

# **Comments on the Position Paper: Review of the National Access Regime**

**2 June 2001**

## **Preface**

This submission is based on an intimate knowledge of the Victorian Electricity Industry Restructuring, the close involvement with the establishment of the National Electricity Market (NEM) and over 10 years experience in electricity cost modeling and pricing development, both under a regulated environment and in the new competitive market.

Electricity Markets Research Institute (EMRI) undertakes research with primary focus on:

- Public benefit aspects of competitive electricity markets:
- Technical and market efficiency,
- Equity issues,
- Transition issues going from integrated utility in a monopoly market to competitive marketing.

A brief write-up of the work of EMRI and a short biography of the author are given in Attachment A.

## **Introduction**

The present Review by the Productivity Commission is of national significance and timely:

- The national Access Regime is the cornerstone of the National Competition Policy
- It is now 5 years from the establishment of the National Competition Policy
- Affects infrastructure assets to the value of \$ 50 billion
- Major importance to the fortunes of most Australian businesses
- Vital to the quality of life enjoyed by Australian households

It is EMRI's view that it is the last two points that justify the conclusion "reliance on the anti-competitive conduct provisions of Part IV of the Trade Practices Act would not be a viable stand-alone mechanism" and so concur with the Review conclusion on that aspect.

The Position Paper makes the point "competition is a means to an end, not an end in itself. The current approach necessitates that, under the declaration process, efficiency effects are addressed as part of a residual public interest test, rather than being a 'first order' consideration". We are also told "While the impact on economic efficiency is always a primary consideration in determining community welfare, the NCC has indicated that it will consider other matters. These include environmental matters, social welfare and equity considerations, such as the maintenance of community service obligations (CSOs) and regional development".

All great stuff! Unfortunately, this is the beginning and the end of the story. These wonderful concepts espoused at the beginning of the report do not get a mention in the

nitty gritty of the comment, analysis and recommendations contained in the rest of the document. There is a deafening silence as to how these noble concepts can be assessed and incorporated into regulatory guidelines. Maybe they fall into the “too hard basket”. What a pity! Without these items being accorded their due place in the regulatory framework, there will always be something missing (the soul) in regulatory decisions, leading to dismay and dissention on the part of the intended beneficiaries.

### **Victorian Access Regime for Electricity**

Electricity Supply Industry (ESI) restructuring started with Victoria and as such Victoria has the oldest Access Regime. The National Electricity Market (NEM) is governed by its own Code and has its own Access arrangements. A retail electricity customer in Victoria is therefore subject to the Victorian Access regime for retail aspects and for network (distribution and pass through Transmission) access while electricity (commodity), which is sourced from the NEM, is subject to the NEM Access regime. There is no truly National electricity market as yet.

Victoria established State wide uniform prices in 1940 after much protracted public debate going far back as 1920. Whether this is a CSO or a USO (universal service obligation) is not material but it was the wish of the people – the community. Given that reasonably priced electricity, gas and water are “Vital to the quality of life enjoyed by Australian households” there is compelling reason for ensuring that at least reasonable quantities of these items are afforded to all in the community – be they rich or poor, in town or in the country, remote or near. Then we also have the important objective of “regional development” to think of. If the community expressly require ‘affordable prices for all’, the Governments must accept the charge (ie the will of the people) and meet the costs from the public purse or some other efficient arrangement – the Auction System proposed by Prof Milgrom comes to mind. In the past State Governments owned these utilities and ensured equitable prices by different means. In Victoria, there was an implicit locational cross-subsidy from urban to rural customers, in New South Wales the State Government achieved similar results by requiring different rates of return from the urban and rural distribution / retail businesses. It is unfortunate that the move to the NEM was done without due acknowledgement of this prior public benefit. The NEM now gets the blame for the actions of the respective State Governments responsible for withdrawing the prior public benefit as it was not an explicit arrangement.

Proposal 7.1 says “The Commonwealth Government should be required to submit its industry access regimes for certification. For existing Commonwealth regimes, any immunity from Part III A should be removed”. Well! What about State Industry Access Regimes? The Review of the National Access Regime would not be complete if its application to State instruments were also not reviewed.

In April 1995 the Victorian Government wanted an assurance that its reform / privatisation agenda would not be hampered by the new Amendments to the Trade Practices Act which was expected to become law in July 1995. The Trade Practices Commission was charged by the Assistant Treasurer to review and report whether

Victorian arrangements were consistent with the Competition Principles Agreement and can be considered 'effective'.

The TPC report of May 1995 (not mentioned in the Position Paper) had many adverse comments on the Victorian access arrangements. One of the areas of concern was the **handling of the urban to rural cross-subsidies**. "Cost reflectivity would suggest that it would be better to use some means other than price distortions to deliver support to target groups. Nonetheless, it is apparent that the CPA sees a continuing role for CSOs in Principle 2(4)(b), provided the instructions are explicit and the CSO is transparent".

In this regard the Commission concluded "that they are not inconsistent with the CPA and notes that the NGMC Code arrangements make provision for such adjustment mechanisms during the period to 2000". Note the last three words "the period to 2000". The ORG Distribution Pricing Review 2001 has extended the price distortions in question for another 5 years.

Another area of concern expressed in that report was regarding **capital contributions** for network augmentation. "the two guidelines do not have any detailed provisions to ensure that distributors cannot 'double-dip' for augmentation costs already covered".

Yet another area of concern was connected with **dispute resolution procedures** and the process to appeal a determination of the ORG before a Government appointed Panel. "The appeals are limited in that they can only be on grounds that there has been bias, or the facts on which the determination is based has been misrepresented. The grounds for appeal through the courts are also limited in that they can only be made on the grounds that the ORG has exceeded its powers or a failing of procedural requirements".

Sad to say there was a case where both these concerns were justified. A customer made a contribution of \$1.9 million to get two 66 kV lines from the factory to the Terminal Station – the boundary of the distributors system. This payment covered the full cost of one line, half the cost of the other line (as it was upgraded from 22 kV), the cost of connection assets at the Terminal Station and the cost of connection assets at the customers site. The contribution was made after the regulatory asset base was established and as such that \$1.9 million is not included in the regulatory asset base for the distributor. There was a special tariff set for this customer following the Pricing Review and it did not give any credit for the \$1.9 million contribution. The decision by the ORG to approve this tariff was appealed to the Appeal Panel – who held that they have no jurisdiction to hear the appeal as the approval of a tariff was not a 'determination' by the ORG. Effectively, this \$1.9 million contribution by this customer is a loss at a time the industry is struggling to make a profit. The distributor used for its own benefit the ORG Determination that the network distribution tariffs had to lie between the upper bound of 'stand alone costs' and the lower bound of 'marginal cost'. The Determination made no provision for the treatment of customer contributions already made or their portability when new tariffs are created.

The sad thing is that this rural distributor was also given a raw deal by the ORG – being given the biggest price reduction out of the 5 distributors, almost twice the price reduction of a well endowed urban distributor. Well endowed in that its customers are more affluent, more densely packed and happened to have had the highest franchise fee (used by the Victorian Government to claw back excess profits supposedly from franchise customers after allowing for an appropriate retail margin). It seems like a knee-jerk reaction, when you are under pressure – apply the pressure onto someone else. This distributor unsuccessfully challenged the ORG decision in the Supreme Court and now according to a recent newspaper report has decided to get out of the distribution business.

It is significant to note that the distributor when asked to justify the new tariff claimed that the customer contribution was outside the regulated asset base but was not linked to the assets on which this particular tariff was based. The distributor in question did not receive extra revenue in this instance but the customer was very badly penalised. Such abuse (misguided maybe but still an abuse) of monopoly power should be prevented.

**Proposal 8.1** of the Position Paper seems to condone such conduct and is to be deplored.

EMRI also wish to highlight an unintended consequence of the asset value adjustment involved in the Victorian approach to locational cross-subsidies. During the SECV days when there was uniform pricing across Victoria, the small rural customers (mostly) were subsidised by a very large number of commercial and urban small customers. The asset adjustment only met part of the high costs of serving rural customers. Now, mostly the large customers in the rural DBs have to meet the subsidy shortfall – the premium being as much as 40% extra (compared to urban DBs). Although the distribution component of a large customers bill is not that high as for a small customers, the impact on the bottom line of a large customer is significant - especially in the context of economic conditions as they are today.

### **Recommendations**

1. The current Review of the National Access Regime would not be complete without addressing matters raised in the May 1995 Report by the previous Trade Practices Commission vis a vis the Victorian Access Regime (as modified by the accommodation of the NEM Access regime).
2. Proposal 8.1 should include reference to banning ‘double dipping’ both from the network owners part and as it impacts the customer.
3. Proposal 8.1 should include reference making it mandatory for State based Access regimes also to have effective dispute resolution procedures to resolve customer concerns with regard to tariffs.

## Attachment A

**Electricity Markets Research Institute (EMRI) undertakes research with primary focus on:**

- Public benefit aspects of competitive electricity markets:
- Technical and market efficiency,
- Equity issues,
- Transition issues going from integrated utility in a monopoly market to competitive marketing.

**Other research & consultancy work cover:**

- demand side response in the context of the electricity pool market
- retail pricing and value studies,
- demand forecasting,
- network and ancillary services pricing,
- pricing of externalities eg Greenhouse Gas Emissions.

### **Contact Details:**

**Lasantha Perera, Director  
Electricity Markets Research Institute  
P. O. Box 6158,  
Vermont South VIC 3133, AUSTRALIA**

**Telephone : +61 3 9803 7170  
E-mail : [lasantha@bigpond.com](mailto:lasantha@bigpond.com)**

### **Biography of Lasantha Perera, Director - National Electricity Markets Research Institute**

Until July 1999, was Manager Pooling with Eastern Energy Ltd. Played a significant part in the deliberations of various bodies connected with the setting up of the National Electricity Market, including membership in the Dispatch and Pricing Reference Group. Was a founding member of the National Retailers Forum and have made many submissions to NEMMCO, NECA and the ACCC on different facets of the National Electricity Market.

Was inducted into Eastern Energy at its inception in 1994 and as Manager Pricing and Forecasting set up their Pricing and Forecasting section, participated actively in the trade sale process and managed the contestable customer pricing process.

As Pricing Analysis Manager with SECV spent seven years working on pricing development, cost of supply studies and the development of industry cost models, and defining price paths to reduce cross-subsidies. Was an active participant in the Victorian Electricity Supply Industry Restructuring process involving industry codes, Tariff Order and network pricing.

Has a MSc in Technological Economics from the University of Stirling in Scotland, is a Chartered Engineer from both the Electrical and Mechanical Institutes in the UK. Has over 35 years experience as an engineer / techno-economist, with work experience covering electricity generation, distribution, contracting, engineering jobbing, co-generation plant maintenance and R&D into renewable energy sources.