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National Electricity Market Campaign

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Total Environment Centre

Submission to the AEMC

National Electricity Amendment (Total Factor Productivity for Distribution Network Regulation) Rule 2011

Draft Rule Determination

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TEC's Support for Reform of the Current Model of Regulation

TEC has long been an advocate for reforming the building block approach to regulation. TEC is primarily concerned that the building block approach, in linking Distribution Network Service Provider (DNSP) profits to the level of assets owned, encourages inefficient investment decisions. Specifically, DNSPs are not incentivised to pursue non-network alternatives to meeting demand.

TEC is therefore receptive to the consideration of alternative models. TEC commissioned a report in 2008¹ that considered the Total Factor Productivity approach to distribution network regulation (TFP). While the report noted that TFP could lessen the problem outline above, and also the problems associated with the ex-ante capex approach, it concluded that the persistence of a price cap could negate any benefit resulting from the implementation of TFP.

TEC agrees with the AER² that TFP could be “less intrusive” and would require less “detailed, firm-specific cost forecasts”. TEC is concerned that the current regulatory framework is weighted heavily in favour of Network Service Providers (NSPs). Aspects of this bias, such as the fact that NSPs have better information than the regulator, are compounded by the current approach, where a large amount of NSP-specific data is required to make revenue determination. TFP could help to eradicate some of this bias. On the other hand, TFP has the potential to make revenue determinations less transparent. TEC therefore urges caution in adopting a new regulatory approach and therefore welcomes the AEMC's decision to request that the MCE consider TFP in more detail before proceeding with a rule change.

Some of the issues regarding economic regulation are currently being considered by the AEMC through the Economic Regulation of Network Service Providers rule change proposal, to which TEC will make a submission in due course.

TEC's Support for further Consideration of TFP

While TEC supports reform of the current approach, TEC is not yet convinced of the efficacy of TFP in achieving efficiency as compared to other approaches. TEC agrees with other stakeholders that the infancy of TFP necessitates a more detailed consideration of the options and a more detailed rule change proposal.

TEC notes that a report, commissioned by the Utility Regulators Forum in 2002, stated, “one of the first steps in further developing a TFP approach is to review the methodology and data requirements associated with calculating a TFP index and to consider the materiality of associated issues”.³ However, this report also noted that while the setting of a TFP methodology would ideally be made as part of the TFP design, debate as to methodology tends to occur simultaneously with

¹ Headberry Partners and Bob Lim & Co, ‘Does Current Electricity Network Regulation Actively Minimise Demand Side Responsiveness in the NEM?’ (Total Environment Centre 2008).

² AER, Submission to Rule Change Proposal.

³ Farrier Swier Consulting, ‘Comparison of Building Blocks and Index-Based Approaches’ (Utility Regulators Forum 2002) available at <http://www.accc.gov.au/content/item.phtml?itemId=332190&nodeId=fd10fa1b3ce365c647a752ea087ebd96&fn=Comparison%20of%20Building%20Blocks%20and%20Index-Based%20Approaches.pdf>.

implementation in an organic manner. There is therefore a need to maintain some flexibility in approaching novel modes of regulation.

The Need for Improved Data in the NEM

TEC fully agrees with the AEMC and other stakeholders with regards the need for more complete data on which to base TFP.

During ongoing research work for a current project, TEC has encountered a number of difficulties with sourcing accurate and detailed information regarding a range of aspects of the functioning of the NEM:

- information used by AEMO to ascertain if the NEM is operating in a secure fashion is not publicly reported; there is currently no reported direct system wide measure for security;
- the NEMs unserved energy indicator (USE) provides no information about the frequency of supply interruptions or the impact of any interruption;
- lack of data or inconsistent data relating to the protection of vulnerable consumers; and
- lack of a standardised indicator of the level of competition in the NEM.

There is, it seems, a general lack of consistent data collection and dissemination in the NEM. In this regard, TEC is pleased that the AEMC has noted the data deficiency in the context of TFP. TEC hopes that data deficiencies in other areas will also, in time, be rectified.

TEC looks forward to further engaging in the discussion of TFP once the MCE has initiated a process for considering the approach in further detail. TEC also encourages the AEMC to investigate data deficiencies in the NEM and looks forward to assisting in that process.