

Australian Energy Market Commission

Public forum

Review into the use of Total Factor Productivity for the determination of prices and revenues

Wednesday, 11 February 2009
Melbourne Airport Hilton

Agenda

1.00 pm	Opening remarks Dr John Tamblyn, AEMC Chairman
1.15 pm	Overview of total factor productivity Dr Denis Lawrence, Economic Insights
1.45 pm	Overview of the AEMC's issues paper Eamonn Corrigan, AEMC
2.30 pm	afternoon tea
2.45 pm	International experience of total factor productivity Dr Denis Lawrence, Economic Insights
3.10 pm	Comments on total factor productivity Peter Clements, Victorian Department of Primary Industries
3.30 pm	Comments from interested parties APIA EUAA
3.45 pm	Open discussion
4.15 pm	Concluding comments on the review process AEMC



Summary of Discussion

On 11 February 2009, the Australian Energy Market Commission (Commission/AEMC) held a public forum to present the key issues emerging from the Commission's review into the use of Total Factor Productivity (TFP) for the determination of prices and revenues (TFP Review). The Commission also sought to obtain views and opinions from stakeholders on the Commission's Framework and Issues Paper (as published on 12 December 2008) and related issues at the forum.

The forum commenced with Commission's Chairman Dr John Tamblyn welcoming all participants and presenters. In a brief presentation, he placed the forum in the overall context of the Commission's TFP Review and invited all participants to address any TFP-related concerns, views and opinions in the course of the forum and/or through the formal submission process (submissions on the Framework and Issues Paper are due 27 February 2009).

Dr Denis Lawrence (Economic Insights) then provided a presentation giving an overview of TFP and its use in energy network regulation.

The third presentation was given by Eamonn Corrigan (AEMC Director). This highlighted the key criteria relevant to the TFP Review and gave an overview of the issues that are discussed in the Commission's Framework and Issues Paper.

The next scheduled item of Dr Denis Lawrence's presentation on the overseas experience with TFP in energy network regulation was not given since it appeared more appropriate to allow extra time for the open discussion. However, handouts of this presentation were provided to participants.

The forum continued with key interested parties providing presentations and brief comments about TFP and the Commission's TFP Review. These were:

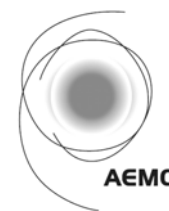
- Peter Clements, representing the Victorian Department of Primary Industry's (DPI), providing information on the DPI's approach to its TFP Rule Change Proposal. It was also noted that:
 - TFP is a regulatory tool that has, in DPI's view, advantages over the building block approach
 - the Victorian electricity distribution service providers can be described as being in a 'steady state' and ready for the application of TFP
 - some aspects of applying TFP may not need specification in the rules – AER guidelines will be sufficient
- Chris Harvey provided a presentation on behalf of the Australian Pipeline Industry Association (APIA). In addition, it was noted that:
 - The challenges of the current financial and economic climate and climate change will affect the applicability of TFP

- TFP is inconsistent with pricing and revenue principles in the National Electricity Law (NEL) as TFP is based on 'past costs' and TFP does not permit revenue to cover future costs
- Roman Domanski from the Energy Users Association of Australia (EUAA) presented EUAA's views. These included:
 - energy users consider that the building block approach has failed to live up to its expectations
 - the issues that have resulted in the failure of building blocks are broader than what can be addressed by just the revenue determination tool used by the regulator.
 - comparative benchmarking is one tool that should be used more by regulators

A copy of all presentations can be found on the Commission's website.

The following key issues were raised in the open floor discussion:

- The implications for using TFP for the regulated asset bases of the service providers were discussed. Concern was expressed that using TFP would effectively provide an opportunity for a revaluation of the assets. It was acknowledged that the valuation of capital is important for TFP and must be considered in light of the desire to maintain the appropriate financing levels. It was also noted that the revenue and pricing principles in both laws state that regard should be had to the established regulatory asset base.
- The forum also discussed whether the inclusion of 'energy' or 'throughput' as an output for TFP calculations would inappropriately encourage service providers to move away from energy efficiency activities. However, it was also noted that relying on a measure of capacity may encourage the building of capacity that may not be required.
- A number of stakeholders (AER, Energy Australia, Energy Networks Association and ACCC) expressed the view that the problems with the current building block approach should be identified at the first stage of the Commission's review. Solutions for those problems, which may include TFP, should then be sought.
- It was noted by the New Zealand Commerce Commission that discussion on whether to use TFP or the building block approach didn't really take place in New Zealand at the time the regulatory regime for energy was established. Factors such as the industry characteristics encouraged the adoption of TFP. However, under the new framework service providers will be able to seek a 'customised' pricing schedule. It is expected that this would rely on a building block approach.
- The Essential Services Commission of Victoria (ESC) referred to its past work on TFP. All relevant information is available from the ESC website. The ESC also opined that TFP should be looked at in a much broader light and not just in terms of regulating networks. That is, the Commission's review and rule change processes may not be the most appropriate way of developing TFP. In addition, the ESC questioned whether the



Commission could successfully complete its review in 12 months. Notwithstanding, the ESC expressed support for making TFP available to service providers and allow it to evolve.

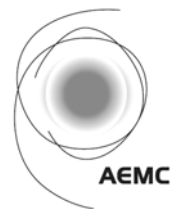
- Participants (including Energy Networks Association, EnergyAustralia and Energy Action Group) discussed the issues surrounding significant changes in capital expenditure programs for service providers. In particular, expenditure related to increasing system security and climate change policies. Dr Denis Lawrence noted that these particular expenditures are not presently incorporated in the current TFP models. However, work is (and should) be undertaken to enhance the output specifications. He noted that these issues are under consideration in New Zealand for its TFP program. Further thinking is required on these matters.
- EnergyAustralia expressed particular concerns about the value of the use of TFP if this approach does not take into account planning standards, replacement issues and service standards, as they tend to make up 50% to 60% of its capital expenditure program.
- The ACCC suggested that it should be acknowledged that the building blocks approach was established in light of a desire to regulate newly privatized businesses. However, it doesn't manage regulation of government owned enterprises very well. In this sense, comparative benchmarking may be useful and is worth considering further.

At the conclusion of the discussion, Dr John Tamblyn thanked all for participating in the forum and encouraged interested parties to continue their participation in the TFP Review by lodging a submission.

Participants

The Commission invited all industry stakeholders to attend the Public Forum. The following attended the forum.

Name	Surname	Company
Vicki	Brown	Energy Networks Association
Tim	Kane	Energy Networks Association
Jason	Cooke	Country Energy
Natalie	Lindsay	Country Energy
Jean-Marc	Kutschukian	Independent Pricing and Regulatory Tribunal
Craig	de Laine	Envestra
Lionel	Chin	McLennan Magasanik Associates
Sebastian	Roberts	ACCC.
Victor	Petrovski	PB World
Brent	Cleeve	CitiPower & Powercor Australia
Stephanie	McDougall	CitiPower & Powercor Australia
Catherine	Webber	NSW Department of Water and Energy
Paul	LeFavi	NEMMCO
Paul	Fearon	Essential Services Commission, Victoria
Jon	Hocking	Integral Energy
Mark	Pedler	Department for Transport, Energy and Infrastructure
Son	Vu	EnergyAustralia
Catherine	O'Neill	EnergyAustralia
David	Healy	NZ Commerce Commission
Warwick	Tudehope	Jemena
Peter	Brennan	Ergon Energy
Steven	Hamilton	AER
David	Bentley	ElectraNet
Simon	Appleby	ElectraNet
Denis	Lawrence	Economic Insights
John	Kain	Economic Insights
Chris	Harvey	APIA
Paul	Callander	APA Group
Peter	Clements	Department of Primary Industries, Victoria
John	Dick	Energy Action Group



John	Tamblyn	AEMC
Anne	Pearson	AEMC
Eamonn	Corrigan	AEMC
Leen	Van den Eynden	AEMC
Meredith	Mayes	AEMC
Darryl	Biggar	ACCC
Daniel	Gay	Department of Primary Industries, Victoria
Craig	Madden	AER
Andrew	Ley	AER
Su	Wu	ACCC
Roman	Domanski	EUAA