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**Publications Inquiries:**

Media and Publications

Productivity Commission

Locked Bag 2 Collins Street East

Melbourne VIC 8003

Tel: (03) 9653 2244

Fax: (03) 9653 2303  
Email: maps@pc.gov.au

**General Inquiries:**

Tel: (03) 9653 2100 or (02) 6240 3200

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The Productivity Commission

The Productivity Commission is the Australian Government’s independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

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The Hon David Bradbury MP  
Assistant Treasurer

Parliament House

CANBERRA ACT 2600

Dear Assistant Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission’s final report into Electricity Network Regulatory Frameworks.

Yours sincerely

|  |  |  |
| --- | --- | --- |
| Philip Weickhardt  Presiding Commissioner | Wendy Craik AM  Commissioner |  |

# Terms of reference

I, Wayne Swan, Deputy Prime Minister and Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby request that the Productivity Commission undertake an inquiry into electricity network frameworks, focussing on benchmarking arrangements and the effectiveness of the application by network businesses of the current regulatory regime for the evaluation and development of interregional network capacity in the National Electricity Market (NEM).

*Background*

Australia’s electricity sector is facing a number of challenges over the coming years. This includes a large investment requirement for networks to replace ageing assets, meet growing levels of peak demand, reliability requirements and to facilitate the transition towards Australia’s clean energy future.

Recent increases in network expenditure, and the resultant flow on to increases in electricity prices for end users, have highlighted the need to ensure networks continue to deliver efficient outcomes for consumers. Network regulation is a complex task requiring difficult and technical judgements. This inquiry will inform the Australian Government about whether there are any practical or empirical constraints on the use of benchmarking of network businesses and then provide advice on how benchmarking could deliver efficient outcomes, consistent with the National Electricity Objective (NEO). In addition, a second stream of this inquiry will examine if efficient levels of transmission interconnectors are being delivered, to inform the Australian Government about whether the regulatory regime is delivering efficient levels of interconnection to support the market.

*Scope of the Inquiry*

The Commission is requested to assess the use of benchmarking as a means of achieving the efficient delivery of network services and electricity infrastructure to meet the long term interests of consumers, consistent with the NEO. In addition, the Commission is requested to assess whether the current regulatory regime, as applied to interconnectors, is delivering efficient levels of network and generation investment across the NEM.

In undertaking the review, the Commission should:

* examine the use of benchmarking under the regulatory framework, incorporating any amendments introduced in the review period, in the National Electricity Rules and provide advice on how different benchmarking methodologies could be used to enhance efficient outcomes; and
* examine whether the regulatory regime, with respect to the delivery of interconnector investment in the NEM, is delivering economically efficient outcomes.

In undertaking the inquiry, the Commission should consider and take into account the work that is currently being progressed through the Standing Council on Energy and Resources, the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER). The Commission should have particular regard for the AEMC reviews into transmission frameworks, power of choice (demand side participation) and the suite of rule changes relating to network regulation currently under consideration by the AEMC in accordance with its statutory obligations.

The Commission should engage with the AEMC, the AER and the Australian Energy Market Operator in undertaking the review. In addition, the Commission should consult with Australian Government agencies, state and territory government agencies and other key stakeholders in undertaking the review.

The Commission will report within 15 months of receipt of this reference and will hold hearings for the purpose of this inquiry. The Commission is to provide both a draft and a final report, and the reports will be published. The Government will consider the Commission’s recommendations, and its response will be announced as soon as possible after the receipt of the Commission’s final report.

Wayne Swan

9 January 2012

# Disclosure of interests

The *Productivity Commission Act 1998* specifies that where Commissioners have or acquire interests, pecuniary or otherwise, that could conflict with the proper performance of their functions during an inquiry they must disclose the interests.

Dr Craik has advised the Commission that she is the beneficiary of subsidised solar PV panels.

Contents

The Commission’s report is in two volumes. **This volume 2 contains chapters 9 to 21, Appendix A and the References**.Volume 1 contains the Overview, the Recommendations and findings and chapters 1 to 8. Appendices B to F will only be available on the Commission’s web site (http://www.pv.gov.au). Below is the table of contents for both volumes.

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# Acknowledgments

The Commission engaged the services of Dr John Tamblyn, a well-known expert on the National Electricity Market (who has recently been involved in two other independent reviews of aspects of the electricity industry) to review some chapters and the overview for the draft of this report. Dr Tamblyn provided valuable feedback to the Commission, for which we are most grateful. However, the views and judgements in this report are those of the Commission alone, and should not be attributed to Dr Tamblyn or any other participant, except where clearly stated.

# Abbreviations and explanations

Abbreviations

AATSE Australian Academy of Technological Sciences and Engineering

ABS Australian Bureau of Statistics

ACCC Australian Competition and Consumer Commission

ACT Australian Competition Tribunal

AEMC Australian Energy Market Commission

AEMO Australian Energy Market Operator

AER Australian Energy Regulator

AEMA Australian Energy Market Agreement

ASU Australian Services Union

ATA Australian Technology Association

CAIDI Customer average interruption duration index

CALC Consumer Action Law Centre

CAPEX or capex Capital expenditure

CBA Cost-benefit analysis

CDF Customer Damage Functions

COAG Council of Australian Governments

CPI-x Consumer Price Index minus a benchmark productivity rate (x)

CPP Critical Peak Price

CSIRO Commonwealth Scientific and Industrial Research Organisation

DANCE Dynamic Avoidable Network Cost Evaluation model

DG Distributed generation

DLC Direct load control

DM Demand management

DMEGCIS Demand Management and Embedded Generation Connection Incentive Scheme

DNSP Distribution Network Service Provider

DPI Department of Primary Industries (Victoria)

DRED Demand Response Enabling Device

DSP Demand side participation

EBSS Efficiency Benefit Sharing Scheme

ENA Energy Networks Association

ERAA Energy Retailers Association of Australia

esaa Energy Supply Association of Australia

ESC Essential Services Commission (Victoria)

ESCOSA Essential Services Commission of South Australia

ETC Electricity Transmission Code

EU European Union

EUAA Energy Users Association of Australia

FCAS Frequency control ancillary services

GDP Gross Domestic Product

HV High voltage

IPART Independent Pricing and Regulatory Tribunal (NSW)

IRSR Inter-regional settlement residue

kV kilovolt

kVA kilovolt ampere

kW kilowatt

kWh kilowatt hour

LRIC long-run incremental cost

LRMC long-run marginal cost

LV Low voltage

LYMMCo Loy Yang Marketing Management Company

MAIFI Momentary average interruption frequency index

MAR Maximum annual revenue

MCE Ministerial Council on Energy

MDMS meter data management system

MED Major event days

MEU Major Energy Users

MFP Multifactor productivity

MNSP Market network service provider

MW Megawatt

MVA Megavolt amperes

MWh Megawatt hour

NECA National Electricity Code Administrator

NECF National Energy Customer Framework

NEM National Electricity Market

NEMMCO National Electricity Market Management Company Limited

NEO National Electricity Objective

NEL National Electricity Law

NER National Electricity Rules

NGF National Generators Forum

NGL National Gas Law

NMS Network management systems

NPV Net present value

NSP Network service provider

NTNDP National Transmission Network Development Plan

NTP National Transmission Planner

N-x Measure of redundancy in network (with higher x being higher levels of redundancy)

OFA Optional firm access

Ofgem Office of Gas and Electricity Markets (UK)

Ofwat Office of Water Services (UK) (On 1 April 2006, the functions of Ofwat were replaced by the Water Services Regulation Authority)

OPEX or opex Operating expenditure

PC Productivity Commission

PIAC Public Interest Advocacy Centre

PSCR Project Specification Consultation Report

PV Photovoltaic

QTC Queensland Treasury Corporation

QUT Queensland University of Technology

RAB Regulatory asset base

RET Renewable Energy Target scheme

RIT-D Regulatory Investment Test for Distribution

RIT-T Regulatory Investment Test for Transmission

SAIDI System average interruption duration index

SAIFI System average interruption frequency index

SCER Standing Council on Energy and Resources

STPIS Service Target Performance Incentive Scheme

SOC State-owned corporation

TEC Total Environment Centre

TNSP Transmission network service provider

TOU Time of use (electricity tariffs)

VCEC Victorian Competition and Efficiency Commission

VCR Value of Customer Reliability

WACC Weighted average cost of capital

WAPC Weighted average price cap

Explanations

|  |  |
| --- | --- |
| Billion | The convention used for a billion is a thousand million (109). |
| Findings | *Findings in the body of the report are paragraphs high­lighted using italics, as this is.* |
| Recommendations | ***Recommendations in the body of the report are high­lighted using bold italics, as this is.*** |