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Review of Transmission Revenue and Pricing Rules
Australian Energy Market Commission
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Transmission Revenue Requirements : Issues Paper

PIAC is an independent, non-profit legal centre based in Sydney. PIAC has established the Utility Consumers' Advocacy Program (UCAP) with funding from the NSW Government. The work of UCAP includes developing policy and advocating for the interests of residential consumers, particularly low-income consumers, in the NSW energy and water industries. Broad policy direction for UCAP comes from a community-based Reference Group.

The following comments are submitted in response to the *Revenue Requirements: Issues Paper* published by the Australian Energy Market Commission (AEMC) as part of the review of energy transmission revenues and pricing. Despite the considerable interest of PIAC in this review we have been able to offer only brief comments at this time. In large part this is due to the current high workload of consultation around national market issues. Some elaboration of our views will be contained in our response to the recent consultation paper released by the Ministerial Council on Energy (MCE).

We note that transmission costs contribute only a small proportion of the energy bills for households. However, we anticipate that many of the principles being discussed in relation to transmission may be applied in the future to distribution services. Together these activities comprise some 50% of average household energy prices.

1. Incentive-based regulation

We offer the general comment that the regulation of transmission revenue and pricing needs to be aimed at meeting the principal objective of the national market – defined in the *National Electricity Law* as including long-term consumer benefit. Accordingly, we argue that the national regulatory bodies must bear in mind the origin of incentive-based regulation in the goal of providing positive gains for both the regulated entities and end-use consumers.

That is, decisions about the economic regulation of transmission functions need to take account of more than possible future investment decisions. At the very least, consumers would be of the view that appropriate regulation should provide more than a simple promise that the ‘lights will stay on’. While the *Issues Paper* gives occasional emphasis to various forms of consumer benefit, PIAC is concerned to see the rules for economic regulation and the decisions eventually made by the regulator give an active and appropriate balance to the interests of both the transmission entities and end-users.

On this point we welcome the *Issues Paper* having raised the possibility of the development of a regulatory scheme which can support non-network options in meeting the energy needs of end-use customers. Unfortunately, we have not been able to formulate detailed comments on this point. However, from the perspective of long-term consumer benefit, PIAC does support these options because of the benefits of avoided costs as well as the potential positive environmental outcomes. We look forward to further investigation of appropriate treatment of non-network options.

2. Form of regulation

The building blocks approach currently used by regulators in the Australian energy market is readily understood by end-users. To put this another way, it is an approach which consumers have come to accept and support.

The reasons for any change need to be argued clearly. It is understood that the regulated entities would prefer more light-handed or less intrusive regulation. On the other hand, PIAC and other consumer groups will find it difficult to support changes to the regulatory approach which result in reduced accountability for energy supply businesses, particularly those which are monopolies.

PIAC believes the building block approach offers regulatory certainty both to the regulated entities and end-users. Having examined cost index approaches in the past, in response to an initiative by the Utility Regulators Forum (URF), PIAC also has formed the view that some of the alternatives to the building block approach are lacking in transparency.

By contrast it is far from clear that cost index approaches can deliver significant benefits to the market or to the users of energy services. For example, cost index approaches do not resolve the critical issue of information asymmetry. They retain a somewhat subjective assessment of costs and thus remain open to concerns of gaming. Nor do they avoid the fundamental challenge of aligning revenue with costs.

Finally, we understand that significant concerns with cost have been raised in the past with the respect to cost index approaches. That is, a cost index approach may involve greater costs to the businesses and consumers while being no less ‘intrusive’ than the current building block approach.

3. Criteria for determining efficient investment

PIAC is strongly of the view that examination of the prudence of investment decisions by network businesses ought to be undertaken on an *ex ante* basis.

In the first instance this reflects the current approach by the jurisdictional regulator in NSW (and, we understand, Victoria) in relation to distribution networks. However, this is not only an issue of the likely application of the pricing principles under development to all energy networks. End-users have spent what is, for us, a considerable level of resources in trying to become literate in the issues associated with economic regulation of energy networks. A move to *ex post* assessment of investment decisions would alter substantially the 'nature of the game' and make it more difficult for end-users to act as a key stakeholder in network regulation.

It is appropriate that investment decisions be tested before the event rather than in hindsight. We point out that in Australia all the jurisdictional regulators at times would have been faced with claims by network businesses for recovery of some level of costs for investment in assets where these claims have been in relation to a concluded regulatory period. Given the nature of network planning and the growth of demand for energy this likely will never be eliminated.

At the same time, it clearly is a more difficult task for a regulator to refuse to permit recovery for assets already constructed. Nor will hindsight overcome the problems of information asymmetry or the difficulties of forecasting demand. Whereas prior scrutiny permits the possibility that, for example, end-users may signal the level of their willingness to pay for certain network assets. Equally, *ex ante* assessment of investment plans allows regulators to retain the option of giving incentives to so-called 'non-network' solutions such as demand management and load reduction programs.

4. Regulatory discretion

PIAC believes the current level of discretion available to jurisdictional regulators and to the ACCC is appropriate. This is not to say that PIAC always agrees with or supports individual decisions made by those regulators. Some stakeholders, the regulated businesses for example, may argue the benefits of less discretion in terms of certainty of outcomes. However, no case has been made that reducing the discretion of regulators would result in decisions of better quality or more attuned to the public interest.

Without question some elements of regulatory decision-making can be determined in advance through the Rules. One example given in the *Issues Paper* is the form for WACC – post-tax or pre-tax. However, the question should be whether it is consistency of approach which is more important than the details of the specific approach adopted by the AER.

In our view the more troubling areas for uncertainty are found in such factors as demand forecasting and the prudence of capital investment. Yet many of these factors by their nature are not conducive to being treated by prescriptive rules designed to remove subjective assessment and decision-making. These factors are perhaps even more important in the regulation of distribution activities which is expected to be brought under the Rules in the future.

As a result, we do not support an approach in the Rules of reducing the current discretion available to regulators.

5. Impact of decisions

It is in the public interest for economic regulation to take account of the financial viability of the regulated businesses. A requirement for a regulator to publish an assessment of the financial impact of regulatory decisions is important in giving assurance to the community that the energy supply industries will continue to be able to provide these essential services. It also is an important accountability mechanism operating on the regulator.

As we have noted above, the national energy market has not been constructed solely for the benefit of the energy supply businesses. The statutory goal of long-term consumer benefit also needs to be satisfied and in a manner which is transparent to consumers.

In NSW the Independent Pricing and Regulatory Tribunal (IPART) makes regular use of analyses of its economic determination to show the impact on customers. These deal with both residential and commercial customers of the regulated energy businesses. In general, these present a minimum of information such as a comparison of prices at the start of a regulatory period with those at the end of each year of the period – often expressed both in terms of changes relative to the CPI and real dollars.

In the case of transmission, the costs of supply comprise only a small proportion of the bills seen by residential users. It may be appropriate to focus the assessment of customer impact in transmission on only large end-users. However, the important principle remains that even brief analysis of this kind is critical to assisting end-users to understand the outcomes of the regulatory process and to identify the extent to which consumer benefit has been met. Clearly this will become more salient when economic regulation of distribution activities is governed by these new national principles.

Accordingly, PIAC argues for a broader requirement to be introduced on the Australian Energy Regulator (AER) such that customer impacts of decisions are to be analysed and reported; and for this be undertaken both for electricity and gas.

Yours sincerely
Public Interest Advocacy Centre Ltd



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