

21 November 2005

Ref.

Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Emailed to: submissions@aemc.gov.au

Dear Sir/Madam

Revenue Requirements: Issues Paper

Thank you for the opportunity to comment on the Australian Energy Market Commission's Revenue Requirements: Issues Paper.

Enertrade is an integrated wholesale energy provider. Enertrade owns and operates the North Queensland Gas Pipeline, a gas-fired power station at Barcaldine and purchases electricity from privately owned power stations through Power Purchase Agreements and trades this into the National Electricity Market (NEM).

Transmission plays a critical role in the effective operation of the National Electricity Market, not just in delivering electricity from a generation source to load centres, but in influencing wholesale energy prices and investment in generation. It also plays an integral role as the mechanism for maintaining reliability standards in the NEM.

In developing the appropriate regulatory framework for transmission, consideration must be given to the impact of transmission on the operation of the market as a whole. Broadly speaking the framework should promote transparency in all aspects of transmission planning to allow other market participants to predict future transmission investment and understand its likely impact on the market. It should also ensure that Transmission Network Service Providers (TNSPs) conduct their activities with regard to their impact on the market.

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Form of regulation

Enertrade supports consideration of less prescriptive forms of regulation for electricity transmission services to the simple revenue cap as the only option currently available under the National Electricity Rules.

Enertrade supports a light-handed approach to regulation which lowers the cost and complexity of regulation facing investors. The form of regulation should provide the right balance between the costs and the benefits of regulation. This balance is likely to differ between particular assets and asset classes. The form of regulation adopted should also offer strong incentives to service providers to operate efficiently as well as adequate incentives for continued investment.

Enertrade considers that there is scope to introduce more flexible forms of regulation for transmission services. Depending on the nature and characteristics of the relevant assets, the Regulator may wish to regulate transmission services via forms of regulation such as price cap or price monitoring arrangements. The Code should provide this flexibility to regulators so that the appropriate form of regulation can be chosen taking into account such factors as the regulated entities' preferred form of regulation, the different trade-offs in forecasting volumes as between price and revenue caps, and any distortions in incentives that arise from the choice of the form of regulation (for example, in terms of incentives to cut costs compared with incentives to improve service quality). Permitting the choice of alternative forms of regulation recognises that the current revenue cap arrangements have significant limitations, in particular in their ability to identify precisely and eliminate potential monopoly rents while not removing reasonable profits, and in the danger that they undermine incentives to undertake new investment (where rates of return are set too low) or improve service quality (where the rewards are small compared with the risks).

Scope of regulation

Enertrade supports a more competitive environment for construction of dedicated connection assets. Enertrade submits that the framework for electricity transmission



should maintain and enhance the current scope for construction and operation of non-regulated assets. This is because the construction of connection assets under fully competitive conditions is likely to result in the more efficient cost of construction, and to provide a benchmark for regulated transmission infrastructure. Allied to this proposal, Enertrade believes that there should also be specific provisions to facilitate the sale of dedicated connection and access assets to generators or users on request for a fair and reasonable price.

Suggestions to improve the competitiveness of the processes for construction and operation of dedicated connection assets include specific mechanisms for:

- access to existing lines to cut and re-route them to serve dedicated generators or loads; and
- access to existing TNSP easements by successful third party construction entities to construct dedicated connection assets.

The arrangements would not need to be more complex than a simple direction to negotiate in good faith on this issues. These arrangements would ensure there are no direct or indirect barriers to competition in the supply of connection and access assets.

Performance obligations and incentives

Inclusion of a service quality incentive regime would ensure that TNSPs make efficient operating decisions which have regard to the impact of their activities on the operation of the market.

Enertrade supports the model proposed by the National Generators Forum in its submission as a positive forward step.

Determining cost components

Ongoing investment in transmission is essential not only to ensure security of supply, but to support growth in electricity demand and promote competition among generators.



The regulatory regime must provide sufficient incentives as well as regulatory certainty to ensure future investment. It must also adequately compensate for the risks associated with investing in electricity transmission.

Enertrade considers that in regulating transmission revenues the best approach is for the regulator to consider whether the access arrangements proposed by the TNSP falls within a range of reasonable outcomes. This approach is preferable to a forensic analysis of the regulated business which attempts to determine a theoretical best price.

Planning

The focus of the Annual Interconnector Review and Annual National Transmission System planning processes has been on interstate transmission links. However, the majority of transmission investment occurs in relation to intrastate links and these links are as critical as interstate links in the overall transmission system.

For both interstate and intrastate links it is important to ensure that decisions to invest are based on the most efficient option. The planning process should demand high levels of transparency to ensure that non-transmission alternatives are always fully and appropriately considered as part of the TNSPs decision-making process.

In a number of jurisdictions, TNSPs function as both transmission planner and network owner and operator. This dual role raises the concern that these TNSPs have an incentive to favour the construction of transmission links over local, more cost-effective generation options.

The South Australian Government has moved to separate these functions to resolve this apparent conflict and improve transparency. It established the Electricity Supply Industry Planning Council to provide expert, independent advice on network planning issues.

Given the central role transmission plays in the efficient operation of the NEM the highest level of transparency of the planning process is warranted.



Conclusion

In summary, Enertrade supports:

- the introduction of more flexible forms of regulation as options for regulation;
- an enhanced framework for negotiating competitive construction of dedicated connection and access assets;
- an incentive regime that provides TNSPs with incentives to make efficient operating decisions which have regard to the impact of their activities on the market;
- a regulatory regime that provides sufficient incentives for continued investment; and
- greater transparent in the planning process for intrastate transmission links.

Yours sincerely

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