

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

Period Activity

The push for the development and implementation of energy market reforms has continued through this period. In addition to the need to develop the over arching policy there has also been an increasing need for the EUAA to be involved in second level issues such as the development of guidelines. 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 this group. The initial work 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.

From this work an implementation plan for the establishment of the Australian Energy Market Regulator (AEMO) will be submitted to SCO. The implementation plan is expected to be based around recommendations including the selection of board members and industry membership of AEMO.

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 am working closely with the supply side to find acceptable solutions to the complex issues. This includes ensuring supporting "industry" involvement in the ownership of AEMO, end users being included in the definition of "industry", that end

users have an effective voice in selecting initial AEMO Board members and ongoing voting rights for end users.

2. *Weighted Average Cost of Capital*

The Weighted Average Cost of Capital (WACC) is a key determinant of the return on equity in the Revenue resets. The values assigned to the WACC parameters has long been a source of concern to the EUAA in that we believe that they are overly generous to the network service providers resulting in a substantial wealth transfer from end users. Accordingly, the EUAA has initiated a project, with funding from the Panel, to challenge these parameters.

On a related issue, the Energy Networks Association (ENA) commissioned NERA to prepare a paper arguing that the process for determining the Risk Free Rate (RFR) is incorrect and that there should be a consequent increase in the WACC value.

The EUAA subsequently commissioned Professor Martin Lally of Wellington University (NZ) to prepare an economic evaluation of the Equity Beta, Gamma and the RFR.

I am responsible for progressing this project. I am worked closely with Professor Lally on the preparation of the papers. In the meantime, I have also been in regular contact with the regulatory authorities and am discussing the issues with them and seeking their views.

This project is of vital importance to end users as, with significant resets occurring in the near future, the wealth transfer to end users will amount to several hundreds of millions of dollars if the parameters recommended by Prof Lally are used.

3. *ElectraNet Revenue Reset*

The ElectraNet Revenue Reset is being conducted by the AER. I was responsible for writing the initial EUAA submission.

The revenue resets are crucial areas for involvement by the EUAA. All network service providers are facing challenges in the face of increasing demand and the aging of networks. This has meant that all the recent resets have sought significant increases in capital and operating expenditure programs. In such an environment, it is essential that revenue reset applications are subjected to thorough scrutiny in order that only efficient expenditure is undertaken.

As noted previously, I was responsible for writing the EUAA submission. In our submission I was able to identify several issues in respect of the capex program and the interpretation of ElectraNet's obligations under the relevant legislation. However, the scope of the submission was necessarily somewhat limited due to the fact that it was prepared without outside expert help.

Feedback from ElectraNet has indicated that the EUAA submission identified many relevant issues and was found to be adding value to the process. As mentioned in previous reports, I have also ensured that there is a constructive relationship with Electranet and the AER during this reset.

4. National Transmission Planner

The AEMC has commenced a review of the establishment of the National Transmission Planner. The EUAA has received funding from the Panel to assist on this project and has appointed MMA as our consultant.

The paper released by the AEMC was very much a scoping paper seeking ideas on how the National Transmission Planner would be formed and its operations. The AEMC has now issued an Issues Paper and the EUAA thoughts and suggestions feature prominently in this paper. I have participated in the development of the approach adopted in the submission, was involved in extensive 'brain storming' activity with the consultant and am helping in preparation of the Submission, which is expected to be lodged in October.

5. Comprehensive Reliability Review

The Australian Energy Markets Commission (AEMC) Reliability Panel's Comprehensive Reliability Review Second Interim Report, was released in August 2007. The EUAA analysed the report, identified issues of concern to members and prepared a subsequent submission. I wrote the EUAA submission responding to this report.

We agreed with the Panel's conclusion that, against the reliability standard, the reliability mechanisms in the NEM has 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.

However, a number of issues need to be further developed and the EUAA is disappointed that the Review has been going for some eighteen months but failed to satisfactorily address these issues or indeed arrive at any significant recommendations. 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. All these are significant issues for end users that we believe should have been addressed in this Review.

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

6. 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, briefing material, as well as managing our involvement in this important issue.

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.

During this period draft legislation covering the transfer of the non-economic aspects of distribution has been addressed, as well as the transitional rules that will cover the revenue resets that are due to commence in 2008.

7. Other Matters

Other relevant activities include:

- Supervised and provided ideas/input into the development of a number of other submissions including
 - Review of Separation of Transmission and Generation
 - Congestion Management Review
 - National Distribution Network Planning & Connections
- Supervised and provided input to the NEM related work of more junior EUAA policy and regulatory staff.
- Provided input into the EUAA Newsletter, web site and Members Meeting Notes.
- Provided input into EUAA Board meetings.

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- Provided input into presentations and meetings by the EUAA Chairman, Executive Director and self, including NEM matters for Ministerial meetings.
- Provided input on aspects of my work related to the EUAA Annual Report
- Met with the AER senior staff on various market issues.
- 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:

The major legislative changes to the Nation Electricity Law and Rules and the National Gas Law and Rules has continued to be a major focus of my work through the period. The EUAA effectively 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. A measure of the success of our involvement is demonstrated by the fact that our participation continues to be sought on a formal and an informal basis through the drafting process. This involvement resulted in several drafting changes that have strengthened the position of end users. I have been responsible for this work.

The establishment of a National Market Operator and the transfer of regulatory functions to the national bodies required significant input from the EUAA. I was the EUAA representative on the Group.

The establishment of AEMO is proving to be a challenging task. The group is developing an implementation plan that addressed everything from membership of the entity, appointment of directors to corporate governance for approval by MCE by the end of the year. I have been instrumental in ensuring end user involvement through my position and role on the Working Group.

The EUAA provided an effective submission on the ElectraNet revenue reset which I developed and wrote. Given the amount of information that accompanies a revenue reset and the absence of any outside expertise, this is a major assignment for an organization such as the EUAA. I was required to allocate a considerable amount of time to analyzing this data to ensure that we identified the issues rather than make generalized statements applicable to other resets. Feedback from ElectraNet officials is that our submission was well received and raised some issues that they were revisiting.

The Comprehensive Reliability Review has continued to require my input. I also developed and wrote the EUAA submission in response to the Second Interim Report. The EUAA considers that this is a vital issue and we are disappointed that the Review has failed to propose any significant actions despite some 18 months of work. Notwithstanding this limited result, we were instrumental in identifying many significant issues including options to address the issue of the Snowy Region. A further paper is to be released in November 2007. We understand that this paper will identify a number of issues that have arisen during the course of the Review but which the Panel considers are outside the scope of the Review. The EUAA has already flagged its position in respect of these issues but we will need to build on this work to ensure that the end user position is clearly enunciated.

The AEMC review into the establishment of the National Transmission Planner commenced during this period. The scoping paper issued was very preliminary and was basically seeking ideas about how the entity would be structured and operate. I am responsible for steering the development of the EUAA position and participated in preparation of the 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. We 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
30 September 2007