

9 December 2011

Mr John Pierce
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By online submission

Dear John

RE: Consolidated Rule Request – National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2011

AEMO welcomes the opportunity to provide feedback on the AEMC's Consultation Paper on the consolidated rule request on the economic regulation of network service providers.

The revenues of network service providers in the current framework are regulated through the ex-ante building block approach. As such, revenue regulation has typically been designed around setting economic and commercial incentives on how assets are delivered rather than the services provided. The current arrangements also provide for a state-by-state approach to revenue setting which allows for inefficiencies and inconsistencies to arise within the framework.

AEMO believes that the revenue setting arrangement in the NEM is an important factor in ensuring the revenue setting and planning frameworks complement each other. AEMO believes that these proposed changes will not address the deficiencies in those frameworks. Therefore the AEMC needs to consider how it will incorporate its learnings from this rule change proposal into the Transmission Frameworks Review.

This submission focuses on the AER's component of the Consolidated Rule Request and how AEMO could provide input to move towards a more transparent revenue setting arrangement.

Determining forecasts of expenditure

The AER have noted in their proposal that the current process for forecasting electricity network businesses capital and operating expenditure restricts their ability to ensure the investment of the regulated electricity networks is efficient. The AER have suggested that this also affects their ability to ensure networks earn appropriate returns.

AEMO considers that a critical input to the revenue setting process is the demand forecasts, which are currently performed by the TNSPs as a foundation for their forecast capital and operating expenditure. This could be seen to risk introducing a bias in the demand forecasts through the incentive on network businesses to forecast higher peak demand growth producing higher forecast expenditures and, where it affects their pricing, low energy growth.

One option is for these forecasts to be provided by an independent party. As the AEMC is aware, AEMO will produce peak demand and energy forecast for each region of the NEM through its National Energy Forecasting Project. The first stage of AEMO's National Energy Forecasting Project is to produce a report in June 2012. This will contain a first set of national forecasts which will include the impact of developments driven by climate change policy, rising electricity prices, and the changing costs of different energy technologies. Following this, AEMO plans to continue to work in consultation with industry through the energy forecasting reference group to monitor changes which impact demand and to provide updated information as necessary.

AEMO will ensure the statewide demand and energy forecasts are produced in a transparent manner, removing uncertainty on the underlying factors used in those forecasts. Network service providers would need to continue to forecast connection point demand and to reconcile those to the aggregate statewide forecast. AEMO proposes that the AEMC consider the benefits of this initiative as part of this rule change proposal.

Efficiency and transparency of regulatory process

AEMO encourages improvements to processes which enhance efficiency and transparency. Therefore AEMO agrees that all key information for the NSP's revenue proposals should be provided with their original submission to allow the AER to draft their decision accurately and within the appropriate timeframe. AEMO also considers that early full disclosure would enable stakeholders to engage more effectively in the revenue determination process and would ensure the process is consistent with the AEMC's original intention.

Contingent projects

The AER have proposed that a contingent projects framework be introduced for DNSPs to account for the risk associated with uncertainty, similarly to the current transmission version. While this can potentially reduce some of the incentives under an ex-ante price setting regime, a well designed framework should be able to reduce the uncertainty of large, unforeseen project expenditure arising during the regulatory control period. AEMO supports the development of guidelines for this framework to apply to DNSPs.

Currently, acceptance of a contingent project by the AER is based on 'trigger events' which are defined in the Rules under s6A.8. There may be potential to define other triggers for contingent projects, including AEMO completing a RIT-T or RIT-D assessment, and therefore AEMO suggests that the AEMC consider such cases in light of the national planning regime work as part of the Transmission Frameworks Review.

If you have any questions please do not hesitate to contact Louis Tirpcou on (03) 9609 8415.

Yours sincerely

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