

26 February 2009

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

Email: submissions@aemc.gov.au

Dear Dr Tamblyn

Review into the Use of Total Factor Productivity for the determination of prices and revenues

The Energy Networks Association (ENA) welcomes the opportunity to provide these comments on the introduction of an alternative form of regulation to determine the prices and revenues for the energy networks sector.

ENA represents energy network businesses which deliver electricity and gas to over 13 million customer connections across Australia through approximately 800,000 kilometres of electricity distribution lines. There are also 76,000 kilometres of gas distribution pipelines. These distribution networks are valued at more than \$40 billion and each year network businesses undertake investment of more than \$5 billion in distribution network operation, reinforcement, expansions and Greenfield extensions.

Past energy sector reforms have led to the development of a world leading wholesale electricity market, with highly efficient generation, network and retailing segments and ENA believes that if Australia is to continue to have a highly efficient sector then it is appropriate to examine the suitability of the regulatory structure from time to time. This has become even more important considering the significant challenges currently facing the industry. However, any changes to the regulation of the sector must be considered carefully and above all not act to undermine the *regulatory certainty* that is essential if adequate investment is to be attracted to the industry.

Because of the fundamental and potentially far reaching impacts on the longer term capacity of network businesses to deliver critical infrastructure, changes to the regulation of revenue and price determinations is an extremely important issue for the industry and consumers. In this context, ENA fully appreciates the extensive effort by the AEMC in drawing together this framework and issues paper.

In its response to the Rule change proposed by the Victorian Minister for Energy and Resources, ENA called for a full review before the proposed TFP rule change or a TFP approach was adopted. ENA is still of that view but has concerns that the process, now being undertaken, has not provided enough details of the proposed model and the methodology driving that model to allow members to comment on its appropriateness.

One of the issues that ENA members are concerned about is that the data that is currently available for input into a TFP model is not robust and therefore inhibits accurate analysis. An additional

concern is the need to define an industry benchmark from comparator firms. Finding comparator firms is difficult for a number of reasons including geographical conditions, customer bases, operating conditions and accounting practices. Before any reliable foundations of a new model can be laid, the underlying methodology must be based on accurate and consistent collection, collation and interpretation of data. Once a transparent and reproducible methodology is established, it may be possible to comment on more specific design elements of a proposed model.

There are a number of policy issues that should be taken into account before any final decisions are made by the AEMC. For example, any new pricing and revenue model for the energy market must accommodate newly emerging Australian Government policies such as climate change and the development of new ways of delivering energy in a carbon constrained economy. These challenges cannot be underestimated in that businesses must be rewarded for appropriate research and development and facilitating innovative energy solutions. It is questionable that a model based on historic data will be able to adequately address these, and other emerging issues.

The implementation of TFP models overseas has raised a number of concerns. For instance, the experience of the Netherlands to date has not been favourable because of ambiguities in the approach to, and intent of, the regulation. As a result, the effective implementation of the model has been set back by significant legal challenges. In New Zealand, where TFP has been used, there has been quality of service issues. The regime acts to penalise investment to improve quality and discourages discretionary investment. The UK currently incorporates both the building blocks approach and TFP methodology for setting the X-factor targets. However, this approach has been criticised as being onerous.

ENA members are not convinced of the merits of running two models as proposed in the issues paper. Members are concerned that data requirements would be imposed on the entire sector rather than just on members that may opt for the TFP regime. Members do not want to see a situation arise where the building blocks model became an essential part of any TFP model or a TFP model is used to inform a building blocks model. The co-existence of two regulatory regimes would have the effect of increasing regulatory burden on industry and on the regulator.

While many users can find fault with the building blocks approach to regulation, that in itself, is not enough to move to another framework. In particular, it is not clear that material deficiencies exist within the building blocks approach that can be remedied through a TFP approach. If a new model is to be adopted, ENA members are strongly of the view that the time should be taken to carefully design a model that can accommodate the changing environment in which the regulated network sector is operating. Above all there should be a model for the entire energy market which will provide confidence that the National Electricity Objective and National Gas Objective will be met. As stated, it is essential that sufficient time is provided to allow for the careful design of the model. Proponents of TFP regulation will argue that TFP has been on the agenda for some time but that debate has been mainly contained to one jurisdiction or to discussion among regulators.

ENA members believe that a more appropriate way to consider changes to prices and revenues regulation is to enter into a staged process. At the very highest level the problem to be addressed must be clearly identified and understood. Once the problem is understood then it is appropriate

to move from the high level goals to discussion of possible solutions to the problems identified, and then to a phase of testing the merits of the solutions identified.

ENA members encourage the AEMC to recommend to the Ministerial Council on Energy that a specific industry working group be established to identify the issues and test the solutions to ensure that any new model meets the emerging needs of the industry and will ensure that cost effective, secure energy is supplied to consumers.

Please contact ENA if you require clarification on any points above

Yours sincerely



Andrew Blyth
Chief Executive