

12 August 2005



The Chairman
Australian Energy Markets Commission
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Dear Dr Tamblyn

Re: EUAA Response to AEMC Review of the Electricity Transmission Revenue and Pricing Rules: Initial Consultation Scoping Paper

The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide a submission to the Australian Energy Markets Commission (AEMC) on its Scoping Paper into the Review of the Electricity Transmission Revenue Pricing Rules.

The EUAA is a non-profit organisation focused entirely on energy issues. Members determine EUAA policy and direction. The EUAA represents a wide spectrum of end-users in all Australian States and have nearly 80 Members, predominantly business end-users with activities across all states and many sectors of the economy. EUAA activities cover both national and sub-national issues. [See <http://www.euaa.com.au/> for more information on the EUAA]

This is an important Review that will impact on the future regulation of transmission services, which are paid for by end users. Perhaps even more importantly, the Review also has the potential to impact on the performance of the National Electricity Market (NEM), including the performance of the wholesale market and through it the energy prices in retail contracts.

The EUAA is pleased that the AEMC have recognised this broader function of electricity transmission services and has stated that it "is keen to ensure that the Review takes into account the broader impact of transmission services and pricing on the competitiveness and efficiency of the NEM as a whole". Further, the EUAA welcomes the AEMC's recognition that it needs to develop a "cost effective regulatory framework for transmission services" that fulfils the National Electricity Law Single Market Objective.

However, the EUAA is concerned that the AEMC seems to only focus on part of the Single Market Objective, mainly "an efficient, safe, reliable and secure electricity system". The Ministerial Council on Energy (MCE) was very explicit in developing the Single Market Objective in that the main focus of the Objective is to "promote efficient investment in, and efficient use of, electricity services *for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity...*"¹.

Any Review of Chapter 6 and subsequent regulatory framework that the AEMC develops for delivering an efficient, safe, reliable and secure electricity system transmission services must ensure it focuses on the long-term interests of consumers of electricity. This is an important matter that the AEMC must address. Without focusing on the long-term interests of consumers of electricity, the AEMC risks developing a regulatory framework which merely allows monopolistic network owners to seek expenditures that result in 'gold plating' of the network. This would be contrary to the long term interests of electricity consumers. The AEMC needs to tread very carefully here as it has been our experience in six electricity transmission reviews (and over 20 network pricing reviews in both electricity and gas) for network owners to seek to exploit opportunities for regulatory gaming or to gold plate their networks if permitted to by regulatory mechanisms.

¹ Sec. 7 of the National Electricity Law.

The timeframe set for responses by the AEMC does not allow the EUAA to develop detailed comments on all the areas raised in the AEMC Initial Scoping Paper. However, it is our understanding that the objective of the Paper is for interested stakeholders to outline their views on the breadth of Review. Hence, the remainder of the submission makes some specific comments on the likely breadth of Review for Transmission Revenue and Pricing Regulation.

Transmission Revenue Regulation

Chapter 4 of the Initial Consultation Scoping Paper is very broad ranging in developing the scope of the Chapter 6 Review and includes such matters as:

- Form of regulation (revenue versus price, building blocks versus total factor productivity)
- Mechanism for establishing the revenue requirements including the determination of the asset base, new capital allowances (*ex ante* versus *ex post* or a combination of both approaches) and the valuation of assets in the existing asset base (roll forward versus re-set)
- Depreciation, return on investment, operating expenditure and allowable pass throughs
- Incentive mechanisms
- Non-transmission alternatives

Quite clearly the AEMC has identified that all these matters have been considered and subject to rigorous public consultation and debate by the Australian Competition and Consumer Commission (ACCC) in developing the Statement of Regulatory Principles (SRP), released in December 2004. The AEMC also says that it will 'have regard' to the extensive body of information that the ACCC has collected in developing the SRP – which we support.

The EUAA believes the AEMC is entitled to embark on a broad approach in Reviewing Chapter 6. Indeed, we believe that there are important aspects of the current approach to transmission regulation that do not serve the interests of end users (and the Single Market Objective) well and that there are inter-related aspects of transmission regulation that are important for any review to take into consideration. However, the AEMC must have regard to existing structures and what lead to their development (as mentioned in the previous paragraph).

We offer the following comments to help ensure the Review fulfils its objective.

Regulatory Gaming

The SRP took approximately two years for the ACCC to finalise and the SRP went through a number of changes before being finalised. At the same time as developing the SRP, the ACCC also conducted the NSW Transmission revenue determination. Developing the SRP as simultaneously conducting a revenue determination provided Transgrid and EnergyAustralia with a significant opportunity to 'game' the regulatory process.

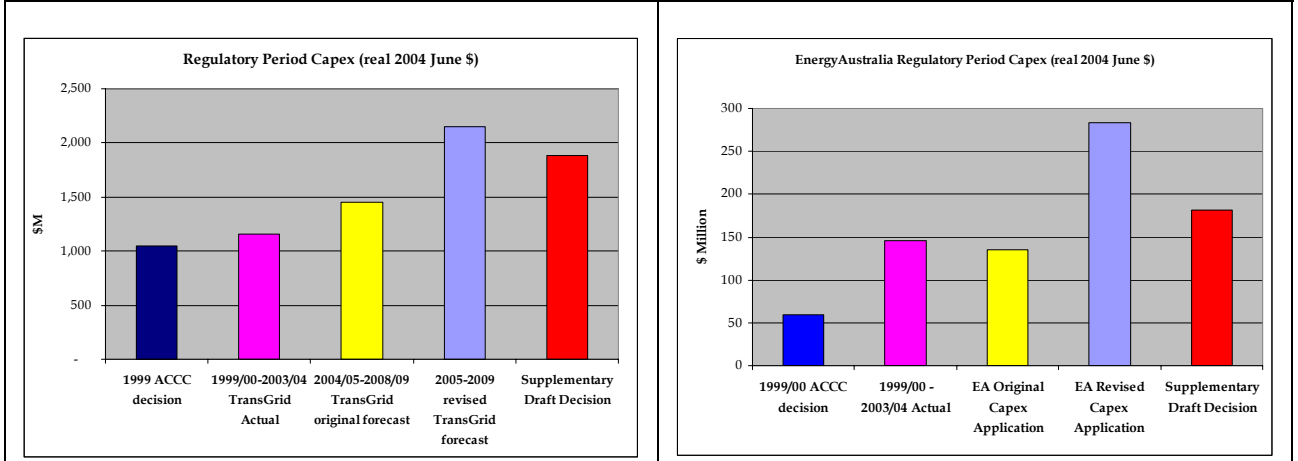
For example, the EUAA calculates that Transgrid and EnergyAustralia potentially 'gamed' their Determination process by some \$200m. This opportunity arose purely because the ACCC changed the SRP to calculate new capital expenditure on an *ex-ante* rather than *ex post* approach half way through the Determination process. Figure 1 below shows how both Transgrid and EnergyAustralia increased their CAPEX by around \$200m purely because they were required to re-submit their CAPEX proposals during the Determination process.

In response to the new *ex-ante* CAPEX proposals, the EUAA sought, from both the network owners and the ACCC, justification for the higher CAPEX proposals. Neither the network owners nor the ACCC in its Supplementary Draft and Final Determinations outlined the rationale for the increased CAPEX.

One important result of the above is that end-users cannot be confident, following a substantive regulatory review, that the capital program that will be required to finance over the next 5 years is robust and justified. We have every reason to believe that the expenditures of Transgrid and EnergyAustralia are 'loaded' and that transmission charges are too high as a result.

The above and the lack of any response from the ACCC means that the EUAA will be required to monitor (as best it can) and devote resources to scrutinising the expenditures of both entities over the next 5 years. We are endeavouring to do that and have applied to the National Electricity Consumers Advocacy Panel for funding (the Panel has deferred its decision on this until October).

Figure 1: Transgrid and EnergyAustralia CAPEX proposals, 2004-2009 ACCC Revenue Determination



As part of the transition to the new AEMC and Australian Energy Regulator (AER) the EUAA has queried both bodies as to the regulatory approach that will be applied to the up-coming Powerlink Determination. This review is of significant importance to our members in Queensland and is due to commence early next year.

Hence, the EUAA recommends that the AEMC ‘draw a line in the sand’ and clearly state the regulatory approach the AER will adopt when conducting the up-coming Powerlink Determination. Once the decision has been made, the AEMC and AER must adhere to the approach in completing the Powerlink Determination. It is clear from above that changing the regulatory approach during the Revenue re-set period is very undesirable.

The EUAA also recommends that, until the AEMC completes the Review of Transmission Revenue Regulation, whatever regulatory approach is applied for Powerlink will also apply to any other transmission revenue re-set that starts prior to the completion of the Chapter 6 Review.

Principle Based Approach

In Chapter 3 of the Initial Consultation Scoping Paper, the AEMC seek comments as to whether other provisions in the Rules that may affect or be affected by the revenue requirements of network owners, should be considered as part of the Review. In particular, the AEMC state that Chapter 5 of the Rules requires transmission service providers to comply with:

- The Regulatory Test
- Reliability Criteria and Technical Standards
- System Standards
- Network Performance Requirements; and
- Network planning and performance

The EUAA believes that the AEMC is justified in focusing on all requirements that might potentially affect transmission service providers’ revenue requirements. The AEMC’s role in this review should be to evaluate whether the current regulatory requirements are the most effective mechanism in dealing with these other regulatory requirements. However, this consideration needs to be firmly tied back and related to the Single Market Objective that the AEMC is governed by.

In dealing with such matters, the AEMC’s could develop principles whereby Chapter 6 provides scope for the AER to take account of any factors that may impact on the revenue requirements of transmission service providers. A principle-based approach to developing a regulatory approach would

provide discretion to the AER if, for example, the AEMC Reliability Panel recommends a change in the Reliability Standard or the soon to be released MCE Regulation Test principles impact on the revenue requirements of delivering transmission services. However, we would not favour giving the AER unfettered discretion in dealing with such matters. Any discretion needs to be soundly based on clear and consistent principles. Again, this needs to be firmly tied back and related to the Single Market Objective that the AEMC is governed by.

Transmission Pricing Regulation

The EUAA agrees with the AEMC that any Review of Transmission Pricing is highly complex and supports the AEMC proposal to the MCE to remove this aspect of the Review from Transmission Revenue regulation. We also support the AEMC seeking a longer timeframe to complete this aspect of the Review.

We also agree with the AEMC that the critical aspects of transmission pricing are:

- The appropriate allocation of transmission costs between generators (new and existing) and market customers;
- The level of cost averaging in the current pricing framework; and
- The appropriate price discounts for users who have genuine options for by-passing the transmission system.

These matters are important to large end users, who have the capacity to provide embedded generation and demand management options as an alternative to network augmentation (if appropriately rewarded).

Moreover, we would urge the AEMC to consider several other aspects of transmission pricing and regulation that are important to end users and in the context of the Single Market Objective, as part of this review:

- The development and application of pricing principles that offer end users greater transparency, information and certainty about changes in transmission prices, and a means to query and dispute any unfair pricing practices (our members have brought several such matters to our attention in the past);
- Progress on the important matter of transmission service standards (which the ACCC has had under consideration for several years without finalisation); and
- Moving to a single national review of transmission prices rather than multiple and disjointed reviews of each NEM jurisdiction.

We look forward to working with the AEMC through the Review process to ensure that the final regulatory framework that is adopted by the AEMC is genuinely in the long-term interests of consumers of electricity.

Consultation Period

The EUAA notes that, in Chapter 7 of the Initial Consultation Paper, the AEMC has set aside a four-week period for interested parties to prepare a response following the release of an Issues and Options Paper on Transmission Pricing Regulation in November 2005 and March 2006. The EUAA believes this period is too short for such a major Review. Chapter 5 of the Initial Consultation Paper (Economic Regulation of Electricity Transmission Prices) contains at least seven areas of transmission pricing that the AEMC consider to be within the scope of a Transmission Pricing Review. All seven areas are very complicated and will require detailed analysis.

The EUAA strongly recommends that the AEMC set aside at least eight weeks for interested parties to respond to the up coming Issues and Options Papers. Further, the AEMC should conduct a Public Information Session on the Issues and Options Paper within two weeks of their release. We

recommend that this timeframe also be adopted for the proposed Issues Paper on Revenue Requirements (stage 1 of the Review process).

If you have any queries regarding our comments, please do not hesitate to contact EUAA's Director Policy and Regulation, Con Hristodoulidis, on telephone number (03) 9898 3900 or e-mail con.hristodoulidis@euaa.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read "Roman Domanski". The signature is fluid and cursive, with a prominent loop at the end.

Roman Domanski
Executive Director