

30 May 2002

Dr Tom Parry  
Chairman  
Independent Pricing and Regulatory Tribunal  
GPO Box Q290  
QVB Post Office  
Sydney NSW 1230

Dear Dr Parry

### **Economic Regulatory Arrangements – (Form of Regulation) Draft Notice**

EnergyAustralia welcomes the Tribunal's intent to apply a weighted average price cap for the regulatory period commencing 1 July 2004 and supports its development of the detailed framework to maintain the weighted average price cap methodology.

However, EnergyAustralia must emphasise that while the selection of the capping method is a key decision, it is only the first step in defining the overall framework for the economic regulation arrangements to support that form of regulation. As was discussed at the Tribunal's public forum and in submissions to your office, the other elements of the overall framework can and will have a major effect on the operation and incentives of any regulatory approach adopted.

Similarly all of the elements must be accurately and appropriately captured in the mathematical expression of the form of regulation. The formula provided in the draft notice is clearly meant to demonstrate the form rather than the content of the control formula, as it only provides for a one-year lag and does not deal with issues such as service quality pass-through costs. Hence EnergyAustralia expects that the formula ultimately applied will be developed in more detail as the overall framework is consulted on. Although it is clear that many of the overall framework issues are to be addressed through the determination process, the Tribunal's notice does raise issues that must be addressed now.

In particular there are three issues discussed in the draft notice which raise the concerns that, if they were to be adopted by the Tribunal, the resulting form of regulation may no longer operate as a weighted average price cap, or would severely undermine the National Electricity Code requirement for a revenue stream and prices which are forward looking.

First, benefit sharing is achieved in the weighted average price cap through the efficiency drivers in the building blocks and through the reduced charges in subsequent years where actual demand is higher than forecast. Any attempt to modify the form of regulation such that rates are scaled down due to higher than forecast demand may not adequately meet the capital needs that increased demand creates. We believe this is a significant aspect of the form of economic regulation and is the defining element of sliding-scale regulation and as such should not be considered as a mechanism to implement the weighted average price cap.

Second, the utilisation of a mechanistic approach to forecasting for the building block parameters has been clearly demonstrated to suffer major shortcomings, as has been highlighted by EnergyAustralia's experience during the current determination period. It has become clear that the forward forecasts of demand and consumption patterns require assessments of the future nature and requirements of electricity consumers, future economic activity, anticipated building developments, and changing weather patterns.

Therefore a level of expert judgement is clearly required to be exercised in order to reach a reasonable assessment of the future nature of the network over the regulatory period, which in some circumstances may bear little or no correlation to long term historic averages.

Without the exercising of qualified judgement it is impossible to establish a set of building blocks that are forward looking, and therefore one of the major tenets of network pricing incorporated in the National Electricity Code would be breached to the detriment of networks, the environment and customers alike.

Third, the use of a correction factor is not consistent with the weighted average price cap model. As outlined in a previous submission to the Secretariat, the use of correction factors by the ORG, now the ESC, was a recognition of the need to maintain the integrity of the incentive mechanisms of the previous determination that had a specific lag time for the correction factors to be applied. The same imperative does not exist in NSW. The only issue that must be considered is the appropriate treatment of the balance of over/under recovery accounts of the DNSPs as at the end of the current determination.

In its earlier submissions on the form of regulation EnergyAustralia argued for a  $P_0$  adjustment to take account of issues arising from the operation of the current determination. EnergyAustralia accepts that this may not be practicable for all of the DNSPs, however the elimination of 'carry-over' issues will greatly enhance the efficiency and incentives of the weighted average price cap framework and should be a major objective of the Tribunal in implementing the new form of regulation.

Recognising the implications that implementation policies have on the ultimate form of regulation delivered, EnergyAustralia anticipates an active and timely exchange of ideas as the details of the economic regulation framework to support the form of regulation are explored in conjunction with the 2004 distribution determination process. However EnergyAustralia has been very clear in its submissions on what framework EnergyAustralia believes is required to maintain an effective weighted average price cap with the appropriate economic signals, and would urge the Tribunal to adopt its approach.

If you have any queries regarding this issue please do not hesitate to contact me on 9269 2145 or Mr. Michael Martinson on 9269 2234.

Yours sincerely,

(GEORGE MALTABAROW)  
General Manager Finance – Corporate Secretary