

E-MAILED



Paul Fearon
General Manager, Regulation and Strategy

27 April 2001

Mr. Michael Rawstron
General Manager Regulatory Affairs
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602

FILE No:
DOC:

Dear Michael,

**JOINT RESPONSE OF THE VICTORIAN ELECTRICITY DISTRIBUTION BUSINESSES:
ACCC DRAFT DETERMINATION ON NETWORK PRICING AND MNSP CODE CHANGE
PACKAGE**

This letter is a submission from the Victorian Electricity Distribution Businesses in response to the ACCC's Draft Determination on the "Network Pricing and MNSP" Code change proposals. This letter reflects the views of AGL Electricity, CitiPower, Powercor Australia, TXU Networks and United Energy.

The Victorian DBs' comments on the Draft Determination are set out below under two main headings:

1. Regulation of distribution pricing in Victoria

On 12 February 2001, the Victorian DBs lodged a submission in response to the ACCC's invitation for comments on NECA's "Network and Distributed Resources" Code change package. That submission:

- noted the existence of similar or "parallel" provisions relating to regulation of distribution pricing and access in the National Electricity Code and in the Victorian regulatory regime; and
- expressed concerns that this may lead to inefficient duplication and overlap of effort on the part of regulators and the Distribution Businesses.

Accordingly, our February submission set out our understanding that the instruments governing regulation of distribution pricing and access in Victoria are those administered by the ORG under the Electricity Industry Act and the Office of the Regulator-General Act. The submission also noted our understanding that:

- the Victorian DBs are not required to comply with two separate, parallel State and National regulatory regimes; and
- in practice, a Victorian DB's regulatory compliance obligations in relation to distribution network pricing and access will be fully discharged if the DB complies with all relevant regulations administered by the ORG, notwithstanding the National Electricity Code.

ACCC
30 APR 2001

The ACCC's Draft Determination on the "Network Pricing and MNSP" Code change package states: "The Commission considers there will be substantial public benefits if a nationally consistent approach is developed for distribution pricing." The Draft Determination also contains a number of proposed amendments to the National Code's distribution pricing provisions, which are similar to provisions already in place in the Victorian regulatory regime.

These factors have reinforced our concerns about the possibility of inefficient duplication and increased costs arising from the development of parallel State-based and national regulatory regimes for distribution pricing and access. We have therefore sought from the ORG clarification of the DBs' regulatory compliance obligations, in light of the apparent move towards development of a nationally consistent approach for distribution pricing. Attached to this submission is a copy of the Victorian DBs' letter to the ORG in relation to these matters, and a copy of the ORG's response.

In view of the ORG's advice in relation to these matters, we do not propose to comment further on the proposed Code changes relating to distribution pricing. We reiterate our strong desire to see that:

- development of regulatory policy by the respective State and National agencies takes place in an efficient, coordinated, and consultative manner; and
- any proposals to change the present Victorian distribution pricing and access arrangements, in the context of a move towards greater national uniformity are sanctioned by the ORG after appropriate consultation, and proceed only if they are in the public interest (that is, only if regulatory compliance obligations are streamlined, total compliance costs are reduced, and the DBs' ability to efficiently manage their businesses is not constrained by unduly prescriptive or intrusive regulation).

We look forward to working with the Office of the Regulator-General, NECA and the ACCC over the coming months to ensure the achievement of these outcomes.

2. Development of new transmission pricing arrangements

NECA commenced its Transmission and Distribution Pricing Review in February 1997. The ACCC's Draft Determination, published nearly four years later contains a condition of authorisation (C4.2) requiring NECA to develop, model and test a default pricing method that satisfies certain principles set down by the ACCC, within 12 months of the ACCC's authorisation of the "Network Pricing and MNSP" Code changes taking effect.

We are concerned that four years after the commencement of NECA's review, the ACCC's Draft Determination proposes, in effect, to further extend the period of review by at least another 12 to 18 months. Whilst we acknowledge that the issues being addressed in this review are complex and controversial, we are concerned that the prolonged and on-going uncertainty about the rules for transmission pricing may be discouraging investment in new capacity by generators and Market Network Service Providers.

We are also concerned about the apparent lack of coordination between NECA and the ACCC during the period leading up to the publication of the ACCC's Draft Determination. We note that NECA's initial response to the Draft Determination (published in February 2001) identified a number of "first-order issues that need to be resolved to support the integrity of the determination and before development work can sensibly begin". The issues identified by NECA included:

- the basis for the usage charge: long or short-run marginal costs, or new investment costs;
- the share of the NSP's total regulated revenue to be represented by the usage charge;
- how the charge should be allocated between generators and other network customers;

- the implicit and acceptable degree of volatility of the transmission prices;
- whether the basis for the methodology is intended to be forward or backward-looking;
- how to move from cost allocation to prices;
- the basis for zones: regions, nodes, or some other construct;
- the role of NEMMCO, including its role in reconciling conflicting assumptions;
- the basis for the five-year prices that the TNSPs will be required to offer; and
- how to reconcile reasonable use of discretion in relation to a number of these issues within a single national regime.

We concur with NECA that these issues are indeed "first order issues". Given the progress made over the past four years in resolving these fundamental issues, we are concerned that the process set out in the ACCC's conditions of authorisation may lead to further delays in the finalisation of transmission pricing rules. We are pleased however that the draft minutes of the ACCC's pre-determination conference state:

"The Chair noted that... the Commission and NECA are in discussion about developing solutions to streamline the process... [The Chair] acknowledged that it would not be useful for the Commission to move forward to the final determination alone and that a more integrated approach is needed."

We strongly support the move by the ACCC and NECA to adopt a more integrated and coordinated approach to resolving these fundamental issues. We look forward to being advised of the details of the approach that the ACCC and NECA propose to adopt.

We also reiterate our concern that there is an increasingly pressing need for swift and efficient resolution of these issues. It seems to us that there is a need for all stakeholders to accept that a greater degree of pragmatism is required in order to come to a common position on these issues.

The application of congestion-based or scarcity-based pricing may provide signals that should encourage demand side response, and the emergence of non-network solutions. However, we are concerned that the application of such approaches needs to be tailored to take account of practical constraints. Some of these constraints were referred to by the South Australian Independent Industry Regulator, Mr Lew Owens, at a recent meeting of the Committee for the Economic Development of Australia.

An article published in *The Australian* on 4 April 2001 quoted Mr Owens as saying:

"The [NEM] model appears to require prices to rise for a considerable period before a new investor could justify investing in new plant and then for prices to fall as the new capacity fights for market share..."

The desire for more responsive and accurate cost signals to consumers... runs into a community attitude which may not be sympathetic to... economic ideals.

Many consumers simply want to pay a known tariff which is fair and reasonable and not be an active participant in the market. Many simply do not have the ability to move their demand and believe that electricity is a public good where average pricing regimes should apply."

We consider that Mr Owens is identifying a set of legitimate and important issues that have not yet received full consideration in the transmission (and distribution) pricing debate. Condition of Authorisation C4.1(3) states that: "Transmission usage prices must reflect the level and location of congestion, at the time usage occurs". For such prices to be effective, the consumers who drive peak demand (including those in the domestic sector) should be:

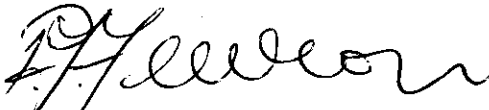
- capable of responding to the congestion-related price signals; or
- willing to pay the (necessarily volatile) congestion-related prices; or
- willing to pay a premium to a third party (such as a retailer) to manage the risk associated with the volatile congestion-related prices.

As noted by Mr Owens, many consumers are presently apprehensive about volatility of electricity prices. To the extent that political or technological constraints presently limit the ability of the end consumer to respond to, or absorb congestion-related transmission (and distribution) prices, then there appears to be reason to question whether the implementation of congestion-related network prices in the near term is sound public policy. We think this is an open question, and one which requires further careful consideration by the regulators and the participating Jurisdictions themselves.

We look forward to commenting in more detail on the specific proposals developed by NECA and the ACCC following the ACCC's authorisation of the "Network Pricing and MNSP" Code changes.

In the meantime, I would be pleased to discuss any queries you may have in relation to this submission. Please contact me directly on (03) 9297-8930.

Yours sincerely



Paul Fearon
General Manager, Regulation and Strategy, CitiPower
On behalf of the five Victorian Electricity Distribution Businesses

**ATTACHMENT TO VICTORIAN DB RESPONSE TO
ACCC DRAFT DETERMINATION ON NETWORK
PRICING AND MNSPs**



Paul Fearon
General Manager, Regulation and Strategy

27 March 2001

Mr. Richard Bolt
Director, Electricity Regulation
Office of the Regulator-General
Level 1, 35 Spring Street
Melbourne 3000

Dear Richard,

**OUTCOME OF DISCUSSIONS REGARDING DB REGULATORY COMPLIANCE
ISSUES**

I refer to the meeting held on 7 March, attended by Greg Wilson and yourself, and the regulatory managers of each of the five electricity DBs. On behalf of the regulatory managers, I would like to thank you and Greg for attending the meeting, and assisting to clarify the Office's views on the issue of potential duplication of the DBs' regulatory compliance obligations under the Victorian regime, and the National Electricity Code.

The purpose of this letter is to set out the DBs' understanding of their regulatory compliance obligations under the Victorian regime, and under the National Electricity Code.

The DBs have raised concerns that many of the provisions of Chapter 5 (connection and access to networks) and Chapter 6 (network pricing) of the National Electricity Code that relate to Distribution Network Service Providers (NSPs) are duplicated in the Victorian regulatory regime administered by the Office. We have expressed concern that this may lead to inefficient duplication and overlap of effort on the part of regulators and the Distribution Businesses. Following discussions with you and Greg, it is the DBs' understanding that:

- The purpose of the National Electricity Code, in so far as it applies to Distribution NSPs, is to set out a common national framework for regulation in areas where it is in the public interest to ensure national commonality.
- Within that broad national framework, the Jurisdictional Regulators are responsible for the development and administration of the regulatory regimes governing the provision and pricing of distribution network services within their respective jurisdictions. Accordingly, we note that:
 - For the period commencing after December 2000, the Office of the Regulator-General is (pursuant to clause 9.7.4(c) of the National Electricity Code) "responsible for the regulation of access to, connection to, the modification of a connection to, the augmentation of, the provision of network services and distribution use of system services and the modification of the provision of

network services and distribution use of system services in respect of Victorian distribution networks”.

- Part D of Chapter 6 of the National Electricity Code sets out the principles and objectives of distribution price regulation in the national electricity market, and subject to the consent of participating jurisdictions, provides for the possible formulation of national guidelines for such regulation. It also explicitly recognises the on-going role of Jurisdictional Regulators (in Victoria’s case, the ORG) “to be responsible within its jurisdiction for the regulation of distribution service pricing”. In effect, this provision has given the State-based regulators sole jurisdiction over distribution regulation in their respective States.
- Part E of Chapter 6 prescribes a specific distribution pricing method. However, clause 6.11(e) of the National Code states: “The Jurisdictional Regulator may, in consultation with Code Participants, develop alternative pricing methodologies to the approach set out in Part E.” In Victoria, the ORG has overseen the development and implementation of distribution pricing methods that are different to the one specified in Part E of the National Code, but consistent with the principles and objectives set out in Part D.
- The regulatory instruments that in practice govern regulation of distribution pricing and access in Victoria are those administered by the Office under the Electricity Industry Act and the Office of the Regulator-General Act.
- Therefore, in effect, a Victorian DB’s regulatory compliance obligations in relation to distribution network pricing and access will be fully discharged if the DB complies with all relevant regulations administered by the Office, notwithstanding the National Electricity Code.

As noted above, we understand that the National Electricity Code sets out certain principles governing the design of State-based regulatory regimes. Compliance with such provisions would, in effect, appear to be a matter for the Office rather than the Distribution Businesses, even though the Office may not be formally bound by the Code.

We note that in its recent Draft Determination on proposed changes to the National Electricity Code’s network pricing provisions, the ACCC states: “The Commission considers there will be substantial public benefits if a nationally consistent approach is developed for distribution pricing.” We also understand that other parties, including NECA, have expressed similar views.

The Victorian DBs are generally supportive of initiatives aimed at streamlining and standardising regulatory arrangements, where it is efficient for the DBs to do so. We would expect the regulator responsible for distribution pricing and access in this State (namely, the Office of the Regulator-General) to be closely involved in any National initiatives to standardise distribution regulation. Obviously, we would also be keen to participate in the detailed consultation processes that would necessarily accompany any such initiatives.

The Victorian DBs are particularly concerned to see that:

- development of regulatory policy by the respective State and National agencies takes place in an efficient, coordinated, and consultative manner; and

- any proposals to change the present Victorian distribution pricing and access arrangements, in the context of a move towards greater national uniformity, do not lead to duplication of, or a lack of clarity of the DBs' present regulatory obligations. Furthermore, the DBs consider that any such changes should be coordinated within Victoria by the Office, and should proceed only if they are in the public interest (that is, if regulatory compliance obligations are streamlined, total compliance costs are reduced, and the DBs' ability to efficiently manage their businesses is not constrained by unduly prescriptive or intrusive regulation).

The Victorian DBs look forward to working with the Office of the Regulator-General, NECA and the ACCC over the coming months to ensure the achievement of these outcomes. In the meantime, the DBs will continue to design and administer their regulatory compliance programs in accordance with the understandings set out in this letter.

It would be very helpful if you could confirm, on behalf of the Office, whether the DBs' understandings as set out in this letter accord with the views of the Office. It would also be helpful if you could provide your views on these matters in early April, to give the DBs an opportunity to consider your views prior to lodging their submission in response to the ACCC's Draft Determination on NECA's proposed "Network Pricing and Market NSP" Code changes.

I look forward to receiving your response. Should you wish to discuss any issues prior to drafting your response to this letter, please contact Mark Harding on 9297-8958.

Yours sincerely

(Signed) Paul Fearon
General Manager, Regulation and Strategy, CitiPower
On behalf of the five Victorian Electricity Distribution Businesses

**ATTACHMENT TO VICTORIAN DB RESPONSE TO
ACCC DRAFT DETERMINATION ON NETWORK
PRICING AND MNSPs**

26 April, 2001
File: CMELE/0049, SELE/0035

Mr Paul Fearon
General Manager, Regulation and Strategy
CitiPower Pty
Locked Bag 14031
Melbourne City Mail Centre Vic 8001

Dear Mr Fearon

REGULATION OF ELECTRICITY DISTRIBUTION

I refer to your letter of 27 March seeking clarification of the regulatory arrangements for electricity distribution that apply in Victoria, given the overlapping provisions of the National Electricity Code ('Code') and regulatory instruments made under the *Electricity Industry Act 2000*.

As your letter acknowledges, the Code provides that the Office remains responsible for regulating the pricing of, access to and use of distribution networks in Victoria. The Office, following consideration of the Code and discussions with NECA, is satisfied that there is little risk that NECA will seek to enforce on the Victorian distributors regulatory obligations in the Code relating to pricing and access. However, the Office will seek to formally clarify the respective responsibilities of the two organisations including, if necessary, through amendments of the Code.

This is not to suggest that the Code has no relevance to the regulation of distribution in Victoria. The Office believes that the Code provides a vehicle for aligning jurisdictional approaches to the regulation of distribution over time. Increasing emphasis is likely to be given by the Office and other regulators to achieving alignment where benefits would arise. Alignment of regulatory reporting requirements has already commenced under the auspices of the Utility Regulators Forum.

Distribution system connection, augmentation and use

The Office is empowered to regulate distribution system connection, augmentation and use under the *Electricity Industry Act 2000*. Were the Office to be bound by the Code,¹ it would be constrained to exercise its powers in a manner that is not inconsistent with the Code (the Office is prevented by the *National Electricity (Victoria) Act 1997* from enforcing the Code itself).

As stated above, the Office accepts that Victoria's regulations should be aligned with Code requirements where this would be beneficial. However, it would be more appropriate for the Code to place obligations on jurisdictional regulators to achieve this objective – where the jurisdiction has established a regulatory regime outside the Code – rather than placing conflicting obligations on distributors. Further, alignment should occur over time and after appropriate consultation.

Although there is common ground between Chapter 5 and distributors' licence obligations, there are important inconsistencies. For example, the harmonics standard in Schedule 5.1 and the power factor obligations of customers in Schedule 5.3 are different to the equivalent standards in the Distribution Code. As you are aware, the performance standards in the Distribution Code are the product of extensive consultation and analysis and form the basis of the Electricity Distribution Price Determination. As discussed above, the Office intends to clarify that the Distribution Code applies in Victoria, and is satisfied that National Electricity Code standards are unlikely to be enforced on Victorian distributors.

Distribution pricing

As noted in your letter, Part E of Chapter 6 is subject to clause 6.11(e), which allows the Office to develop alternative pricing methodologies to those prescribed in Part E. The principles that apply to distribution pricing in Victoria are those set out in the Electricity Distribution Price Determination. Part D of Chapter 6 of the Code will not become relevant until the next review. In any event, Part D applies to jurisdictional regulators rather than distributors and remains subject to the Tariff Order.

Again, the Office sees merit in consultation on the development of nationally consistent approaches to distribution network pricing and price regulation. Dialogue between regulators on pricing principles has already occurred and will continue, although no formal process is yet planned for the development of national principles.

I trust that this addresses the matters raised in your letter.

Yours sincerely

Richard Bolt
Director, Electricity Regulation

Copies: Rohan Jones, AGL Electricity
Brent Cleeve, Powercor
Patrick Murphy, TXU Networks
Roger Pugsley, United Energy
Greg Thorpe, NECA
Michael Rawstron, ACCC
Peter Naughton, DNRE

¹ To date, no order has been issued under section 8C of the *National Electricity (Victoria) Act 1997* that would make that act relevant legislation for the purposes of the *Office of the Regulator-General Act 1994*. Accordingly, the Office is currently not bound to comply with the National Electricity Code.