



TOTAL ENVIRONMENT CENTRE INC.
National Electricity Market Campaign

Suite 2, 89-97 Jones Street, Ultimo, NSW 2007
Ph: 02 9211 5022 | Fax: 02 9211 5033
www.tec.org.au

Submission to Productivity Commission

Electricity Network Regulation

April 2012

Glen Wright
Energy Market Researcher
glenw@tec.org.au

Total Environment Centre's National Electricity Market Campaign

Established in 1972 by pioneers of the Australian environmental movement, Total Environment Centre (TEC) is a veteran of more than 100 successful campaigns. For the last forty years we have been working to protect this country's natural and urban environments: flagging the issues, driving debate, supporting community activism and pushing for better environmental policy and practice.

TEC has been involved in National Electricity Market (NEM) advocacy for eight years, arguing for greater utilisation of energy efficiency and demand side participation to meet Australia's electricity needs.

Electricity Network Regulation

TEC welcomes the opportunity to provide input to the Productivity Commission's Electricity Network Regulation Issues Paper. Increasingly people are becoming aware that the inefficient rules of the National Electricity Market are in large part to blame for the overspend on networks and the concomitant increase in electricity prices.

A range of reforms are currently being discussed to try and alleviate this problem, and TEC is pleased that the Productivity Commission is investigating the use of benchmarking as a method for ensuring that Network Service Providers (NSPs) deliver electricity network services in the most efficient manner possible.

In this submission we do not assess particular methods of benchmarking. Instead, we are writing to present TEC's views on the general issues at hand and express our broad support for the implementation of some form of benchmarking, subject to further inquiry. In particular we support the consideration and assessment of a variety of overseas models.

TEC's Support for Reform of the Current Model of Regulation

TEC has long been an advocate for reforming the building block approach to regulation. TEC is primarily concerned that the building block approach, in linking Distribution Network Service Provider (DNSP) profits to the level of assets owned, encourages inefficient investment decisions. DNSPs are not incentivised to pursue non-network alternatives to meeting demand and their level of profit is not at all tied to the efficiency with which they deliver electricity.

TEC is also concerned that the current regulatory framework is weighted heavily in favour of Network Service Providers (NSPs). Aspects of this bias, such as the fact that NSPs have better information than the regulator, are compounded by the current approach, where a large amount of NSP-specific data is required to make revenue determination. Benchmarking could help to eradicate some of this bias.

TEC is therefore receptive to the consideration of alternative models.

Benchmarking

Benchmarking is widely used in electricity market regulation overseas and can be a valuable tool in the regulation of NSPs.

Enhanced information and transparency about regulated network businesses can benefit the regulatory process as well as improving the behaviour of network businesses. TEC recently released the NEM Report Card, which notes a number of data deficiencies in the NEM:¹ TEC hopes that future implementation of some form of benchmarking could help make the market more transparent by increasing the availability of information.

A well-informed regulator will likely set revenues more effectively. In addition, comparative analysis and reporting could incentivise NSPs to be more competitive in terms of efficiency. As TEC recently noted in a submission to Powerlink's revenue reset process, this company is known within the electricity world to be inefficient, but this is not common knowledge outside such circles, so there is little incentive from a brand-development perspective to increase efficiency.

As to specifics, TEC commissioned a report in 2008² that considered the Total Factor Productivity approach to distribution network regulation (TFP). While the report noted that TFP could lessen the problems with the building block approach, it concluded that the persistence of a price cap could negate any benefit resulting from the implementation of TFP. This suggests the need for broader reform if TFP in particular is to be successful, and the need for similar investigation before settling on a method of benchmarking.

Beyond Benchmarking

While benchmarking could make an important contribution to electricity network regulation in Australia, it is TEC's opinion that the time has come for a more holistic and overarching review of our approach. The 'cost-to-serve' building block approach is out-dated and not used by most of our closest economic partners. Likewise, its successor, the RPI-X approach, is also being questioned, with the UK recently abandoning this approach to benchmarking with a more incentive-driven approach to regulation.

As Marchmont Hill Note:

[I]nstead of continuing to demand more information or draw itself into a de facto manager role for these businesses, the AER should reconsider the nature of incentive regulation, and its real purpose to have electricity networks reveal their true costs of supply.

¹ Dunstan, C., Ison, N., Usher, J., & Harris, S. (2012). The NEM Report Card: how well does the National Electricity Market serve Australia. Sydney: Total Environment Centre. Retrieved from <http://www.tec.org.au/component/docman/doc.../409-nem-report-card-full>

² Headberry Partners, & Bob Lim & Co. (2008). Does Current Electricity Network Regulation Actively Minimise Demand Side Responsiveness in the NEM? Management. Sydney: Total Environment Centre. Retrieved from <http://www.advocacypanel.com.au/documents/Applic280.pdf>

Given network businesses have been through several cost-to-serve building block approaches to regulation, exploring alternate forms of regulation may provide businesses with real incentives to reveal their true costs.³

The RIIO approach adopted by the UK stands for Revenue=Incentives+Innovation+Outputs. Essentially this method of regulation provides a return for NSPs based on incentives to pursue efficiency, rewards for adopting innovative approaches to delivery of network services and targets for outputs.⁴ TEC believes that more holistic reform should also be considered for Australia.

TEC would be happy to provide further information regarding benchmarking methods should the Productivity Commission opt to pursue benchmarking further.

Yours sincerely,

Jeff Angel
Executive Director

Contact:

Glen Wright
Energy Market Researcher

³ Reynolds, J. (2011, September). Benchmarking electricity network monopolies: linking economic concepts on costs, pricing and efficiency. Retrieved from <http://www.marchmenthill.com/qsi-online/2011-09-22/benchmarking-electricity-network-monopolies-linking-economic-concepts-on-costs-pricing-and-efficiency>.

⁴ See Burns, P., & Roberts, M. (2011). The way to RIIO. London. Retrieved from <http://www.frontier-economics.com/europe/en/publications/384/>