

**WORK & ACTIVITIES REPORT FOR ADVOCACY PANEL
STAFF FUNDED POSITION
EUAA DIRECTOR – POLICY AND REGULATION ('NEM SPECIALIST')
Period: 1 April 2007 to 30 June 2007**

Period Activity

This has been a period dominated by several significant reform reviews, major merger initiatives, revenue resets and exposure drafts of both the National Electricity Law and the National Gas Law, which have consequent impacts on the NEM. These initiatives are leading to fundamental changes in the National Electricity Market and have required the development of extensive input to ensure that end user interests are strongly presented in the relevant forums.

Principal Activities

1. Market Operators Working Group (MOWG), Operations Sub Group and Governance Sub Group

COAG at its 13 April 2007 meeting agreed to establish a single industry funded National Energy Market Operator (NEMO), for both electricity and gas. The creation of the NEMO recognises the convergence of regulatory frameworks for gas and electricity as well as the economies of scale and scope arising from a single interface with energy and industry participants. COAG agreed with the Energy Reform Implementation Group that the NEMO should include stronger stakeholder participation and responsiveness.

COAG tasked the MCE with developing, in consultation with stakeholders, a detailed implementation plan by the end of 2007.

To accomplish this task a Market Operator Working Group (MOWG) and two sub groups, the Operations Sub Group and the Governance Sub Group, were established. These groups have now been rolled into one.

I am the EUAA representative on all these groups. The initial work has focused on a wide range of issues including preparation of a detailed implementation plan, corporate structure of the new entity, governance issues, appointment of directors, development of a skills matrix for appointment of directors, accountability and liability, and establishment and supporting legislation. The issues are complex and require expertise not only in energy markets but in corporate governance and the role and operation of regulated entities. I have advocated on behalf of end users in the negotiations and development of the proposal and related position papers. My involvement has been critical as the group is dominated by supply side representatives and invariably the focus trends towards the supply side.

Given the tight deadline imposed by COAG, this project is proceeding quickly and will continue to require a heavy input until the end of the year.

2. Submission to the MCE Review of the National Electricity (Economic Regulation of Distribution Services) Amendment Rule 2007

The Energy Users Association of Australia (“EUAA”) and Energy Action Group (“EAG”) lodged a joint submission in respect of this Review. Changes to the National Electricity Rules (NER) in this package transfer functions for the economic regulation of electricity distribution to the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER). The purpose of the review was to develop a common set of arrangements for the economic regulation of access to electricity and gas transmission and distribution networks, covering:

- pricing principles;
- regulatory guidance (i.e. how the principles are applied, the extent of the regulator’s discretion, and related matters); and
- any associated changes necessary to established regulatory processes (i.e. the steps in the assessment process, timelines)

These issues involve complex economic regulatory issues and will have a profound impact on the future of distribution regulation, which comprises around 40-50 % of customer bills.

The EUAA and the EAG consider the Review and the subsequent draft legislation an important first step in integrating distribution into the national framework. However, the EUAA and the EAG are concerned that the SCO appears, without explanation, have ignored much of the advice provided by its expert consultants (i.e. NERA) in their paper entitled “*Distribution Pricing Rule Framework*” for the Network Policy Working Group. Consequently, these fundamental issues plus detailed comment on the legislation was addressed in our submission. A consultant, Darren Barlow, was appointed to assist in the preparation of the submission.

I was responsible for the management and coordination of this project, as well as developing the EUAA position on this important policy initiative. The development of the joint submission required several reiterations and discussion of the issues with both the consultant and the EAG representative. The final submission eventually contained not only detailed comment and recommendation on individual clauses of the proposed legislation, but also recommendations as to suggested courses of action in respect of a number of implementation issues as they applied to both small and large end users.

This is only the first stage of the development of the legislation and will require a significant commitment until the end of October 2007. Advocacy is required with SCO and other stakeholders and I expect to have a major impact on this using the results to the work to date.

3. MCE Electricity Market Reform – Exposure draft of the National Electricity Law and Rules, and the National Gas Law and Rules

Substantial work has been undertaken in this area with a busy MCE work program and multiple consultation documents being a key driver. Following consideration of submissions, SCO undertook further development of policy issues and changes to the draft legislation, which required thorough examination and preparation of a further submission. Several issues raised in the position papers caused us to undertake an extensive round of advocacy with key Ministers, SCO officials and regulators on issues of importance to our members. This advocacy included meetings and formal correspondence.

I have been responsible for developing the EUAA policy position, as well as managing our involvement in this important issue. While we had the benefit of the involvement of legal experts, this was only one aspect of what was, and continues to be, a major initiative that will govern the fundamental aspects of both the electricity and gas markets.

My role in this project includes:

- Analyzing the Exposure draft to identify major issues and their implications for users;
- Cross referencing to the Exposure draft of the National Gas Law and the National Gas Rules, given the MCE objective that the two pieces of legislation mirror each other to the greatest extent possible, especially regarding consistency with the NEL objective;
- Directing and working closely with legal consultants, Phillips Fox, in preparation of the legal aspects of the EUAA's input and integrating them into a broader submission;
- Working closely with members and regulators to develop and advocate on issues/solutions that reflect major end user interests (including Board and member briefings, newsletter contributions and presentations);
- Working with the regulators to ensure that regulatory aspects affecting end users are addressed and that the regulatory oversight takes account of the asymmetry of power between end users and the supply side of industry;
- Continue to advocate strongly on issues being carried forward from the Chapter 6 (transmission pricing) review such as the "propose/respond – fit for purpose" model interpretation and the information gathering powers of the AER. This drew on past work with which I have been involved. In addition, working closely with the AER on the pricing principles.
- Responding to changing policy initiatives both the NEL and NGL have developed. The timetable is being driven by the desire of Ministers to implement the new legislation by 1 July 2007, which is leading to a collapsing of the consultation process. An example of this was the flagging that the powers of the AEMC are to be increased with no information as to what is envisaged. I took the lead at the public forum in raising the implications for end users of such an action and making sure our concerns were on the table.
- Prepared correspondence to Ministers detailing areas of concern to our members.

4. Powerlink Revenue Reset

Our involvement with the Powerlink revenue reset process continued during the period under review.

During this period, I prepared a further submission and also responded to the AER on points that Powerlink raised in response to issues in our submissions.

I am currently working with our consultants on an analysis of the final determination that will form the basis of a report to EUAA members. This analysis will also be used in a meeting with senior AER officials, that I will lead, to examine the process, the impact of our involvement, the outcome and address issues of concern that we have not only in respect of the outcome on the Powerlink determination but also how future revenue resets are to be conducted. Lessons learnt will be discussed.

The EUAA was the major user participant in this reset process and the value of our input has been acknowledged by the AER. Powerlink also recognized this and submitted detailed responses to the AER on issues that we raised in our submissions. Following both our submissions, Powerlink wrote to the AER to address the issues raised and initiated meetings with us to discuss our submissions.

I also provided briefing for a meeting between the EUAA Executive Director and the CEO and COO of Powerlink and provided a Members' Briefing summarizing the impacts of the final decision. This briefing will be followed by the detailed report and also an examination of the extent of the price rises on individual members. I am providing detailed comments on drafts of this to ensure the relevance to end user impacts.

5. Comprehensive Reliability Review

The Australian Energy Markets Commission (AEMC) Reliability Panel's Comprehensive Reliability Review, Interim Report, was released in April 2007. The EUAA analysed the report, identified issues of concern to members and prepared a subsequent submission. I was responsible for oversight of this work, which was primarily undertaken by the EUAA. My role included identification of issues and into the preparation of the submission.

The EUAA agreed with the Panel's preliminary conclusion that, against the reliability standard, the reliability mechanisms in the NEM have been satisfactory to date. The EUAA also agreed with the Panel's concerns that there are risks on the horizon which may affect incentives for the installation of further base load generation capacity in the medium to long term, and these risks need to be addressed to create appropriate incentives for the installation of any further generation capacity.

There are, however, a number of issues that need to be further developed. For example, a consideration of future greenhouse policy responses at both the State and Federal levels, and a consideration of the further development of measures to introduce demand side management into the electricity market, future development of wind generation opportunities and the impact of wind on reliability standards are key elements in any evaluation of the future effectiveness of the current reliability standard. Additionally, the continuing existence of retail price caps and consequent lack of incentives for the reduction of peak loads, the introduction of interval metering without adequate price signals (as is currently proposed), and the question of medium term weather trends in Australia are all critical in arriving at a conclusion as to whether the current reliability standards across the NEM will continue to be acceptable and will be (or can be), in practice, met by the market.

A further interim report is to be released in August 2007. I have identified key issues that will need to be addressed and am planning the work program accordingly.

6. Other Matters

Other relevant activities include:

- Supervised and provided input to the NEM related work of more junior EUAA policy and regulatory staff, including guidance, involvement with various submissions, etc.
- Provided input into the EUAA Newsletter, web site and Members Meeting Notes.

- Provided input into EUAA Board meetings.
- Provided input into presentations and meetings by the EUAA Chairman, Executive Director and self, including NEM matters for Ministerial meetings.
- Met several times with ElectraNet on their forthcoming revenue determination and their desire to consult closely with the EUAA. This has succeeded in forging a constructive relationship with senior Electranet personal involved in the reset, which is already proving to be valuable in terms of the EUAA's contribution to the review.
- Met with the AER senior staff on various market issues.
- Prepared correspondence to COAG Ministers supporting the recommendations of the Energy Reform Implementation Group.
- Provided advice to individual members on energy issues.

Advocacy:

- Preparation of submissions and other relevant correspondence as input into reviews
- Preparation of briefing material on NEM issues for advocacy meetings with Ministers, senior bureaucrats and regulators
- Discussion of issues with Board, members and other end users
- Attended and/or presented at Public Forums / Hearings
- Analysis and evaluation of issues from an end users' perspective
- Face to face meetings with officials, regulators, end users and market participants on various advocacy matters.

Outcomes & Outputs:

This period has been particularly challenging for me in my role as Director of Policy and Regulation at the EUAA. The National Electricity Market is undergoing significant change not only from the initiatives undertaken by government but also by market participants. During this period the rewriting of the Nation Electricity Law and Rules and the National Gas Law and Rules and the fact that even though they are inter dependent they are not moving forward in sync has been challenging. The EUAA forcefully represented end users in formulation of these vital pieces of legislation and I believe that we have been successful in ensuring that end user views have been heard and taken into account. While we have been fortunate in having the services of legal experts in preparation of our submission this is was only one aspect with most of the work being undertaken in house under my responsibility.

The establishment of a National Market Operator and the transfer of regulatory functions to the national bodies have required a significant input from the EUAA. No less challenging has been the change being driven by the market participants. We remain concerned at the level of reaggregation that is occurring through mergers and acquisitions. We are equally concerned at the level of re-integration in both the electricity and gas markets and have continued to advocate strongly on these issues. I have continued to be responsible for our work on mergers and will continue to advocate strongly on this issue with governments, senior officials and regulators.

While it is still at a relatively early stage, the work of the Market Operator Establishment Group will be crucial in establishing an efficient market operator that successfully marries the electricity and gas markets and establishes the national transmission planner. The short time frame under which this task needs to be accomplished has meant that issues have to be

considered quickly, relying on the expertise of the Market Operators Working Group, of which I am a member representing end users.

The Comprehensive Reliability Review has continued to require my input. The terms of reference have been expanded and new dimensions added. It is now closely aligned with other major reviews including the Congestion Management Review of the AEMC. A number of major issues for end users will emerge in the draft report.

In the Powerlink reset the EUAA was seen by both Powerlink and the AER as 'the representative' of end users and we raised issues that were instrumental in a thorough examination of the applications and a reduction in the amounts sought. The importance of our role is demonstrated by the fact that Powerlink responded directly to the AER on issues that we raised in our submissions indicating the importance with which the regulated business saw our involvement. It is also pleasing that we have been able to maintain a strong working relationship with Powerlink even though there was a significant difference in our positions. The Chairman of the AER has agreed to meet with us to discuss our concerns about what we consider is a significant back-down in the AER between the draft and final decisions. I am leading this work.

Looking forward to future AER reviews, Electranet has initiated a number of meetings to work through issues in respect of their current reset application, including a presentation to EUAA on their Application. I have established a close relationship with them and will be primarily responsible for the EUAA submission.

The establishment of a close working relationship with the AER and key Commonwealth agencies is also something on which I place great value. Officials from the AER and senior officials (Commonwealth and State) have worked closely with us on many of the issues and this has helped to bring end user issues to the fore. I have also established relationships with officials in the AEMC as well as State regulators. I intend to further these relationships in future.

The challenges for the EUAA are not diminishing but increasing. We have, for example, both the AER and AEMC looking at different aspects of transmission service standards while at the same time the Comprehensive Reliability Review and the Congestion Management Review are underway. In addition, the current high prices in the electricity market, makes the issues of vertical integration, reaggregation, competition and climate change responses even more important. The next period ahead and beyond will be equally challenging.

Robert Davenport
31 July 2007