



**Australian Energy Regulator**

**Submission**

**Australian Energy Market Commission**

**Review of the Electricity Transmission Revenue and Pricing Rules**

**Initial Consultation: Scoping paper**

**August 2005**

## Introduction

The Australian Energy Regulator (AER) is responsible for regulating the revenues of transmission network service providers (TNSPs) in the National Electricity Market (NEM). As the AEMC's review of chapter 6 is directly relevant to the AER's role as transmission revenue regulator, the AER welcomes this opportunity to comment on the scoping paper. The AER has largely commented on the aspects of chapter 6 that it administers, namely the regulation of transmission revenues, but has also commented on the consistency between transmission and distribution regulation. The AER has not commented on the pricing rules which form part of the scoping paper. However, the AER is supportive of splitting the review process between transmission pricing and revenue regulation, and extending the timeframes for a review of pricing.

The aims of chapter 6 are amongst other things to establish an "incentive-based regulatory regime" which "fosters an efficient level of investment" and "efficient operating and maintenance practices". Assessing the extent to which these objectives have been met is a complex task, but there is now considerable data on regulatory outcomes. So far we have seen high transmission investment levels coupled with price stability and evidence of improved operating efficiency and service standards.<sup>1</sup> However there may be scope for improvements in the efficient provision of transmission services.

There are a number of problems with chapter 6. The chapter lacks focus and clear direction to the regulator. There are over 50 objectives and principles which have led to repetitive and overlapping objectives. Further, the Australian Competition and Consumer Commission's (ACCC) experience in administering chapter 6 suggests there is a case to re-visit some of the underlying principles, for example in relation to asset valuation. The AEMC's review provides a timely opportunity to address these issues.

As required by chapter 6, the ACCC has developed a detailed framework for the regulation of transmission services in its Statement of Regulatory Principles (SRP), guidelines (including service standards guidelines, ring fencing guidelines and information requirements guidelines), the regulatory test and its financial model (the Post Tax Revenue Model). Given the extensive consultation involved in developing these regulatory instruments the AER will be adopting these principles and guidelines as its initial regulatory framework. A copy of the AER's Compendium of Regulatory Principles will be forwarded to the AEMC shortly.

The AER encourages the AEMC to have due regard to the detailed regulatory approach set out in the compendium and to focus on aspects of chapter 6 which are deficient rather than opening up matters that are relatively settled.

This submission addresses key aspects of the scoping paper, including its overall objectives and focus, issues covered by the SRP and alternative forms of regulation such as productivity based approaches.

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<sup>1</sup> See the Australian Competition and Consumer Commission's annual regulatory reports, *Transmission Network Service Providers Electricity Regulatory Report for 2002/03* and *Transmission Network Service Providers Electricity Regulatory Report for 2003/04*.

## Review objectives

The AEMC's scoping paper proposes that the central issue for the review be to:

*'...assess the scope and form of transmission regulation that will best contribute to the achievement of the NEM objective - an efficient, safe and reliable electricity system.'*<sup>2</sup>

The report to the Council of Australian Governments from the Ministerial Council on Energy (MCE) entitled "Reform of Energy Markets" is relevant to considering the overall focus and objectives for the review. The MCE considered that "the current regulatory arrangements have delivered high levels of transmission system reliability."<sup>3</sup>

The main area of concern was a perception that transmission constraints had persisted and these could be mitigated by additional transmission investment. Addressing transmission constraints requires consideration of complex issues such as the form and application of the regulatory test, definition of regional boundaries, the representation of constraints and planning arrangements. Decision making on these matters lies largely outside the Chapter 6 review.

The MCE findings lend support to the need for a focused and targeted review of Chapter 6.

The focus of the review seems entirely appropriate, but more specific objectives would also help the AER and other interested parties in providing comments. As a starting point it would be useful for the review to identify and address specific concerns with the existing framework.

The AER considers significant gains are possible by improving the clarity and operation of the current arrangements. This would involve identifying and addressing existing weaknesses, gaps and anomalies in Chapter 6. In particular, the AER supports reflecting the primacy of the NEM objective through the rationalisation of overlapping and repetitive objectives and principles currently found in Chapter 6. At present there are in excess of 50 principles, objectives and other matters to which the AER must have regard. There is, for example, duplication in relation to the following objectives and principles:

- efficient investment
- regulatory certainty, consistency and transparency
- issues of equity and
- the promotion of competition in upstream and downstream markets.

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<sup>2</sup> Australian Energy Market Commission, *Review of the Electricity Transmission Revenue and Pricing Rules, Initial Consultation: Scoping Paper*, July 2005, p 3

<sup>3</sup> Ministerial Council on Energy, *Report to the Council of Australian Governments: Reform of Energy Markets*, 11 December 2003, section 7.2

## **AER's Statement of Regulatory Principles (SRP)**

The scoping paper canvasses a broad range of transmission regulation issues already covered in the AER's SRP. It states that it will consider the following issues covered by the SRP:

- use of CPI-X building block approach
- valuation of assets
- the relative merits of the ex-post and ex-ante approaches to determining capital allowances
- treatment of depreciation
- cost pass through mechanisms
- rates of return on assets and
- incentive mechanisms for operating and capital expenditures.

The paper also discusses a number of procedural matters covered by the SRP including:

- timeframes for AER transmission decisions
- the procedural model for AER transmission decisions (i.e. a propose-respond or apply-assess model)
- treatment of confidential information by the AER
- requirements/powers for the AER to publish regulatory guidelines and
- circumstances under which the AER can revoke or amend a determination

The SRP was developed through extensive industry consultation and met with broad industry support. The TNSPs in their submission in response to the Exposure Draft of the National Electricity Rules noted that:

*“... substantial work has been undertaken by the ACCC in consultation with the industry in the finalisation of the ACCC's Statement of Regulatory Principles (“SRP”).*

*The TNSPs consider that it would be unfortunate if this work were to be overlooked when the review of chapter 6 ... is carried out. If this review were effectively to start afresh this would ignore and waste the significant effort already undertaken by many industry stakeholders with the ACCC.*

*Therefore ... the TNSPs suggest that ... the AEMC, in making the rules provided for by section 91 of the NEL ... reflect the principles underlying the SRP.”<sup>4</sup>*

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<sup>4</sup> Electricity Transmission Network Owners (ElectraNet, Powerlink, SPI PowerNet, Transend, TransGrid), *Response to the Exposure Draft of the National Electricity Rules - Submission to the Ministerial Council on Energy Standing Committee of Officials*, 1 February 2005, p 7

A key objective of the SRP was the promotion of investment certainty for transmission companies. This initiative received significant support from industry in the development of the SRP. For example, in response to the release of the Draft of the SRP, SPI PowerNet noted that the SRP:

*“...outlines a more consistent, clear and practical framework and process while still allowing appropriate regulatory discretion. Most importantly, it is less backward looking than the previous document, focusing on creating incentives for future investment and operating decisions. In doing so, it removes significant regulatory uncertainty from the TNSPs...”*<sup>5</sup>

The AER encourages the AEMC to take the SRP into account and only re-open issues where significant shortcomings are identified through the consultation process.

### **Economic Regulation of Transmission**

The AEMC must make rules in relation to the mechanisms or methodologies for determining maximum allowable revenue and prices to be applied by the AER as specified in item 20 of Schedule 1 of the NEL. The AEMC questions whether its review should consider alternative approaches to the current CPI-X building block approach to determining allowable revenue. The scoping paper states that:

*“.... The Commission’s intended approach in this Review is to seek to develop Rules that, where possible, are flexible enough to accommodate alternative outcomes from the wider debate on the appropriate market arrangements for transmission”.*<sup>6</sup>

There are a number of alternative approaches that can be used as supplements or alternatives to the current building block approach. These include productivity based approaches that utilise estimates of total factor productivity (TFP) and partial factor productivity. There are other benchmarking approaches that could be utilised. These alternatives may prove to be an improvement over current regulatory arrangements.

The AER supports providing flexibility in the rules to respond to developments in regulatory best practice over time within appropriate parameters defined in legislation and the rules. As a first step the Utility Regulators’ Forum has developed common templates for collection of input and output data required to apply TFP regulation. The AER will collect this data from this year onwards. The AER is committed to undertaking further work on the merits and implementation issues associated with TFP.

Revenue caps for TransGrid, EnergyAustralia, Powerlink, SPI PowerNet, VENCORP, Electranet, Transend and Murraylink will be in operation at the time changes to chapter 6 are introduced. Further, during the course of the review the process for Powerlink’s revenue reset will be underway, with Powerlink’s revenue reset application due to be lodged on 1 April 2006. Both Powerlink and the AER are

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<sup>5</sup> SPI PowerNet, *SPI PowerNet Submission on Draft Statement of Regulatory Principles and Background Paper*, 15 October 2004, p 3

<sup>6</sup> Op cit 2, p 18

already devoting significant resources into this process. One of the issues the AEMC should consider is whether transitional arrangements for these decisions are required.

### **Economic Regulation of Electricity Distribution**

The regulatory framework established by chapter 6 is largely identical for both distribution and transmission. Reflecting this there is a considerable consistency of approach between the AER and jurisdictional regulators, and over time there has been convergence in the approach of the various regulators.

To the extent practicable, an objective of the review should be to maintain consistency in terms of the regulatory objectives, principles and arrangements for transmission and distribution regulation.

While there are some differences between the two sectors, the review could consider whether and the extent to which differences in the characteristics between these two sectors warrant the application of specific rules to each sector.

The AER notes that the MCE as part of energy reforms has been directed by the Council of Australian Governments to assess:

*“The potential for harmonising regulatory arrangements, removing inconsistencies and integrating networks.”<sup>7</sup>*

The AER encourages the AEMC to take this principle into account in conducting its review.

One way of addressing the issue is to combine the reviews currently being undertaken by the AEMC in relation to transmission and the MCE in relation to distribution. The AEMC has been established as the rules review body and has appropriate expertise to conduct a combined review. The AER will raise the issue with the MCE.

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<sup>7</sup> Op cit 3, p 3.