



EnergyAustralia™

EnergyAustralia
Submission to

Australian Energy Market Commission

Review of the Electricity
Transmission Revenue and Pricing
Rules

Initial consultation: Scoping paper

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Energy

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1. Executive Summary

EnergyAustralia welcomes the Australian Energy Market Commission's (AEMC) review of the electricity transmission revenue and pricing rules. A summary of EnergyAustralia's key issues for consideration by the AEMC include:

- Support for the AEMC's proposed two stage review process
- Alignment of the Australian Energy Regulator (AER) tasks under the rules with the governance arrangements in the national electricity law. EnergyAustralia maintains that the rules assign inappropriate scope to the AER on market development issues
- Support for the current CPI-X building block form of regulation. However, the review should not preclude consideration of alternative forms of light-handed regulation, in particular, for contestable services
- Review of the revenue and pricing objectives and principles to ensure consistency with the national electricity market objective
- The form of price control (such as revenue cap/ price cap) should be reviewed in light of the efficiency criteria in the national electricity market objective
- Methods of providing greater certainty and consistency in the building block components such as asset valuation, roll forward methods, depreciation
- Rethink on the approach to incentive mechanisms covering investment, operating costs and standards of service
- EnergyAustralia does not believe it is appropriate for an economic regulator to impose an incentive regime relating to service standards when there is a comprehensive jurisdictional standards regime already in place (as is currently the case for distribution service standards in NSW resulting from the recent Ministerially imposed licence conditions)
- Review of the allocation of shared transmission costs to all users, in particular, incumbent generators, in light of the national market objective
- Maintenance of flexible transmission pricing structures to allow transmission network service providers to signal costs to users
- Review the scope for regulatory discretion and prescription in the regulatory decision making process
- Strong support for the review and establishment of regulatory procedures covering timeframes, processes for review including the propose-respond model, information provision and the circumstances for amending and revoking pricing determinations.

2. Introduction

EnergyAustralia welcomes the Australian Energy Market Commission (AEMC) review of electricity transmission revenue and pricing rules. This review presents a critical opportunity to advance the state of economic regulation for the electricity network businesses.

EnergyAustralia's response to the AEMC scoping paper is guided in the hope of achieving an effective incentive based regulatory regime that facilitates the economically efficient use of, and investment in, the national electricity network. The scope and form of regulation is critical to achieving this objective.

Given the scope of the task set out in the National Electricity Law, (NEL) EnergyAustralia supports the two stage review process proposed by the AEMC. This will allow the regulatory revenue principles to be established separately from the more complex issues of pricing.

EnergyAustralia's response to the AEMC scoping paper draws on its experience with the regulatory arrangements under the former Code as an integrated network comprising both transmission and distribution assets.

3. EnergyAustralia experience

EnergyAustralia operates a transmission and distribution network which has been subject to economic regulation by both ACCC and IPART. The experience to date with the provisions in the Code and the implementation by regulators has led to the view that the form and scope of regulation of networks requires considerable reform to achieve best practice regulation¹.

EnergyAustralia's experience as a transmission and distribution network service provider, with the current provisions in the Code has been disappointing due primarily to:

- Regulatory intrusion (micro-management) stifling incentive based regulation
- Uncertainty, lack of transparency and predictability causing a greater degree of regulatory risk
- Limited accountability for regulatory decisions
- Delays in regulatory decisions leading to price uncertainty which affects both EnergyAustralia and its customers
- The costs to EnergyAustralia and its customers arising from the separate economic regulation of our transmission assets due to the current Rule definition of transmission (even though these assets represent only 12 per cent of our total network assets).

The AEMC revenue and pricing review offers a critical opportunity to redress the existing shortcomings and inconsistencies in network regulation. The structure of this submission is to comment on revenue regulation, pricing regulation, other issues and procedures.

¹ Refer to Utility Regulators Forum discussion paper *Best practice utility regulation* (July 1999) for discussion of best practice regulation.

4. Role of the AER

The Australian Energy Regulator (AER) has been established as the economic regulator for transmission and has the market monitoring and enforcement roles. There are a number of areas in the Rules where the AER has been given tasks that EnergyAustralia considers to be outside of the scope under the NEL. The key areas that require review are:

- Clause 6.2.1(d): the AER in agreement with the jurisdictional regulator may deem assets of between 66kV and 220 kV that do not operate in parallel, or provide support to, higher transmission voltages, to be subject to regulatory arrangements for distribution pricing. Previously, under the Code, there was power for the transmission network service provider (TNSP) to deem assets operating between 132kV and 66kV to be distribution assets. Clause 6.2.1 was in EnergyAustralia's view inappropriately changed so that the TNSP no longer has this power to initiate a change to the status of assets. This issue needs to be open to review, particularly in light of the considerable administrative costs imposed on EnergyAustralia and its customers of having to undertake separate transmission and distribution regulatory reset processes for what is an integrated distribution network.
- Clause 6.2.3 (c) provides for the AER to decide on whether "sufficient competition exists to warrant the application of a regulatory approach which is more light-handed than revenue capping and, if so, the form of that regulation". This issue is linked to the key principle in Clause 6.1.1(b) (1) of promoting competition. However, we do not believe that the AER is in the best position to decide on competition issues, as this is clearly an issue that is better addressed by the AEMC. The promoting of competition is linked to market development and as such should involve the AEMC.
- Clause 6.2.4(d)(3) allows the AER to revoke a determination where there is a substantial change in ownership of network assets which may lead to a material change in the revenue requirement of the TNSP following the change in ownership. Whether or not this is appropriate from an economic perspective is debatable, but in any case is difficult to understand how the AER would be in a position to make this decision. This type of unfettered power could cause significant uncertainty for potential investors. Where there is a change in ownership, EnergyAustralia argues that the AER should only be able to revoke a determination in accordance with the Rules with permission from the owners.
- Clause 2.5.2(c) provides the AER or Jurisdictional Regulator to determine which parts of a network service, which is no longer a market network service, should be prescribed services, ie subject to network revenue determination. However, EnergyAustralia queries whether it is appropriate for the AER to carry out this role as it encroaches on competition and market development.

5. Economic regulation of transmission revenue

5.1 Transmission revenue objectives

The work by the Productivity Commission on the National and Gas access regimes and the Commonwealth Governments response in 2002 provides an economically robust guide to developing a set of revenue and pricing principles for electricity networks.

The AEMC review needs to address ways of ensuring that:

- The terms “objectives”, “principles”, “form and mechanism” of economic regulation are unambiguous and consistent within the Rules
- The objectives of transmission revenue regulation are consistent with the NEM objective and with the revenue principles in the National Electricity Law
- The principles for regulation should focus the on manner in which the regulatory regulation is administered. For instance principles such as transparency, light-handed, certain, predictable outcomes
- While the MCE has restructured the NEM objective into a simple structure the objectives of network pricing are multi-layered and inconsistent
- Inconsistencies within the objectives and principles need to be addressed.

5.2 Form of regulation

The Commission invites comment on whether, in the light of the NEM objectives and the requirements of s.35(3), this Review should consider alternative approaches to the current CPI-X building block approach.

As a general principle, EnergyAustralia favours the retention of the existing accrual building block approach to regulation. We would be concerned that a fundamental change to another approach (such as Total Factor Productivity) may not deliver appropriate revenue trajectories to match business costs. For example, in the current period of high demand growth but modest energy growth, an increasing unit charge is required to match increased capital expenditure. This outcome may not arise from an alternative approach to determining regulated revenues.

Furthermore, this review has a deadline of 1 July 2006 which does not provide sufficient time to properly consider alternative forms of incentive regulation. However, the Rules should not preclude the consideration and application of alternative arrangements to the CPI-X building block arrangement, especially for services that have the potential to be subject to contestability. Should lighter handed forms of regulation be contemplated, there needs to be consideration of appropriate lead times and transition arrangements to avoid regulatory uncertainty of any such changed arrangements.

Principles developed by the Productivity Commission and the Prime Minister’s Taskforce on Infrastructure recognise the need for light-handed regulation. Investigation into more light-handed incentive based form of regulation should be the perpetual aim of the AEMC. As part of its market development role, the AEMC should be aiming to develop methods and incentives that would lead to less not more regulation while still fulfilling the NEM objective. This can be achieved through a separate review or Rule change process initiated by an interested party

In addition to the form of regulation, the form of price control (revenue cap, price caps) needs to be subject to review to ensure that the efficiency objectives of the national electricity market are met. EnergyAustralia notes that the current wording of the Rules precludes the consideration of any form of price control other than a revenue cap for prescribed transmission services. We believe the suitability of other forms of price control (including a weighted average price cap) should be canvassed in the Issues Paper.

As an observation, there is general inconsistency in the use and meaning applied to regulatory terms. There needs to be consistency in the regulatory terms in order to form a more logical discussion of the issues. As start, a list of terms is contained in the table below:

Form of regulation	CPI - X incentive based, rate of return
Base revenue calculation	Building block approach vs benchmark
Pass through	Cost based vs benchmark
Form of price control	Revenue cap vs Price cap
Secondary incentives	DM, SOS factors

5.3 Mechanism for establishing the revenue requirements:

The Commission invites comment as to whether there are any other issues that need to be considered in this Review in addition to those identified above.

Asset base criteria:

- Generally, the Rules need to explicitly list the approach to the valuation of assets as well as the method for rolling-forward assets into the asset base. This is needed to provide greater certainty to the network owners. It is clearly inappropriate to have billions of dollars of assets subject to vague regulatory discretion at each review period, as has been the case to date.
- The method for determining assets values and the scope for review and adjustment for capex needs to be made more explicit in the Rules. Asset valuation under the building block approach requires greater prescription to reduce the risk of regulatory uncertainty. The issue of asset valuation under the Code was vague and allowed inappropriate level of regulatory discretion.
- EnergyAustralia would welcome a review of the processes for examining the capital expenditure requirements ex ante and ex post. The main aim for EnergyAustralia would be to establish an effective ex ante review process and incentive mechanisms to avoid unnecessary regulatory micro-management of projects. There should be greater reliance by regulators on incentives and internal capex evaluation processes rather than a forensic review of individual projects on an ex post basis.

5.4 Depreciation, return on investment and operating expenditure

The Commission invites comment on whether there are costs additional to those outlined above that should be considered as part of the Review.

The inclusion of accrual building blocks components within the Rules is supported.

The items in clause 22 in Schedule 1 to the NEL implies that the building block approach has been sanctioned as the method for setting revenue. However, there are significant additional cost elements which should be included:

- Return on working capital
- Tax payable.

Also in the case where capital contributions have been received from transmission customers there should be compensation for the 30% tax applied by the Australian Tax Office as revenue. This element is of particular relevance where capital contributions are made to the business, since their accounting and taxation treatment leads to a significant loss of value and cost impact on network businesses.

Costs that are not within the control of the network service provider should not be subject to efficiency incentives. Furthermore, non-controllable costs should be passed through prices to consumers. If such "pass throughs" were not a core component of the regulatory framework, TNSP's would necessarily be required to estimate an allowance for significant and unanticipated events and incorporate this allowance into its required revenue submissions. Customers would therefore be paying at least some costs towards events that, by their very nature, are uncertain and may not transpire during the regulatory period. A cost pass through mechanism that allows the pass through of costs only *if or when* they occur is a more effective approach to dealing with such uncertainty.

5.5 Incentive mechanisms

The Commission invites comment on what issues should be included when considering incentives for regulated transmission systems to make efficient operating and investment decisions.

EnergyAustralia believes the AEMC also needs to consider the incentive regime as part of the review. In particular, the form of revenue transitioning applicable to encourage efficient capital investment and operational decisions should be considered. An essential consideration of such transitioning is preserving financial capital maintenance via an "NPV-neutral approach".

EnergyAustralia strongly agrees with the AEMC that the design of an effective incentive regime can be a more cost effective alternative to more intrusive forms of regulation. EnergyAustralia is concerned at the intrusive nature of regulatory pricing regulation that has emerged in electricity which has blurred the distinction between "lighter" and "heavier" handed forms of incentives. The micro-management approach has become a compliance exercise aimed at cost cutting or reporting on a project-by-project basis rather than an incentive regime aimed at facilitating long term efficient investment.

It is not obvious to EnergyAustralia that an “over-engineered” approach to developing an incentive framework (which necessarily involves increased regulatory intrusion and focuses on short term behaviour) is superior to an approach which is focussed on securing long term efficient investment in infrastructure assets through transparent, longer term incentives. There is considerable risk with an over-engineered approach that, in addition to the increased compliance costs and “perverse” incentives that may be created, its results are not “approximately correct”, but rather “precisely wrong”.

It must be remembered that the CPI-X framework by its very nature is an incentive-based system that encourages efficient expenditures, as a business will always be better off (in a financial sense) by curtailing its expenditures. Simply stated, a priori a dollar of (operating) expenditure saved results in a dollar increase in (pre-tax) profits. The need to “encourage” further expenditure reductions, through separate instruments such as an “opex carryovers mechanism”, we do not believe has been established.

As part of the AEMC review, it is imperative that there is a fundamental rethink of the approach to incentive regulation covering investment, operating costs and standards of service. Issues for consideration of an opex incentive mechanism include whether such mechanisms assist or hinder the deliver of the market objective. If it is determined that such a mechanism should be implemented, then the following issues need to be examined: benchmarking to historic level of spend not other related businesses, taxation effect, inter-period effects, interplay with other incentive mechanisms, benefit sharing, symmetric mechanism with penalty floor, correction mechanisms.

Standards of service incentive regime:

- The Rules need to be amended to take into account the revenue requirements for the technical and reliability standards of service imposed by the jurisdiction. New obligations may in future be imposed on EnergyAustralia which apply to the transmission network.
- EnergyAustralia does not believe it is appropriate for an economic regulator to impose an incentive regime relating to service standards when there is a comprehensive jurisdictional standards regime already in place (as is currently the case for distribution service standards in NSW resulting from the recent Ministerially imposed licence conditions). There should be consideration of an option for voluntary incentive regime ie with consent of the owner to improve standards. The extent of revenue at risk should be limited in agreement with the owner.
- Any incentive regime administered by the AER needs to harmonise with the obligations set by the jurisdiction and should not attempt to “second guess” the specified targets (ie., is it the economic regulator’s role to provide incentives for a business to achieve higher or lower standards than deemed appropriate by the jurisdiction).
- Any incentive regime needs to adhere to criteria such as being easy to understand, administer and comply to and consistent with jurisdictional obligations.

5.6 Non-transmission alternatives

The Commission invites comment on what issues are relevant when considering non-transmission alternatives as part of this Review.

The consideration of non-transmission alternatives should have increased prominence given the focus of the national electricity market objective on efficiency in electricity services. In addition the Rules contain an objective relating to non-discrimination in technology. Areas that require review include:

- The impact of current pricing allocation arrangements (ie incumbent generators not paying for transmission transportation services) on embedded generators.
- Methods to neutralise any discriminatory hurdles faced by new technologies, techniques and approaches that in the long run may have the potential to improve network efficiency. These may include incentive mechanisms, specific investment funds for learn-by-doing projects, revenue maintenance mechanisms for DM projects.
- The impact of the forms of price control have on the incentives for non-transmission alternatives.
- Establishing clear policy direction on the issue of non-transmission alternatives to enable establishment of clear regulatory guidelines for reimbursement to the transmission owners.

6. Economic regulation of electricity transmission prices

6.1 Matters in existing Rules on electricity transmission pricing

The Commission invites comment as to whether the Rules appropriately cover the scope of matters that ought to be taken into consideration in this Review, and if not, what additional matters, or fewer matters, should be covered under the Rules.

EnergyAustralia comments that:

- Pricing principles need to be reviewed in light of the new national electricity market objective
- The form of price control applying to transmission services needs to be reconsidered in light of the new national market objective. The Issues Paper should canvass the appropriateness of forms of price control other than a revenue cap for the provision of transmission services and the impact such forms of price control may have on matters such as revenue certainty vs efficient pricing
- Discrimination in favour of the existing generators does not result in efficient outcomes at the distribution level
- Non-payment by incumbent generators needs to be reconsidered in light of the government policy for “greener” technology
- The issue of appropriate CPI to be adopted and the timing of the publication of prices needs to be considered.

- EnergyAustralia draws the AEMC's attention to the innovative developments on UK network pricing. OFGEM has established robust economic principles for the efficient allocation of costs to network users.

6.2 Transmission pricing arrangements

The commission invites comment on whether it should be seeking to simplify and clarify the transmission pricing objectives and principles in the course of the Review.

Transmission pricing objectives should be reviewed and where possible an indication given of their relative importance. As commented earlier, the revenue and pricing objectives and principles in the Rules need to be streamlined and aligned with the national electricity market objective. The AEMC should also incorporate the content of the Productivity Commission's well thought out high-level pricing principles as a sound economic guide to revenue and pricing principles.

Cost reflective pricing would imply that prices for the network should reflect the marginal cost of network provision. However, Short Run Marginal Costs are not appropriate for pricing infrastructure with a service life of 40 years or more. Thus, a fundamental principle is that infrastructure costs should, where possible, equate to Long Run Marginal Cost estimates for the network. This applies equally to usage of the network by customers and generators.

6.3 Range of charges

The commission invites comment on whether this Review should address the range of charges set out above.

EnergyAustralia agrees that the review should take into account all of the categories of cost which currently form part of transmission charges. Consideration should be given to whether incumbent generators should be allocated a portion of shared services costs.

Consideration should also be given to the negotiation framework. For instance, the Productivity Commission's pricing principles sanctions discriminatory pricing where it aids efficiency. This should be open to debate within electricity. Any discounts should be recouped from other customers.

The Commission invites comment on whether this Review should consider avoided TUOs rebates.

The issue of avoided TUoS needs to be raised in the Issues Paper. TUoS rebates are a second-best distortion arising from the lack of an appropriate price signal for generators connected to the transmission network.

EnergyAustralia's view is that if the TUoS charging regime is reviewed and an appropriate level of charges to large generators established, TUoS rebates would be unnecessary.

It should be noted that the approach taken to this matter by OFGEM is strongly preferred, both in relation to Generator TUoS charges and the imposition of a charging regime for generators connected to the distribution network.

6.4 Allocation of shared network costs

The Commission invites comment on whether this Review should consider the allocation of shared network costs between users of the transmissions system.

The allocation of shared services needs to be reconsidered in light of the new national electricity market objective and the impact on efficient use and investment of electricity services. In particular, the allocation of a share of costs to generators connected to the transmission network needs to be reviewed for the reasons outlined above.

6.5 Form of shared network use of system charges

The Commission invites comment on whether this Review should consider the methodology(ies) for determining shared network usage charges.

The key issue is the need for national consistency in the allocation methods used by transmission network service provider otherwise distortions may occur among regions.

It is important that TNSPs have clarity as to how they determine usage charges and the use of standard approved software is strongly supported. However, that approach will also need to be supported by a workable negotiation framework where TUoS charges would otherwise result in uneconomic outcomes. Such a regime is currently in place by the ACCC, which correctly places the onus on the customer to prove the discounted charge would be economically efficient.

With regard to the process of cost allocation, as already indicated, transmission charges should reflect the LRMC of the network and in this regard OFGEM's approach for the UK network would appear to give sensible outcomes both for generators and customers. However, the configuration of the Australian National Grid differs markedly from the UK, having regional centres of load and generation and the UK approach may not be directly applicable.

An incremental improvement to the existing TUoS allocation would arise from the use of Modified CRNP (as currently described in the Rules).

Any proposal to change the existing TUoS cost allocation will need to consider the transitional arrangements to apply where changes in TUoS charges would result.

6.6 Structure of charges

The Commission invites comment on whether this Review should consider the degree of flexibility retained by transmission system operators to determine the structure of charges, and whether alternative structures should be considered.

EnergyAustralia believes the current level of flexibility provided by the Rules in determining the structure of charges to be appropriate. The governing principles for pricing are to be set out in the Rules and charge structures should be set with regard to these principles. However, an area for review is rule 6.5.5 regarding the extent of the cap on the change in the customer TUoS usage charge.

Rules were to specify charge structures, this would act to prevent innovative solutions which might arise from the combination of features such as critical peak pricing and load or generator control.

6.7 Inter-regional TUoS transfers

The Commission invites comment on whether this Review should consider inter-regional TUoS transfers.

In principle, prices across the National Grid should be determined without regard to jurisdictional or ownership boundaries. This is currently the case in NSW with the TransGrid and EnergyAustralia networks and this arrangement works satisfactorily.

The AEMC should consider inter-regional TUoS charges. However, in so doing, due regard will need to be paid to the inter-regional payments and price changes which would result

7. Other issues

7.1 Transitional arrangements

The Commission invites comment on the inclusion of any issues that may relate to savings and transitional arrangements.

There are a number of current transmission regulatory decisions or arrangements in place for EnergyAustralia, the impact of which extends beyond the current regulatory period. Consequently, should the AEMC make provisions in the Rules that facilitate savings and transitional arrangements, EnergyAustralia believes that the AEMC should ensure that these regulatory decisions or arrangements are allowed to wind down or expire (unless otherwise agreed with the NSP. In this case, the decision of the AEMC to deviate from the current arrangement should have regard to principles such as NPV neutrality).

For transmission, the most obvious issues requiring “grandfathering” are:

- Any negotiated contracts between the transmission network service provider and network customers need to be recognised.
- Contingency projects: Contingent projects were initially designed by the ACCC with the view to ‘re-opening’ the Decision should such a project be triggered. But the Code, as it existed, did not accommodate the re-opening of a Decision. The ACCC formed the view that the (then) Code did not accommodate an adjustment to the revenue cap

within a regulatory period. In any case, the ACCC established a separate mechanism, to apply to contingent projects that occurs for five years from the commencement of the project (ie., not necessarily aligned to the five year regulatory period). At the next regulatory reset after the end of that five year period, the depreciated value of the contingent project will be included in the RAB. As a result, should one of the contingent projects be “triggered”, there is a need for continuation of the incentive mechanism created, or (with the agreement of the TNSP) an NPV-neutral alternative.

- EnergyAustralia’s transmission business is subject to an S-factor as part of its revenue cap regulation. The S-factor was introduced by the ACCC as part of its NSW and ACT transmission network revenue cap Decision for 2004-09. The S-factor provides a financial incentive to out-perform a single performance measure (transmission circuit availability) which is measured across a calendar year. The financial benefit (or penalty) is applied to the revenue cap allowance of the following financial year, some six months later. The arising lag between the performance measure (based on calendar year) and financial adjustment (based on financial year) creates uncertainty in the final six months of the current regulatory period as to how performance for that six months will affect EnergyAustralia’s revenue cap allowance, if at all.
Ex-ante capex allowance: A significant proportion of EnergyAustralia’s transmission capex for the 2004-09 regulatory period was set under an ex-ante allowance. One of the features of the operation of the ex-ante allowance, as articulated in the ACCC’s Decision on EnergyAustralia’s 2004-09 revenue reset, is that the closing RAB for 2004-09 regulatory period “ *will be set based on the opening RAB and the roll forward value of the depreciated actual capex. This is regardless of whether the sum of the actual capex is more or less than the sum of the ex-ante allowance*”. EnergyAustralia submits that the AEMC note the implications of the operation of the ex-ante allowance and its incentive, as articulated by the ACCC in its Decision, in its consideration of savings and transitional arrangements.
- Discount recovery: Clause 6.8.5 of the Code allows EnergyAustralia, and other TNSPs, to recover from other customers the amount of a discount on TUoS charges on application. Should the application be made after May 2002, the Code requires that discount recoveries are approved at each revenue reset. But in the case where an application was made prior to May 2002, the Code allowed for the ACCC to approve the discount recovery at the time of application. EnergyAustralia’ believes that the discount recovery guidelines be included in consideration of savings and transitional arrangements so as to ensure the grandfathering of discount recovery applications made prior to May 2002.
- Ring-fencing guidelines and the associated waivers. EnergyAustralia’ sought and received a waiver for the ACCC’s transmission ring fencing guidelines. In order to ensure that the provisions for a waiver continue, EnergyAustralia’ is seeking the inclusion of the ring fencing guidelines in the AEMC’s review of savings and transitional arrangements.

7.2 Chapter 5 Issues

2. The commission invites comment on the relevance of each of these rules to this Review and whether there are other Rules which are beyond the scope of this Review but which may be relevant to it.

An important issue that needs to be addressed is consistency between the national electricity law (NEL) and the Rules on the definition of regulatory obligations. The scope of regulatory obligation in the Rules needs to align with the NEL.

Section 16(2)(a) of the NEL provides:

"...the AER, in making a transmission determination, must in accordance with the Rules - provide a reasonable opportunity for the regulated transmission system operator to recover the efficient costs of complying with a regulatory obligation.." In the NEL, "Regulatory obligation" is very broadly defined.

However, the Rules currently only provide for recovery for a more limited set of obligations. For example Clause 6.2.4(c)(2) provides:

(c) In setting a separate revenue cap to be applied to each Transmission Network Service Provider in accordance with clause 6.2.4(b), the AER must take into account the revenue requirements of each Transmission Network Service Provider during the regulatory control period, having regard for:...

(2) any service standards imposed by the Rules which are applicable to the Transmission Network Service Provider, and any other standards imposed on the Transmission Network Service Provider by the AER in accordance with the Rules or by agreement between the Transmission Network Service Provider and the relevant Transmission Network Users;

It is appropriate that the AEMC Review address the issue of recovery of costs relating to the full range of "regulatory obligations" specified under the NEL.

Under the NEL, jurisdictional rules and regulations need to be factored into the consideration of regulatory obligations. The Rules need to allow for the jurisdictional obligations to be factored into regulatory decision-making.

EnergyAustralia is subject to standards of service set by the jurisdiction. Recent changes saw the introduction of new licensing requirements for distribution standards of service. Similar requirements may be imposed by the jurisdiction on transmission services. These obligations need to be factored into revenue requirements as well as ensuring that any obligations imposed by the AER are consistent and not duplicative with the jurisdictional arrangements. Any standards of service incentive regime needs to be aligned with the jurisdictional obligations.

Another issue is that EnergyAustralia maintains that the Regulatory Test is a "rule making" responsibility, and that to ensure proper separation of roles that it should be promulgated by the AEMC and its compliance administered by the AER. This is the consistent governance model of separating the rule-maker (AEMC) from the enforcer (AER).

8. Regulatory procedures

8.1 Guiding discretion – economic regulation of electricity transmission

The Commission invites comment on whether this Review should consider the appropriate balance between discretion and prescription when the AER is making a transmission determination.

- The AEMC needs to raise the question of what issues are appropriate for regulatory discretion and what should be clearly prescribed. This issues goes to the heart of the regulatory risk issue. The greater the regulatory discretion the greater the regulatory risk.

8.2 Procedural requirements for AER decision making

The Commission invites comment on what issues are relevant when considering the process to be followed by the AER in making a transmission determination.

- EnergyAustralia strongly supports the review of the issues raised by the AEMC including the review and establishment of regulatory procedures covering timeframes, processes for review including the propose-respond model, information provision and the circumstances for amending and revoking pricing determinations. The principles of regulatory best practice covered in the Utility Regulatory Forum discussion paper are a start to the criteria for regulatory procedures.
- Of particular interest to EA is the development of a propose-respond model to address short-comings in the existing regulator-determined model.
- The propose-respond model places a clear responsibility on the access provider to propose an access arrangement, including pricing, that is consistent with the objective of the Rules (in this case the NEM objective). As has been tested in the context of the national gas access regime, the regulator is then required to accept the proposed access arrangement, if, it is inconsistent with the objectives of the access regime. This model applies to the gas industry and has been recently adopted in Western Australia. In order to be effective, the propose-respond model must be supported by clear access to independent merits review of the regulator's decision not to approve the service provider's proposed access arrangement as filed (this issue however, is outside the scope of the AEMC's review).
- There needs to be a responsibility on the AER to provide clear reasons for its decisions to demonstrate how proposals were considered.