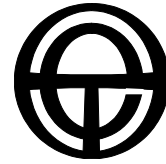


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SUBMISSION

National Electricity Law amendments package

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1. Introduction

Total Environment Centre (TEC) is pleased to be able to participate further in the energy market reform program. We have restricted our comments in this submission to electricity matters and the National Electricity Market (NEM), and those involving public consultation issues. We have focused on those findings and recommendations which we consider problematic, and note that we have submitted prior submissions on many of the issues raised in the electricity amendments paper¹.

In summary, our recommendations in this submission are:

- TEC recommends the additional inclusion of an environmental and a social objective alongside the existing NEM Objective. All three objectives should reside in the National Electricity Law.
- Many recommendations for amendments to the rule change process will create barriers to the participation of consumer and public interest groups.
- TEC recommends a price control model; building block CPI-X methodology; and a revenue cap for distribution.
- If the AER is to select the form of regulation for distribution, the MCE must clarify the details of those forms of regulation to be applied and the process by which the AER will make that decision. This whole area needs considerably more public consultation.
- Incentives should be developed to encourage cost-effective network demand management (DM²). DNSPs should be required to earmark a specific minimum spending level for DM: between 10% and 25% of the projected network capital expenditure should be set aside for cost-effective DM projects, on "use it or lose it" terms. Alternatively a "D" factor system could be applied, as in NSW, which is intended to promote DM by networks through the use of incentives; that is, the DNSP must demonstrate that its DM implementation costs are less or equal to the avoided distribution costs before it can pass through any costs to customers.
- The Rules should refer to a Demand Management Code of Practice for distribution networks, with the NSW model to be adopted as a minimum (including the protocol for disclosure of information).

¹ For example, submissions to the MCE's 2006 Comprehensive Legislative Package; the Expert Panel on Energy Access Pricing's Draft Report; and the Public Consultation on a National Framework for Energy Distribution and Retail Regulation.

² DM in this submission can be read to include 'demand response', 'demand side management', 'demand side response', 'energy efficiency' and 'non-network solutions'. In general, DM can include both the management of peak loads and energy efficiency as a way of meeting capacity requirements most cost effectively. It includes a diverse array of activities that meet energy needs, including cogeneration, standby generation, fuel switching, interruptible customer contracts, and other load shifting mechanisms.

- If incentives for DM fail to eventuate or are disregarded by networks, networks should be required to implement non-network solutions where more cost effective than augmentation.

2. NEL amendments

Objective

Although the primary focus of the NEL may be considered to be economic efficiency, it also includes provision for the “long term interests of consumers”. These interests can no longer be limited to economic efficiency to the exclusion of broader long-term interests, including environmental and social considerations. This is becoming particularly clear with the explosion of information about imminent economic and social costs of greenhouse emissions. Total Environment Centre, in consultation with Gilbert + Tobin and with the assistance of several consumer groups, produced a report in November 2006 titled “How Should Environmental and Social Policies be Catered for as the Regulatory Framework for Electricity Becomes Increasingly National?”, which we have previously sent to the MCE. One of the proposals in that report was for the development of two further objectives to sit alongside the NEM objective (to be the NEL objective as proposed in the amendments paper). They encompass concerns of many consumers in terms of impacts from the electricity system:

Environmental

“The Market Environmental Objective is to contribute to achieving ecologically sustainable development and is to have regard to the effect on the environment of the generation, transmission, distribution, supply and use of electricity and related activities including achieving a permanent reduction in the total global emissions of greenhouse gases.”

Social

“The Market Social Objective is to promote the long term interests of consumers with respect to the supply of electricity as an essential service including addressing the particular vulnerabilities that particular classes of consumers may have such as customers who are: disabled or chronically sick; of pensionable age; of low income; and/or residing in rural areas.”

The report also notes (on p 8) that:

Each (or most) of the jurisdictions currently have these kinds of [environmental and social] policies/programs in place. The range of policies and programs already in place clearly demonstrates that there is broad consensus among all the jurisdictions that action or regulation needs to be taken to elicit or facilitate social and environmental outcomes.

Given this consensus, it is time to revisit the decision to include only a single objective in the National Electricity Law.

Environmental and social objectives would also provide a framework for a more complete transfer of jurisdictional regulations to the national level – as opposed to the partial move to national regulation currently proposed – which leaves a large amount of regulatory mechanisms stranded in the ‘jurisdictional directions’ basket of regulatory and licensing leftovers.

3. Rule change process amendments

Minimum content

The Rule Change process via the AEMC is a valuable mechanism for ensuring all stakeholders have the opportunity to participate in the NEM. It was established as a relatively open arrangement to allow access for all parties, at least in terms of approaching the AEMC about problems with the Rules. A climate of accessibility has been established for perceived difficulties to be raised with the AEMC so that they may be able to develop solutions to those difficulties, whether by a Rule change or some other mechanism.

The current proposals represent a tightening up of access to any initial AEMC investigation of a perceived problem. The proposal that a proponent should address, “benefits and costs of the proposed rule change and potential impacts of the change ...” (p 18) is potentially a massive burden for any applicant, and is an even larger hurdle for consumer representatives or individuals. It is reasonable to ask applicants to provide an adequate description of the difficulty, but to require an elaboration of potential costs of any resolution is an unreasonable burden for a not-for-profit organisation with limited resources. The same argument applies for the suggestion that for, “a change to the rules where the benefits will primarily fall on the proponent ...” (p 18) they are required to detail the potential impact – this would be require more resources than a small organisation may be able to muster.

Fast-track process

In principle, it is not unreasonable to fast track applications on the basis of another organisation having already undertaken consultation. In practice, however, this is fraught with risks. There has been a very clear consultation process developed for the AEMC to canvass opinion and it is unlikely that any other body – including the AER and NEMMCO – would develop an identical process. If it is planned that other bodies will establish the same guidelines as for the AEMC then the proposal could be feasible. In the meantime it is highly possible that other consultation mechanisms will be less stringent than those of the AEMC and therefore will not properly air the issues.

Therefore, TEC would not support the fast-track suggestion unless it can be proven that “open consultation” by other bodies would match that of the AEMC, which has developed a suitable process and are developing a sophisticated set of consultation skills through implementation of that process. Improvements could be made, but the AEMC has so far proven itself more adept at this than other bodies to date. If the problem for the AEMC is simply under-resourcing then increased resources should be made available to enable it to fulfil the current role.

Consolidation

Consolidation of rule change applications by subject matter is a pragmatic response. Consolidation for other reasons would need more detailed explanation than that presented in the paper (p 20) to be acceptable. The time line is emphasised, but content is of more significance and the draft Bill does not adequately address this problem.

Greater discretion for the AEMC in problem solving – as long as it is based on adequate consultation – would assist with applications where a particular problem has been identified but the proponent is uncertain of the appropriate solution, or where a new solution is raised during consultation. This would make the consultation process more iterative and open to new ideas and directions, and would improve its coverage of issues. TEC would therefore support this resolution as long as further consultation is a basic requirement.

Timelines

The expansion of timelines where the AEMC deems it necessary – within the guidelines proposed in the draft Bill – would be appropriate given the extent of consultation required. However, the AEMC should be able to shorten the timelines where it considers a matter needs more urgent resolution. The changes to allow for response to new issues are also helpful for resolving complex issues.

Application fees

The lack of resources of small organisations presents a major obstacle to the establishment of fees. As was raised at the NEL Forum, any major business would easily absorb these costs and pass them onto the consumer; but for a non-profit public interest organisation – whether incorporated or not – it would represent a significant barrier and would exclude them from ever applying to the AEMC.

Regulation of the NEM is far from settled and there are likely to be anomalies in the Rules for a long time to come. A moratorium on fees is not appropriate either, as the proposed fees would always be a significant barrier to small organisations and individuals. A moratorium could be appropriate for large businesses, but stabilisation of regulation is so distant (for instance, it is far from clear when national retail regulation will be established) that it is not feasible to design a suitable period at this point. There is mention of possible waivers, but there is so little detail given that the proposal is meaningless.

4. National Electricity Rules (distribution)

Forms of regulation

The presentation of options in the paper for forms of regulation of distribution revenue has not sufficiently clarified the MCE's position on the preferred form of regulation. The stance appears to be simply that the AER would be free to decide case by case which form of regulation to apply. This is the conclusion we have drawn, but clarification is certainly required as to whether that is indeed the case since the situation is confused; and, if so, how that would be executed in practice.

To argue against the burden of regulation and thus promote light-handed regulation on one hand, and yet allow the AER to decide on the form of regulation on a case-by-case basis, seems to be contradictory. Too great an increase in the discretionary powers of the AER will enhance the climate of uncertainty for both business and consumers. If the authority of the AER is to be significantly augmented then stringent guidelines will need to be developed – in the interests of all stakeholders, including the AER – and the paper gives no indication of this happening.

There are fairly detailed descriptions in the paper of the components of the direct control/building block methodology, and no doubt many of these components would be used for the other forms of regulation. However, there is no clear sense of what other components would be included in the alternative forms, nor exactly how the AER is intended to reach a decision as to which form of regulation should be applied to each distribution business, or facets of their business. Clear guidelines, inserted within the Rules wherever possible, would be a preferable solution. These could include descriptions of the services DNSPs provide and the type of approach to be taken by the AER for each kind of service.

Revenue cap

TEC is in favour of the revenue cap method of assessment for distribution – as for transmission – since it is an important means of encouraging networks to carry out their investments prudently. Without such a cap, networks have a reduced incentive to carry out their operations within budget, and instead often seek to encourage greater, and more wasteful, consumption of electricity. TEC would argue for the control model (versus negotiate/arbitrate or no control) as so much monopoly power is wielded by each Distribution Network Service Provider (DNSP), with genuine competition really only evident in the retail sector.

The Appendix to the paper lists differences between transmission and distribution, but the descriptions are too slim to support different forms of regulation. DNSPs have formed geographic monopolies in practice because of the type of infrastructure they are engaged with. There is only a handful of DNSPs in each State, and these businesses also operate in more than one State. The size of investment required for most of their infrastructure and operations is also relevant – they may in some cases be smaller than transmission investments, but they nonetheless generally represent a substantial capital investment. Not all States are using a price cap, and the arguments presented in the many papers on reform of the NEM have not adequately explained the bias against a revenue cap model for distribution.

TEC takes issue with the failure of regulators to acknowledge DNSPs as natural monopolies in contrast with the treatment of TNSPs, which are understood to be such monopolies. DNSPs do form monopolies, by a number of criteria:

- Although capital investment in distribution networks is not as lumpy as for transmission, nonetheless there are high capital costs (poles, wires, transformers, sub-stations).
- There are physical reasons for geographic monopolies, that is, it would be counter-productive and inefficient to duplicate the physical infrastructure: there are economies of scale which cannot be replicated.

- Distributed/embedded generation (DG) does not counter this market power, since the electricity generated is injected into the existing infrastructure via a distribution network and access to distributed networks is on the basis of asymmetrical negotiation.
- Customers (effectively retailers or embedded generators) have limited power over the service provider and access costs are largely hidden, except perhaps for large consumers.
- For electricity, the alternatives are generally limited and virtually all households in Australia have electricity. In many areas there is no gas provision; there are some alternatives for heating (space and water) but substitution is limited for many uses (lighting, appliances).

These arguments apply whether a price cap or a revenue cap method is followed.

Moreover, to leave it to the regulator to decide on which form to use (that is, control model with building block methodology and revenue cap versus the many ill-defined alternatives) will only increase the costs of regulation. It is not prudent to leave major decisions to the AER's discretion as this can lead to greater inconsistency than already exists. The Rules have been established as a substantial and sophisticated set of directions for the NEM; it would be an oversight not to include these matters within their ambit, with details set out as far as is practicable.

The failure by regulators to acknowledge DNSPs as natural monopolies has led to the retrograde step of reverting to a recommended hybrid or a price cap as alternative forms of regulation. In contrast to a revenue cap, the price cap form reduces incentives for efficiency, in breach of the NEL Objective: "efficiency in the *use* of electricity". Therefore, any price cap system *must* include incentives for DM to counter the massive incentives and cultural bias for DNSPs to sell more electricity.

Demand management and the D-factor

TEC has consistently supported a revenue cap with extra incentives for DM, such as the facility for a set-aside percentage for demand management. A revenue cap provides greater incentive for consideration of non-network solutions since the network can absorb the savings of augmentation deferrals, while allowing for flexibility in pricing. A price cap, in contrast, rewards networks for more electricity sales, and does not impose limitations on network augmentations even when more cost-effective alternatives are available.

A revenue cap alone will not necessarily increase the uptake of cost-effective DM opportunities: added incentives for DM are needed whatever the form of regulation. There must be incentives for DM to counter the massive incentives and cultural bias for DNSPs to sell more electricity. Such incentives should ensure that networks are able to recoup revenue for the cost of carrying out demand management and retain the savings of avoided augmentation. The purpose is to promote consideration of more efficient non-network solutions and, conversely, to reduce the motivation for the networks to encourage excessive consumption (that is, by selling more electricity).

The regulator should be required to ensure that networks **implement** DM opportunities – rather than just investigating them – when they are found to be more cost-effective than network expansion. In a competitive market, the failure of networks to weigh up

non-network and alternative generation options goes against the intentions of the National Electricity Law and adds unnecessary costs for consumers. Much lip service has been paid to the concept but there has been little real action across the NEM.

DM under a price cap

There is a useful model in NSW, the "D-factor", which is intended to promote DM by networks through the use of incentives on condition that, "the DNSPs must demonstrate to the Tribunal [IPART] that its demand management implementation costs are less or equal to the avoided distribution costs before it can pass through any costs to customers."³ The mechanism allows DNSPs to recover:

- *approved non-tariff-based demand management implementation costs, up to a maximum value equivalent to the expected avoided distribution costs ...*
- *approved tariff-based demand management implementation costs*
- *approved revenue foregone as a result of non-tariff-based demand management activities.*

An alternative method (aside from the D-factor) to promote DM is for generous incentives to be developed to encourage cost-effective network DM. DNSPs could be required to earmark a specific minimum spending level for DM: between 10% and 25% of the projected network capital expenditure could be set aside for cost-effective DM projects, on "use it or lose it" terms. Since the requirement for either of these would be to implement DM where cost effective, such incentives in fact promote efficiency within the NEM and are in the long term interests of consumers.

³ IPART, *Guidelines on the Application of the D-factor in the Tribunal's 2004 NSW Electricity Distribution Pricing Determination*, April 2005, p 1