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Our Ref: P06/318

Dr John Tamblyn
Chair
Australian Energy Market Commission
By email to submissions@aemc.gov.au

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Dear Dr Tamblyn

Proposed National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006

The Public Interest Advocacy Centre (PIAC) is pleased to provide the following comments on the draft Rules for the economic regulation of transmission services. This submission is intended to provide the Commission with some clarification of the points PIAC has raised previously in its preliminary response to the draft proposal for changes to the Rules.

PIAC is an independent, non-profit law and policy organisation that identifies public interest issues and works co-operatively with other organisations to advocate for individuals and groups affected. PIAC is funded by the New South Wales Government through its Utility Consumer Advocacy Program to represents the interests of NSW consumers, and particularly low income and disadvantaged residential consumers, in energy and water markets. The effective economic regulation of Transmission Network Service Providers (TNSPs) contributes to consumer outcomes in the national energy market. While transmission costs constitute a comparatively small proportion of residential electricity bills, supply augmentation and non-network investment decisions made in the transmission network have significant downstream impacts on other areas of the energy market, such as the market price of wholesale energy.

National Electricity Market Objective

PIAC is mindful of the aim prescribed for regulation of the national electricity market of delivering consumer benefit. As the Commission is aware, PIAC and many of our community sector counterparts take a very broad view of how consumer benefit should be understood. That aside, however, it seems clear to us that consumer benefit is not set in stone. Changed circumstances in the community as well as changes in external factors on the electricity industry have the potential to alter significantly the understanding of what consumer benefit means.

PIAC therefore wishes to commend the Commission for its efforts in seeking to achieve an appropriate balance between certainty for stakeholders and discretion for the regulator. We note there has been discussion already about the extent to which the Commission should rely on codification and of the differences between giving guidance to the Australian Energy Regulator (AER) in the form of principles and constraining its discretion through the use of more prescriptive rules. In principle we do not have concerns with the attempt by the Commission to strike this balance. However, in some specific instances we believe it would better serve the interests of consumers for the proposal to set out somewhat different degrees of discretion.

Our view remains that it is desirable for the regulator to have a considerable degree of discretion. In part this is because such an approach should enable regulators to take a less conservative stance when making decisions. For example, the proposal for some flexibility around the calculation of the weighted average cost of capital (WACC) for future regulatory periods should reduce the likelihood the regulator (either the Commission or the AER) will err on the side of caution and introduce a higher value for WACC than might otherwise be reasonable.

The mantra of 'keeping the lights on' is far too broad to reflect the complexities facing the industry and consumers. Thus we place a considerable priority on regulators, rather than particular stakeholders such as the regulated businesses, retaining an appropriate level of discretion.

Codification of WACC Parameters

Among the areas where we are concerned about too much prescription are the proposed Rules setting the equity beta and the cost of debt for Transmission Network Service Providers (TNSPs). The decision to codify not the methodology but the value creates some regulatory tension. A fixed value parameter can address the Commission's stated goal of regulatory certainty but risks undermining the equally important goals of efficient investment and avoiding the extraction of monopoly rents.

PIAC and other community stakeholders are concerned to ensure that the nominated values reflect these goals. That is, PIAC expects that the Commission would take a less conservative stance in order to balance these priorities. We further note the administrative benefit of having the parameters fixed for a series of AER determinations over the short-term, rather than enabling lengthy, costly and complex debate at every transmission revenue determination. However, this remains contingent on values being set in the current and future five-year periods to reflect appropriately the relatively low commercial risk facing TNSPs.

Research commissioned by the AER as part of its submission to the draft Rules confirms that a BBB rating stands well below the average debt rating for the TNSPs. PIAC notes with concern the strong view put forward by the AER and other stakeholders that a BBB debt rating is too conservative. While the Commission has chosen to reflect on recent regulatory decisions to establish suitable parameters, the recent and generous expenditure patterns of TNSPs suggests that the fixed value need not demand a conservative estimate on the cost of debt.

It is equally concerning that so little debate is taking place with respect to the proposed equity beta value. PIAC is not in a position to make recommendations regarding the level at which the equity beta should be set. However, past considerations of an appropriate equity beta value have called on extensive research and analysis of Australian and international markets. The concerns about removing regulatory discretion on the equity beta have not been alleviated through the Rule change process.

PIAC's view is that both the equity beta and the costs of debt remain areas where more robust investigation is needed. In particular PIAC considers that the values chosen for these factors are far more conservative than could be justified on the basis of the real commercial risk faced by these businesses.

Promoting Efficient Investment

In its previous submission to the AEMC, PIAC expressed its strong view that examination of investment decisions by TNSPs ought to be undertaken on an *ex ante* basis. PIAC remains concerned that the proposed Rule, specifically the *ex post* review of overspends, provides insufficient incentive to undertake efficient investment and pursue least cost approaches to network constraints. The proposed combination of regulatory mechanisms weighs the regulatory process in favour of the networks pursuing capital investment with only a weak review in terms of market and consumer benefit.

The regulatory benefit available to generate a return of capital through the Regulatory Asset Base (RAB) must support the broad aims of the regulatory model. PIAC is therefore unclear of the purpose served by an *ex post* review of overspends in the context of an effective incentive-based regulatory regime.

We note the TNSP's view that the *ex post* review enables sufficient discretion to account for changing circumstances during the regulatory period which may contribute to an investment overspend. However, PIAC notes that the proposed re-opening mechanism allows major investment events to trigger a review of the revenue cap. Additionally, the automatic pass through takes consideration of other external factors, such as regulatory and safety requirements, which could not be factored into the opening capital expenditure program. These mechanisms reflect the 'lumpy' investment profile of transmission networks as well as the highly regulated nature of the services provided by TNSPs.

PIAC submits that there is sufficient flexibility available to TNSPs through these mechanisms to enable efficient investment in transmission infrastructure in the absence of an *ex post* review of overspends.

The combination of *ex ante* reviews with *ex post* reviews, will contribute to greater price uncertainty for end-use consumers. If the AEMC determines to pursue an *ex post* review to allow for the networks to respond to investment overspends it must be rigorous in both process and content. The statutory goal of long-term consumer benefit needs to be satisfied in a manner that is transparent to consumers.

Yours sincerely
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