



Chris Harcher MP
Minister for Resources and Energy
Special Minister of State and
Minister for the Central Coast

V121/1603

RECEIVED
18 MAY 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

I am writing concerning the Australian Energy Market Commission's (AEMC) Directions Paper for the Economic Regulation of Network Service Providers Rule Change process.

Discussion about this proposed rule change is taking place at a time of unprecedented increases in the cost of electricity. Aside from the more recent carbon tax and green scheme cost imposts, increasing network costs have also been a contributor to the electricity price pressures on households and businesses.

It is therefore timely to look at both national and state policy settings to determine what actions can be taken to appropriately balance the interests of consumers and network businesses.

As you would be aware, to reduce the impact of electricity price rises on households the NSW Government has already implemented a number of measures. In regards to the network businesses, the NSW Government has:

- commenced the reform of the State's three distribution businesses to place downward pressure on network charges which contribute to around half the total cost of electricity bills;
- implemented a new dividends policy that will cap dividends from the NSW Government owned electricity businesses at existing forecast levels; and
- commissioned the Australian Energy Market Commission to review the electricity network licence conditions to halt any over-spending which may be forcing up power prices.

The Australian Energy Regulator's rule change proposal raises important questions about the national policy settings.

It is recognised that returns on capital are the single most significant component of electricity prices and the Standing Council on Resources and Energy has also commissioned work in this area.

As the AEMC has indicated in the Directions Paper, the return on capital can contribute approximately 50 to 70 percent of the network costs paid by end use consumers. I am aware that there is debate amongst stakeholders as to whether or not the appeals process is sufficiently broad to take into account all factors. However, given the importance of the return on capital on final prices, it is important that any network appeals in regards to the determination process clearly takes into account all factors which contributed to the final cost of capital decision.

It is pleasing to see that you are considering options for how the National Electricity and Gas Rules could be amended so that when a network appeals a weighted average cost of capital decision all factors must be taken into consideration.

It is important that NSW electricity businesses continue to invest in their networks to ensure secure and reliable supplies for the growing requirement of NSW customers. However, the amount of investment must be at efficient levels that do not impose unnecessary costs on consumers. Over-investment in the network (also known as 'gold plating' of the network) needs to be properly identified and addressed. In the network price and revenue regulatory framework, protections for consumers stem from ensuring an efficient level of investment by network businesses, effective communication between the regulator and the network businesses, and the opportunity for effective consumer engagement in the regulatory process.

In this context, the NSW Government considers that strengthening existing processes to support consumer engagement as well as strengthen the network/regulator relationships and information flows is critical.

The regulation and operation of electricity and gas network businesses is a complex area and an ongoing strong relationship between the Australian Energy Regulator and network businesses, where communications are ongoing is important to ensure that all parties have a clear understanding of the regulatory process and network business operations so that efficient investment decisions result in the sound outcomes for consumers. Ongoing communication will assist in developing better relationships and information flows.

Should you have any further enquiries about this matter, I have arranged for Ms Katharine Hole, Executive Director National Policy and Sustainability, Division of Resources and Energy to assist you. Ms Hole may be contacted at the Department's Sydney Office on (02) 8281 7371.

Yours sincerely



2.5.12.

Chris Hatcher MP