

**Network of Illawarra Consumers of Energy
Suplimentary Submission in response to the
Transmission Planning and Investment
Review Stage 2 Draft Report
August 2022**

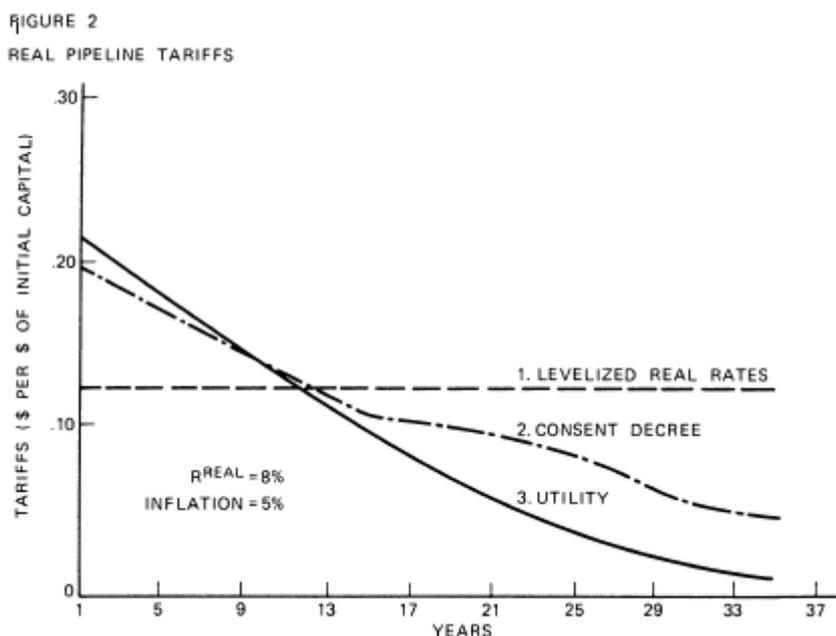
Network of Illawarra Consumers of Energy

Suplimentary Submission in response to the Transmission Planning and Investment Review Stage 2 Draft Report

This short suplimentary submission is made simply to provide additional information on the inappropriateness of the existing regulatory framework to new major investment projects, as initially outlined in the submission under the heading "The current approach to the return on and of capital".

The approach to regulation used for energy networks in Australia is described as a form of CPI-X incentive regulation that uses the "building block model" (Biggar 2004). The genesis of this model is the adaption of Littlechild's original RPI-X price cap approach to the "RAB model" in the UK (Bolt 2003). Both these terms refer to the formula used to calculate the revenue for the reference year in the incentive approach.

In the US this formula has been described as the "utility formula" and Navarro et al. (1981) contrasted it with other formulas used for large, one off-investments such as new pipelines or transmission lines. The figure below showing real tariffs per year is drawn from this paper.



As the chart shows, the paper observed that "The utility formula involves a massive transfer of the price burden to near-term consumers and conversely affords unwarranted subsidies to future consumers" and that "The utility formula's marked front- end loading of rates creates an institutional barrier to the efficient planning and scheduling of large projects".

The perhaps surprising part is that the paper by Navaarro et al. is over forty years old and that its conclusions are relatively simple. We encourage the AEMC to consider more carefully the question of the appropriate approach to financing new transmission investment.

References

- Biggar, D 2004, 'Incentive regulation and the building block model', paper presented to Australian Conference of Economists, Sydney, Australia,
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- Bolt, C 2003, 'The future of RPI-X and the implications for utility investment in the UK', in *PROCEEDINGS-CRI*, pp. 65-86.
- Navarro, P, Petersen, BC & Stauffer, TR 1981, 'A critical comparison of utility-type ratemaking methodologies in oil pipeline regulation', *The Bell Journal of Economics*, pp. 392-412.