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Our Ref:

Dr John Tamblyn
Chair
Australian Energy Market Commission
PO Box H166
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22 March, 2006

Dear Dr Tamblyn

Transmission Services Rules Proposal

The Public Interest Advocacy Centre (PIAC) has welcomed the opportunity to participate in the process of designing new arrangements for the economic regulation of electricity networks. Unfortunately the level of resources available to PIAC as a community organisation is very limited by comparison with the size and complexity of the issues being considered. Accordingly, at this point we are able to provide only brief comments on the Commission's proposed changes to Chapter 6 of the National Electricity Rules (the Rules).

The Commission may be interested to know that PIAC and another end-user body have made a joint application to the Advocacy Panel for funding based on the Commission's proposal. This funding would be used to permit a small number of community groups to obtain independent advice on the contents of the proposal and their likely impacts on small volume consumers. We hope that this will enable us to provide more detailed and considered comments to the Commission in the near future.

In the meantime, PIAC believes the Commission may find it useful to receive an indication of which elements of the proposal we believe warrant particular attention. These include the:

- success of the Commission in providing greater certainty to stakeholders while retaining an appropriate exercise of discretion for the regulator (the Australian Energy Regulator);
- treatment of risk in the proposed changes to the Rules given our strong view that electricity networks face very low commercial risk;
- difficulty for consumers in obtaining clear information about the investment decisions being made by electricity networks and the appropriate level of cost recovery through prices charged to end-users;

- opportunity given to network businesses to determine the level of CAPEX both prior to and during each regulatory period;
- concern with the effectiveness of the efficiency incentive, particularly given that the proposals for CAPEX appear to create far stronger incentives; and
- reasonableness of the parameters proposed for determining the cost of capital.

PIAC will endeavour to provide more detailed views on these issues, particularly in relation to CAPEX and the cost of capital. In the interim, however, we can offer a brief expansion of our concerns with the proposed changes to the Rules around CAPEX.

We understand that the Commission has not drafted the proposed changes to the Rules in order to produce outcomes of particular changes in the level of investment in networks or end-user prices. On the other hand, our view is that at present and for the foreseeable future increases in network CAPEX (both transmission and distribution) are a major factor in the increasing cost of electricity to consumers. As a consequence we are concerned that the changes to the Rules proposed by the Commission may create a greater likelihood of such outcomes.

The proposal would give to the networks (limited to transmission entities at this stage) even greater scope to determine their CAPEX needs than exists at present. That is, rather than imposing on the network businesses an obligation to show the need for and efficiency of their proposed spending the proposed Rules appear to shift the obligation to the regulator to demonstrate the contrary case.

In our view this does not provide the economic regulator with an appropriate degree of discretion. Nor does it assist the regulator to address the inherent problem of information asymmetry. Indeed, given that much of the debate in the national market at present places enormous emphasis on ‘keeping the lights on’ it may be that the regulator will have little choice but to accept the forecast CAPEX submitted by the network businesses.

We note it is proposed that the regulator would retain discretion around the extent to which the forecasts meet a series of tests including whether:

- a proposal satisfies the regulatory test;
- the forecast is based on reasonable estimates of demand; and
- the costs indicated are reasonable in meeting any regulatory obligations.

However, we note that the regulatory test sets out a very broad set of requirements. That is, it tends to establish parameters within which proposed capital spending must fit but is not clear on how much rigour is to be imposed on proponents in observing those restrictions. For example, the regulatory test relies on measures such as what is ‘commercially feasible’ and on ‘reasonable’ scenarios and methodologies. Again, in our view these hurdles place a burden on the regulator rather than the network businesses. Certainly it is unlikely that end-users will be in a position to challenge the CAPEX forecasts under this framework.

In our view these concerns are amplified by the proposals for dealing with CAPEX during each regulatory period. The proposal to roll-forward the regulated asset base (RAB) to incorporate the CAPEX expended during each year of the regulatory period could have implications for the rate at which consumer prices for electricity rise in the future – that is, the shape of the ‘price path’. This matter will be commented on in greater detail in our forthcoming submission.

More importantly, PIAC is concerned at the possible impact on prices of the terms by which network businesses are proposed to be able to re-open the determination of the revenue cap. In principle a mechanism for a re-opening is appropriate as a reality check that can protect the interests of both the businesses and end-users. Indeed, this mechanism may be of greater benefit than a light-handed approach to forecasts of CAPEX. However, the grounds for securing a re-opening, as proposed, again represent a shift in the onus to the regulator to determine, on broad grounds, that additional CAPEX is not appropriate.

Any of these steps in the treatment of CAPEX could be argued to be reasonable and prudent. Our view is that, when taken together, the proposed changes to the Rules around CAPEX conjure a scenario where end-users will face repeated price rises with few opportunities to ensure that an appropriate balance is being struck between the interests of consumers and the network businesses.

We look forward to being able to give the Commission more considered views on these matters in the near future.

Yours sincerely
Public Interest Advocacy Centre Ltd

A handwritten signature in black ink, appearing to be 'JH' followed by a long, sweeping horizontal line.

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Senior Policy Officer

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