

Review into use of total factor productivity methodology for the determination of prices and revenues

Draft Report Stakeholder Workshop -29
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Opening Remarks

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Background - objective and scope to the Review

Purpose of the Review

- advise the MCE whether, at this stage of market development, giving business the **option** to use a TFP based approach to set allowed revenue/price would contribute to either the NEO and/or NGO
- if so, what amendments to the NER/NGR should be made to enable the use of a TFP approach and under what circumstances

Scope

- Gas and electricity, both transmission and distribution sectors

Outputs

- Comprehensive assessment of the merits and disadvantage of a TFP methodology compared to the current building block approach in theory and in practice
- Improve stakeholders understanding of TFP
- As part of the AEMC market development role, there is a role to continue assess what is the most appropriate form of regulation for networks

TFP Review –Process has been slow but constructive

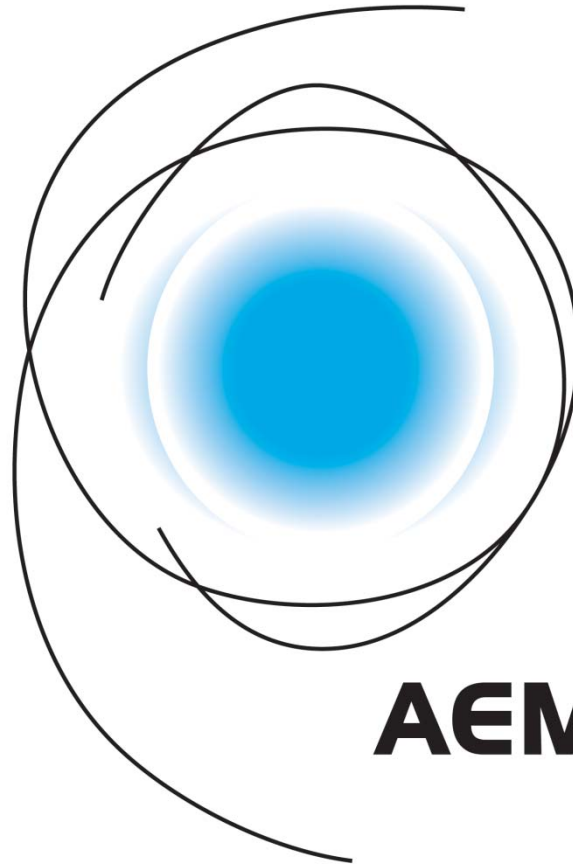
- 23 June 2008 – Victorian Minister for Energy and Resources submits rule change proposal to permit TFP methodology in electricity distribution
- Oct 2008 – AEMC parks rule change assessment and initiates wider review into the possible use of TFP methodology
- 12 Dec 2008 – TFP Issues and Framework Paper published
- June 2009 – Release of supporting consultancy reports on data availability and incentives
- 23 July 2009 – Perspectives on the Building Block Approach published
- 28 August 2009 – Release of TFP Design Discussion Paper
- Sept/Oct 2009 – Industry workshops on how to design a TFP methodology
- 17 December 2009 – Release of Preliminary Findings Paper
- 29 June 2010 – Release of Modelling comparing TFP methodology with building blocks approach

Recap on key points arising from submissions to Preliminary Findings Paper

- Network business not convinced about additional economic properties of TFP. Hard to assess without understanding complete design of methodology. Especially to understand how Po will be determined
- Concern whether a TFP index could accurately reflect the productivity of a network business, especially if reliability and security of supply measures are excluded.
- Transmission businesses want the AEMC to make a definitive statement that TFP should not be applied to transmission regulation
- Some disagreement on whether there is a need for a TFP reporting requirement to be specified in the Rules
- Most stakeholders advise against drafting of detailed Rules at this stage
- General support for looking further into alternative options to reforming the building block approach and also incorporating outcomes of OFGEM's RPI-X@20 Review. Consider this prudent before any final decision on TFP. Caution against regulatory change for change sake as this increases uncertainty

Work since preliminary findings

- Develop our thinking on the appropriate Po methodology
- Commissioned Economic Insights to test practical application of TFP against current building block approach. Objectives where to:
 - Test TFP against a range of reasonable scenarios using Building Blocks as a counterfactual
 - Develop understanding of the incentive properties of a TFP methodology
 - Provide a working model for stakeholders and to assist in further policy debate and design
- Further consideration on how Rules implementing TFP should be drafted



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