

**WORK & ACTIVITIES REPORT FOR ADVOCACY PANEL
STAFF FUNDED POSITION
EUAA DIRECTOR – POLICY AND REGULATION ('NEM SPECIALIST')
Period: 1 October 2007 to 31 December 2007**

Period Activity

The push for the development and implementation of energy market reforms has seen some further progress through this period. These initiatives are leading to fundamental changes in the National Electricity Market and have required the continued development of extensive input to ensure that end user interests are strongly presented in the relevant forums.

The period has also seen a change of Government at the Federal level and the EUAA will need to assess how this impacts its advocacy and consequences for any modifications to the work undertaken by this position. This assessment is underway, as is initial contact with new Ministers and senior officials, but the Prime Minister and Minister for Resources & Energy have already given indications of an active reform agenda. The position is contributing to this (see separate item below).

Principal Activities

1. Market Operators Working Group (MOWG)

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) was established.

Robert Davenport was 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 establishing the Australian Energy Market Regulator (AEMO) was submitted to SCO. The plan was 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. We advocated on behalf of end users in the negotiations and worked closely with the supply side to find acceptable solutions to the complex issues. This included supporting "industry" involvement in the ownership of

AEMO, end users being included in the “industry”, that end users have an effective voice in selecting initial AEMO Board members and ongoing voting rights for end users.

SCO accepted virtually all of the recommendations of the Working Group and this was endorsed at the MCE meeting in December. A key next step will be the formation of an ‘industry’ group, involving Association CEOs, to agree to 2 nominations for the AEMO Board selection panel (expected early in 2008). As far as we are aware, the task of the Working Group has now concluded and further work on the establishment of AEMO will involve submissions and other formal advocacy. We were very pleased with the outcome of this process and our involvement was constructive in this. Especially pleasing was the constructive contribution we made to the Working Group and its recommendations, the level of co-operation achieved with the supply side, the role we helped to secure for end users in the appointment of AEMO Board members, the ‘merit based’ structure of the Board and the ongoing governance structures. Although a few matters remain to be resolved, the fact that the MCE accepted nearly all the Working Group’s recommendations was also very pleasing. To our knowledge, this was one of the most effective MCE-industry-end user joint processes ever undertaken by the MCE.

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.

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

We have worked closely with Professor Lally on the preparation of his advice and provided comments on drafts. He has now provided his advice which confirms that the WACC parameters are over-estimated. This advice is being used as primary input into further work in the form of a Rule change proposal also in receipt of Panel funding.

We have now briefed legal advisers and met with them several times. They are in the process of providing a Rule change proposal and we are commenting on drafts of this. We expect to also involve Prof Lally in commenting on this, especially the technical aspects. Significant further work is anticipated in the period ahead.

We have also been in regular contact with the regulatory authorities and are 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. Our staff position was responsible for writing the EUAA submission.

Revenue resets are crucial areas for involvement by the EUAA. All network service providers are facing challenges in the face of increasing demand and aging 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.

The AER released a draft determination in November. Internal assessment of the draft indicates that the AER has understood many of the issues raised in our submission but also that the limited scope of our submission may have resulted in the AER not fully grasping all of the issues. A significant increase in average transmission charges of 3% pa (real) is implied over the next regulatory period. Whilst some of expenditure increases are due to assessed necessary increases in capex and opex, and material and labour cost increases that are unavoidable, we remain unconvinced that the full increase is justified? The Panel's decision to limit funding for advocacy, which prevented the application of engineering expertise to this review, may be contributing to this outcome. Due to a lack of funding and resources we are unlikely to take further significant interest in this review and will rely on points made in our initial submission.

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.

EUAA thoughts and suggestions feature prominently in the AEMC issues paper. Our staff position contributed to the development of the approach in our submission and will be helping in preparation of our Submission, which is expected to be lodged in January. Discussions were also held with the consultant and AEMC staff on the submission.

5. Letters to New Incoming Federal Government

The EUAA has taken the initiative in writing to the newly elected Rudd Federal Labor Government on behalf of end users to raise a range of important policy matters, including ones involving the NEM. The newly elected Government put a number of important energy and climate change policies to the electorate during the campaign and has, since the election, raised the profile to reform issues. Meetings of the COAG and MCE have also been held in December.

Our staff position is being put to use in assessing the new Government's emerging policies related to the NEM and in developing related communications with the new Federal Government, including letters to the Prime Minister and other key Ministers.

6. AEMC Congestion Management Review

Contributed to a further submission to the AEMC related to its Congestion Management Review Draft Report released in September. This was done with expert assistance from an external consultant. The submission raises a number of issues of omission in the AEMC draft, including concerning the Regulatory Test for network augmentation and demand side response. This draws on previous work and knowledge of the EUAA through its extensive advocacy work. It also expresses concern about some process issues.

The submission provides broad support for many of the AEMC's positions but raises a series of issues for further consideration by the AEMC:

- Some important issues are subject to narrowly based recommendations;
- Expresses alternative views on matters including negative settlement residues, mispricing information and locational pricing that we believe will deliver greater benefits to end users and would be more consistent with the NEM Objective.

Staff position resources contributed to the submission, including involvement in drafting, adding value in terms of previous EUAA advocacy on related issues, providing a 'quality filter' in terms of end user focus and ensuring consistency with other EUAA positions.

7. Other Matters

Other relevant activities include:

- Supervised and provided ideas/input into the development of a number of other submissions including the Review of Separation of Transmission and Generation
- 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.
- Provided input into presentations and meetings by the Executive Director.
- 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
- 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:

Major outputs/outcomes during this period included:

- Contribution to the MOWG report to SCO on the establishment of the AEMO with a view to ensuring the effectiveness of AEMO as market operator and also to ensure end users are acknowledged and involved in establishment and ongoing operations.
 - MCE and SCO decisions confirm the effectiveness of this work as nearly all recommendations have been accepted and the end users will play a formal role

- in AEMO Board appointments and could also be given a role as 'shareholders' (if outstanding recommendations from the MOWG are accepted by MCE)
- Contributions to Prof Lally's report on WACC parameters which has identified over-estimated parameters that will now contribute to a major Rule change proposal.
 - This succeeded in establishing an expert view that current parameters are over-estimated by regulators resulting in higher prices to end users and that there is a strong case to modify these in the Rules. A Rule change process has now commenced, with Panel funding involved (see below). If this succeeds it will result in significant reductions in network charges in future years. In any case, it will raise important issues for broader consideration by energy regulators and help to place pressure on them to reduce these parameters.
 - Appointing legal advisers to the WACC Rule change process, briefing them and commenting on a draft Rule change proposal.
 - Contributing to assessment of the policy positions of the newly elected Federal Government and opening lines of communication with them on end user positions, including letters to the Prime Minister and key Ministers.
 - The outcome sought here is to establish a constructive and ongoing relationship with the new Government and seek to ensure they are well informed of end user positions.
 - Continued to network with key regulators and policy officials on specific issues and to build relationships/trust.
 - The broad outcome sought here is to contribute to the effectiveness of future advocacy efforts. There are already signs of this working through stronger relationships with Ministers, senior officials and regulators.

It should be noted that there are several other advocacy issues referred to above where outputs are expected in the next period but where substantial foundations work has been undertaken in the present period.

As mentioned at the outset, the recent change of Government at the Federal level is also showing signs of a more active reform program and increasing challenges for the year ahead.

Departure of Robert Davenport

As previously advised, Robert Davenport departed the position towards the end of December. With the short term nature of future funding provided by the Panel (ie until 30 June 2008), it is felt that it will be difficult to attract a suitable person into the position unless a way can be found to offer greater continuity. This is a matter of concern to the EUAA and we have therefore raised it with the Panel in a recent letter to the Executive Officer.

Bearing the short-term nature of the funding arrangement in mind, the EUAA is attempting to now find the best way possible to resources to undertake the work funded by the Panel and is pursuing several avenues. We will advise the Panel of the outcome as soon as possible.

Roman Domanski
9 January 2007