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Dear Anna

Re : Discussion Paper on the form of regulation

The Public Interest Advocacy Centre is grateful to the Tribunal Secretariat for the release of its *Discussion Paper*. This has been invaluable to us in developing a deeper understanding of the various options raised in the original issues paper of last August. In this we have appreciated the support of the Secretariat as we have attempted to come to terms with a complex area of regulation. Similarly, we wish to acknowledge the opportunity given to us to attend the recent public forum on the form of regulation and hear the views of the distribution businesses on these issues.

In its first submission to the Tribunal concerning this review of the form of regulation, PIAC stressed its preference for a model that can be readily understood by consumers. In particular, we put forward the view that this would enhance transparency of regulatory decision making.

Bearing this in mind, and having had the opportunity to explore further the structure of the various models suggested for the form of regulation, it is important we stress to the Tribunal our belief that residential consumers will best be served by either of the variable revenue cap models.

In our view, either of these options meet the criteria of being a model which is easy to understand. This is because each links any future movement in prices to changes in total demand within a distribution area. Growth in total demand would result in falling prices as the fixed revenue cap is distributed amongst more customers. Conversely, declining total demand would increase the burden on individual customers. We have come to the view that this is much more readily explained to residential consumers of electricity than the concept of an average cost and the consequent re-balancing of prices.

We note, once more, that revenue cap models establish an inverse relationship between movements in demand and price. Equally, PIAC is aware of the implications of either variable revenue cap model for volatility in the prices paid by end-use customers. In our view, however, these are consequences arising from the requirement in the National Electricity Code that distributors operate under a revenue cap and not a price cap. In any event, the scale of volatility surely will be muted by the application of side constraints to final prices. In addition, such price movements seem certain to produce clearer outcomes for consumers than the current approach of 'unders and overs' with all its associated regulatory discretion in dealing with over-recovery by the businesses.

Of particular interest to PIAC is the use of marginal costs in the rolling growth variable revenue cap model. While each of these models has the effect of driving down average costs for all consumers, this last option described in the Secretariat's *Discussion Paper* provides a clear benchmark for prices by identifying the gap between marginal and average costs. We would expect, as a result, that any estimation of marginal costs by the Tribunal would be hotly debated by the distribution businesses. Nevertheless, we consider that this model would enable residential consumers more readily to understand the cost components of their bills.

From our understanding of the discussions with the distributors at the public forum there is only one distributor in NSW who considers that their demand may decline over the next regulatory period. Australian Inland Energy and Water could face decreased demand from industry that could increase prices across AIEW's customer base under a revenue cap. While this is not an issue for the form of regulation, it may be an issue for the types of side constraints that are allowable in Tribunal's distribution pricing determination.

If you have any queries about the issues raised in this correspondence, please do not hesitate to contact me or Jim on 9299-7833.

Yours sincerely
Public Interest Advocacy Centre

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