

*Major Energy Users, Inc*

*The voice of energy consumers*

**Transmission Revenue**

**AEMC Draft Rule Proposal**

Review Forum 8 March 2006

Presented by David Headberry, Public Officer, MEU

# The MEU goals for the review

- MEU seeks a transmission system which is
  - ❖ economically efficient and overall lowest long term cost to consumers
  - ❖ Facilitating of a true national electricity market
  - ❖ grows to meet consumer needs and reduce generator market power (both intra- and inter- regional)
  - ❖ secure in the long term (users have invested in the long term too!)
  - ❖ reliable
  - ❖ delivers acceptable quality
- MEU supports incentives for improving service (quality and cost)
- MEU seeks evidence that the promised benefits will occur, despite apparent reduced oversight

# The AEMC High Level Principles

- Increase incentives to invest and operate the transmission network to deliver efficient outcomes for the market, participants and consumers
- Increase clarity and certainty and so permit efficient investment

MEU fully supports these principles, but points to the need for downstream industry to remain internationally competitive, as it is this which adds to the national wealth

Whilst unstated, the AEMC proposal implies a trend to lighter handed regulation

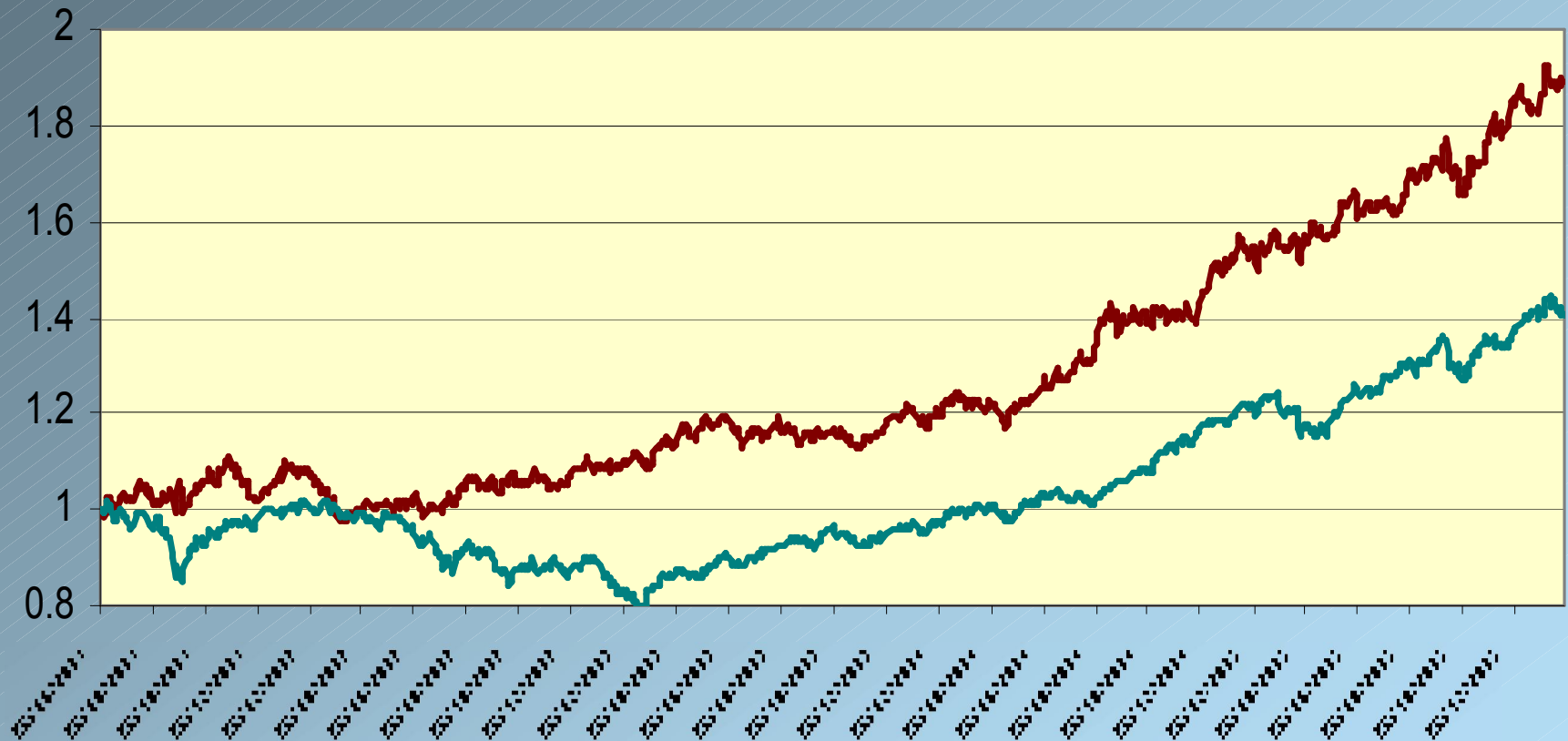
# Light handed regulation is an admirable goal, but ...

- Many of the infrastructure assets are now owned by trust and other specially designed ownership vehicles
- The establishment of these ownership vehicles has made major profits for merchant banks with set up fees and, more importantly, continuing trailing fees.
- The payment of these trailing fees, and special dividends to government owners, is a major loss of funds which should be used for investment in assets
- Part owners provide asset management for the ownership vehicles, creating barriers to information disclosure and fee payments

The AEMC proposal makes no reference to the impacts of these ownership approaches to costs incurred, but which have a major impact on funds available for investment

# The key driver for investment is profit

Movement of Utilities index (red) relative to ASX 200 (blue), June 2001 to present



# To put this into perspective

- S&P Utilities index includes DUET, Hastings, Alinta, AGL, APT, Envestra, GasNet, SPI AusNet, Spark.
- These companies comprise >90% of the index
- They were awarded MRP of 6% and beta of 1.0
- The ASX 200 shows an MRP of 6.05% and CommSec calculates beta at 1.08
- Utilities index shows an MRP of 11% and CommSec calculates beta at 0.31
- All energy transport companies are being overly well rewarded for their investments comparative to competitive industry

**So why is there a problem?**



*Major Energy Users Inc*

*The Voice of energy consumers*

# Where is the lack of investment that needs encouragement?

- PowerNet hasn't augmented to make Murraylink work better or fix Heywood, but is this due to the regulatory approach? - No!
- SNI was defeated by Murraylink interests
- ElectraNet, Transend, TransGrid all asked for higher capex than was allowed and PowerNet and VENCORP got what they asked for. Powerlink currently has 20 capital projects on the go
- DBs capex requests are consistently higher than they are ultimately allowed

The prime reason for augmentation not proceeding is that projects don't meet the Regulatory Test criteria

# The failure of the Regulatory Test

- Snowy can use its generator layout to constrain flows between Victoria and NSW to spike prices and increase profits
- Other generators look to constraints to do the same.
- The benefit of augmentation of transmission is it reduces generator market power
- Consumers pay the bulk of transmission costs
- The ACCC decided not to include market benefits to consumers in the regulatory test as this was considered economically neutral – a transfer of wealth
- This transfer of wealth argument only applies if there is equal payment for transmission – which there is not!

The prime reason for some key augmentation not proceeding is that projects don't meet the current Regulatory Test criteria



**Major Energy Users Inc**

*The Voice of energy consumers*

# The proposal – Neutral issues

- The SoRP will be continued in most aspects, although this still has a number of problematic aspects
- CAPM inputs will be assessed every 5 years.
  - ❖ Acceptable if the new CAPM inputs apply to all decisions including those currently running.
  - ❖ Unacceptable if they only apply to new decisions
- The need to protect previous decisions is recognized, and to have a transition phase

# The proposal – the good

- More time is to be dedicated to reviews
- Guidelines for applications are to be set, including what information is required and in what format
- AER is to have oversight of cost allocations
- Greater attention to negotiation with end users to minimize stranded assets
- Ability for AER to remove stranded assets from RAB, but with some constraints
- Discretionary powers of the AER are to be retained but there is to be guidance to their use and outcome
- Incentive to have networks available when they are needed

# The proposal – the bad

- Limited investigation into opex and capex claims – how are the amounts assessed as “reasonable”?
- Depreciation rates at the election of TNSP – can be an upfront cash cow leaving future consumers at risk
- All capex considered prudent and efficient to be rolled into RAB including cost overruns – reduces pressure for project controls
- Re-openers allowed for unforeseen need for capex – what happens to other capex approved, paid for, but not used?



# **The proposal – the bad (cont)**

- **Incentives too low powered – 1% at risk**
- **Constraints on incentive payments are relaxed**
- **Encouragement for >5 year regulatory periods at NSP election, but allowing NSPs to re-open permits NSP a significant benefit**
- **Minimizing prescribed services and increasing negotiated services opens risk to end users, as DBs have almost all connections and they can pass through transmission costs**

# The MEU assessment

- It is return (amount and certainty) which drives investment
- There are funds being directed away from the businesses
- Why do we need to incentivise investment when the actuality doesn't reflect a need
- It is the Regulatory Test which prevents needed investment
- It is a “curate's apple” proposal, parts of it are good, but maybe there is more bad
- There are changes proposed which have unintended consequences and these need to be addressed



**Major Energy Users Inc**

*The Voice of energy consumers*

# The MEU conclusions

- Reducing regulation by a light handed approach has not resulted in better outcomes overseas or even in Australia (see the ACT Sydney Airport decision)
- Consumers need to be convinced that giving more freedom to regulated businesses will benefit consumers
- Regulators need to examine more deeply the costs the various ownership structures impose on consumers
- MEU will actively participate in the future work to resolve these