Regulatory discretion and procedural requirements

Guiding discretion – economic regulation of electricity transmission

Clearly the AEMC should consider the balance between discretion and prescription in the role of the AER in undertaking a transmission revenue determination.

Some level of discretion for the AER is clearly required, however the greater this is the less regulatory certainty will exist for the TNSPs and for the market as a whole. In determining this level of discretion it may be useful to start with the proposition that the process be highly prescribed, for example the determination of a TNSP's WACC being defined as a formula in the Rules, and that the AER has to demonstrate the clear benefits that would be derived from increasing their level of discretion.

The appropriate balance is likely to be best determined by the AEMC considering carefully the views of both the AER and the TNSPs.

Guiding discretion – electricity transmission pricing

As the NGF is of the view that a major review of transmission pricing is not necessary we do not consider that the Review should consider the methodologies for determining shared network usage charges.

It is acknowledged that there are some areas of ambiguity in the pricing Rules, but in our view, rather than a full review of the pricing Rules the best approach would be to address each of these ambiguities in turn.

Procedural requirements for AER decision making

The NGF is of the view that the NEL provides adequate guidance on the procedural requirements and the details of how these should be implemented are largely a matter for the AER and TNSPs with appropriate guidance from the AEMC.

Timetable for consultation on making electricity transmission revenue and pricing Rules

The NGF strongly supports the proposed two stage process.

The AEMC will clearly have limited resources and therefore should focus its efforts in the area where the need is most pressing.

It is clear the most important issue to be resolved is the Rules associated with transmission revenue determinations, as there is clearly a problem that needs resolution and the NEL provides a significant amount of guidance of what is required.

It is not at all clear that there is a major problem at all with the transmission pricing Rules and so it is appropriate for this to be dealt with at a later stage. Given the lack of guidance in the NEL of this issue the NGF is of the view that the initial task in this area should be establishing the magnitude of any problem with regard to transmission pricing Rules.

