

28 March 2008

c/08/4921

Mr Steven Graham
Chief Executive
Australian Energy Market commission
Level 5
201 Elizabeth Street
Sydney NSW 2000

Dear Steven,

Thank you for forwarding me a copy of The Australian Energy Market Commission's Statement of Approach for its Review of demand-side participation (DSP) in the National Electricity Market together with the NERA Report dated 20 February 2008.

Over the years the Essential Services Commission has made a number of observations in relation to the manner in which network regulation impacts on demand side participation in the National Electricity Market.

Although more relevant to your Stage 2 Review I am pleased to attach a copy of a short report the Essential Services Commission (ESC) engaged Pacific Economics Group (PEG) to complete titled "Energy Market Policy and Regulatory Barriers: How Energy Networks Can Contribute to Energy Market Objectives".

This PEG report examines some of the ways network regulation has impacted on the evolution of the structure of the energy industry, including industry capital structures and the effect this has had on the way businesses (including new entrants) view risk, the source and magnitude of returns across the complete value chain and importantly their appetite for investing in and pricing new and innovative energy service products and services.

The ESC notes that the AEMC Review is initially focused on identifying and removing barriers, impediments and obstacles in the Rules and assessing a rule change proposal that would seek to place certain requirements and obligations on network businesses to facilitate greater DSP. Without detracting from the importance of examining these matters the ESC believes that a more complete strategic insight will be achieved by assessing the effects on incentives of regulatory approaches that promote the separation of the natural monopoly elements of the industry from the competitive retail and wholesaling sectors or alternatively facilitate the efficient integration of these sectors whilst ensuring ongoing protection from the exercise of market or monopoly power.

Relatedly, the ESC notes that the Victorian Government through the Department of Primary Industries is currently considering submitting a "rule change" proposal to enable the AER to apply TFP indexing in the regulation of electricity network businesses.

I would welcome the opportunity to elaborate on any of the matters outlined above. More information can also be obtained from our website at www.esc.vic.gov.au

Yours sincerely



PAUL FEARON
Chief Executive Officer