Major Energy Users Inc.

Australian Government Productivity Commission

Electricity Network Regulation

Comments on the Draft Report

Submission by

The Major Energy Users Inc

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The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission. The content and conclusions reached in this submission are entirely the work of the MEU and its consultants.

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Executive Summary

The Major Energy Users Inc (MEU) supports the Productivity Commission's comprehensive framework of recommendations which will assist in winding back recent trends in steeply escalating electricity prices.

The major cause of spiralling electricity prices is due to the unbalanced and biased rules introduced by the AEMC in 2007 (on the transmission networks) and flowing from that, the rules finalised by the Standing Committee of Officials of the MCE in 2008 (on the distribution networks).

Whilst there has been an unfortunate focus on the performance of the AER by the Commission and other critics, in the considered view of the MEU, the focus should also be on the other new institutions' performance as well, and an independent review undertaken into the AEMC in the same way as the Expert Panel's review of the Limited Merits Review regime and the performance of the Australian Competition Tribunal.

The "…poor focus on consumers despite their interests being on the overarching objective of the regulatory regime…" (PC page 2) must surely be also directed at all NEM institutions that have contributed to the escalation in network prices – in this case the rule makers – and therefore a review undertaken of them to improve their performance, governance, resourcing, transparency and accountability.

The MEU is a strong supporter of the Consumer Advocacy Panel's role in assisting and promoting consumer advocacy. The MEU's consumer advocacy role has been enhanced through the valuable assistance of the Advocacy Panel.

There is no support for a representative consumer body to represent "consumer views" as there is not always a unified or necessarily shared view (at all times) amongst the wide and disparate range of consumers. A lean and relatively inexpensive consumer advocacy funding body as at present should be continued.

The MEU does not agree with the Commission's views regarding the adequacy of interconnectors. The fact that a constraint on connectors has enabled, in some regions, generators to exercise market power frequently and persistently is evidence that weak interconnection has led to massive wealth transfers from consumers to generators.

The MEU is particularly concerned at the extent of governmental interventions in the electricity market, often in the guise of myriad Federal and States climate change and energy savings schemes. There is the potential for the direct and indirect costs of such schemes to overwhelm the benefits of genuine electricity reforms via the framework of reforms proposed by the Commission and by rule

makers and regulatory agencies and consumers will be no better off. The MEU recommends that the Commission puts the spot light on such distortions to the electricity market, which are having adverse economic and social consequences and are not in the long term interests of consumers.

The MEU also provides comments in this submission on most of the Commission's recommendations and on a number of requests for further information

1. Introduction

The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the draft report by the Productivity Commission.

The MEU agrees that spiralling network costs are the main contributor to the escalation in electricity prices over the past five years and it is correct to examine the related issues responsible and to seek to address them via the comprehensive framework of reform recommended by the Commission.

There is, however, an equally insidious set of issues that have adversely affected electricity markets over recent years and these could be expected to provide an overhang over the electricity market over the next few years or more.

The extent and depth of government – Federal and State – intervention in the electricity market has also contributed to significant electricity price increases. Most concerning is that the plethora of climate change and energy saving schemes – of which there are nearly 300 – is sharply distorting the electricity market for consumers and investors, not only by adding to the costs of electricity but creating significant uncertainty for both upstream and downstream investments.

Equally disconcerting is that the plethora of government climate change and energy savings schemes will have a life of its own, with a multiplicity of possibly duplicative, questionable and open-ended regulatory interventions and imposts, thereby potentially negating the benefits that could arise from all the present efforts by government and energy regulatory authorities to rein in the escalation in electricity prices (such as those recommended by the Commission). The MEU strongly recommends that the Commission puts a spotlight on the concerns raised in relation to the heavy imposts that electricity consumers see as a result of these requirements that distort the essential cost reflectivity and non-discriminatory nature of the electricity market. The administrative and compliance costs of such schemes are also adding significantly to the costs of doing business in Australia.

For example, the renewable energy target scheme provides an incentive for forms of generation that result in the need to invest in networks that result in the networks being grossly under-utilised. Intermittent generation is such a form of generation. Here networks are required to accommodate large amounts of flow for short periods of time. Within the draft recommendations, the Commission proposes that consumers who use electricity at times of high demand should be charged for the cost to provide the network assets needed to accommodate the high usage. In contrast, governments have incentivised generators which do exactly the same thing (increase the need for network assets for short periods of time) but which are not being levied with the costs that are required to accommodate the short term usage or the congestion that they cause..

The MEU generally supports the recommendations suggested by the Commission in its draft report, but has firm reservations after its assessment of some of them. Such issues include its assessment of interconnectors and on the Australian Energy Regulator. In addition, the MEU considers that the performance of the key NEM institutions, including importantly the AEMC, require independent review to ensure proper resourcing and quality performance. This will follow the recent review of the limited merits review regime which looked at the performance of the Australian Competition Tribunal and the AER, in the context of whether their performance were consistent with the National Energy Objectives (:…in the interests of consumers.

This submission expands on the MEU's reservations and also provides comments on many of the Commission's recommendations in a table in section 4 of this response. Unless specific issues or recommendations are raised and discussed in this submission, the Commission should assume that its recommendations contained in the draft report are supported – indeed, as many of the recommendations have long been recommended by the MEU (but to no avail).

The MEU also adds a note of caution and concern. The draft recommendations prepared by the Commission are often closely inter-related – that one recommendation cannot be implemented without another being implemented. The MEU sees that a number of the recommendations are unlikely to be implemented in the near future (such as the sale of government owned networks). This means that other recommendations (such as the cost of debt to be included in the weighted average cost of capital) need to be adjusted until the lead recommendation is achieved. The MEU has noted that the PC has made recommendations should another recommendation not proceed to address a number of such inter-relationships and comments have been provided in relevant sections of this MEU response.

The MEU notes with interest the proposal included in the draft report which provides a time frame for the implementation of the various draft recommendations. The MEU welcomes this and sees that such an inclusion provides an excellent road map for the implementation of the PC recommendations. The MEU is concerned, though, that many of the recommendations will take too long to implement and so deliver benefits to consumers who are already exposed to considerable hardship.

2. Comments on Some Draft Recommendations

Overall, the Major Energy Users (MEU) considers that the Productivity Commission (PC) has carried out a valuable exercise in the development of its draft recommendations and the reasoning behind them. As a result, the MEU supports the bulk of the recommendations and has noted this in the table addressing each recommendation. There are some areas where the MEU considers that PC has not fully appreciated all of the aspects that affect the issues associated with each of the recommendations. The MEU therefore comments specifically on a number of recommendations in the this section

2.1 Draft Recommendations 7.1 and 7.2 – Ownership

These recommendations are strongly supported by the MEU. Governance arrangements applying to State owned businesses are particularly important, especially in the light of the AEMC's inadequate final position in relation to the prescribed treatment of the financing costs of the State-owned networks by the AER in pricing reviews.

The MEU remains concerned that governments have traditionally looked on increased dividends and tax equivalent payments from state-owned network businesses to fund budget requirements and the AEMC's final position as pointed above, will not prevent network businesses from implementing inefficient capital investments

Along with the Standing Committee on Energy and Resources (SCER) Expert Panel looking at the limited merits review regime, the MEU considers that the electricity rules have been developed for application to privately owned network businesses yet they are applied to government owned entities which constitute over 80% of all electricity networks. There is a significant mismatch between the rules and the ownership structure and it must be recognised that ownership for a large proportion of electricity networks will not change in the foreseeable future. Therefore the rules have to be pragmatic (in view of the degree of economic and social hardships arising from the continued escalation in electricity prices) and recognise that government ownership of networks has to be assumed to continue and that the incentives for cash strapped governments to look for disguised forms of taxation by way of utility dividends and other payments or imposts will be present.

There are two core aspects regarding government ownership that must be addressed by the PC

2.1.1 Cost of debt

Governments can access debt at much lower costs to private entities due to their higher credit rating, and thereby provide debt to their networks at cost

rates much lower than privately owned networks. With this lower debt rate, government owned networks should be able to provide the services at a lower cost than private networks all other things being equal.

With the new rules providing a WACC to government owned networks based on accessing debt as a private entity, the incentive on government networks to overspend will continue to increase. In contrast, the challenge in acquiring debt by private networks provides an inbuilt control on private networks to constrain overspending.

The MEU considers the PC has to recognise that, despite their draft recommendation for governments to sell their network assets, this is unlikely to occur, at least into the near future Therefore the PC has to make recommendations that will constrain the overpayment to government owned networks due to the disparity between the cost of debt to government networks and the cost of debt to private networks. The MEU considers that this can be achieved by the rules stating that the cost of debt incurred by government networks must reflect the cost of debt lent to the network by its associated Treasury Corporation.

2.1.2 Conflict of interest

The PC has made recommendations (7.2) regarding the requirements of the Boards of the government owned network corporations but the government owners themselves have a significant conflict of interest in being both owners of networks and being members of the oversighting government body (currently the Standing Committee on Energy and Resources (SCER). SCER has the ability to set policy (as they were the final arbiters in setting the distribution rules in 2007/08) and to appoint officers to the various entities and institutions managing the electricity market.

The MEU considers that network owners should not be permitted to make policy that affects the rules applying to networks. Similarly, government owners of generators should not be permitted to make policy that affects the rules applying to generation. When a member of the Board of a corporation considers they have a conflict of interest, it is required they absent themselves from the Board meeting where that conflict might arise and so cannot be seen to influence the decision. The SCER members should similarly be required to absent themselves when there is a conflict of interest between ownership and the setting policy or appointing officers that can impact their ownership of assets.

In the MEU's view, it is important that perceptions about conflicts of interest are avoided by following basic governance arrangements such as those mentioned above.

2.2 Draft Recommendations Involving Benchmarking

Increasingly there is a greater use of related parties to carry out tasks for regulated networks. Gas pipeline businesses have increasingly struck related party contractual arrangements to undertake operations and electricity network businesses are also moving in this direction. The issue of related party transactions and transfer of funds to parent corporations for "management support" and other similar profit transference under the guise of service provision needs to be recognised as not being an additional (double dipping) cost to provide the regulated service.

The benchmarking to be undertaken by the AER must include such related party transactions/arrangements, which have up to now been largely non-transparent because of claims of commercial confidentiality.

2.3 Draft Recommendations Involving Governance

The MEU generally supports the recommendations involving better resourcing of the AER and greater control and accountability (Draft recommendations 21.1 and 21.2). The MEU reiterates this support in its specific comments regarding those recommendations.

The MEU has noted that there is a significant move by some to have the AER role excised from the ambit of the ACCC. The PC provides a litany of the complaints about the activities of the AER but fails to comment about the overarching complaint that consumers raise that the most significant problem of escalating prices is overwhelmingly caused by the current set of rules (now recognised to be biased in favour of regulated firms) which has led to unbalanced outcomes that the AER was unable to address. It is these outcomes and constraints on the AER that caused many of the concerns raised by consumers. It must also be seen that complaints of the AER by regulated firms could be suspect as they have a clear vested interest in doing so, in order to "push" for better regulated outcomes.

The MEU is of the view that the AER should remain part of the ACCC for a number of reasons, but particularly so because the roles of the AER and ACCC in regulation provide strong links in consumer protection. The MEU is concerned that an AER independent of the ACCC will reduce the quality of energy regulation as staff resourcing the AER independently will be provided with less of a career path – an issue that was seen in the state regulators when energy regulation was transferred to the AER. There will also be a loss of expert staff and of staff with relevant expertise and corporate memory.

Notwithstanding this move for segregation of the AER and ACCC, the MEU is pleased to note that the PC, in its role of reviewing the energy regulatory environment (and making the recommendations it does regarding resourcing the AER) has implied that the AER should remain within the purview of the ACCC. .

But the MEU considers that the PC has erred in limiting its requirement for independent review to just the AER, because the performance of the AEMC has significant impacts on the network rules and the electricity market, and hence the impacts on consumers.. .

Therefore, the MEU also strongly recommends that the draft recommendations also cover the other key NEM institution (especially the AEMC). The MEU has participated in many reviews conducted by the NEM institutions over the years and believe that it is timely for the institutions to be independently reviewed. Just as the recent Expert Panel review of the limited merits review regime has concluded the need for very substantial reform of the regime, the MEU considers that the other NEM institutions will benefit from a similar review.

In particular, there are strong reservations about the performance of the AEMC, beginning with its decisions relating to the Transmission Revenues and Pricing Reviews and Rule changes in 2007, which have been at the heart of the recent network price escalation and have now been in operation for over the past 5 years. These transmission rules became the basis of the electricity distribution rules developed by the Standing Committee of Officials of MCE (now SCER) in 2008 and the gas rules in 2009. It was the incentives built into the electricity transmission rules that have been the driver for the explosion in electricity network costs in the past five years.

In fact, the Commission's recommendations for an ex post audit of capital investments and a rejection of the automatic rolling in of past capital expenditure into the Regulatory Asset Base, are basically reinstalling the rules that were in the previous National Electricity Code; these rules were removed by the AEMC despite strong opposition by consumer groups, the AER and State regulators. In fact, the MEU specifically warned the AEMC at that time of the significant adverse consequences of their decisions. But our concerns were disregarded.

Since the AEMC developed the electricity transmission rules, there have been strong reservations expressed about perceptions of its governance arrangements by the Energy Reform Implementation Group report to COAG[1].

[1] ERIG commented in its key findings (January 2007) that "Better governance including reforms to [NEMMCo and] AEMC would improve efficiency"

The MEU also has some reservations about the performance of the AEMC and has concerns regarding some of its reports and reviews over recent years – some have recommended certain actions which have subsequently been reversed after detailed stakeholder input and, with others, there have been intriguing reversals of views late in review processes. Whilst the MEU accepts that positions can and should reverse if the facts indicate a need for change, the fact that these changes occurred only after considerable additional stakeholder input, raises its own implications. The fact that these reversals occurred after considerable consumer input implies there is a need for more informed resourcing and capacity building, particularly that involving better understanding of consumer interests and issues.

The MEU also notes that the AEMC responses to two recent rule changes[2] proposed by the MEU again reinforces the MEU view that there is a lack of understanding and appreciation of the needs and concerns of consumers

The MEU will cooperate fully in any independent review. It is therefore strongly recommended that the draft recommendations 21.1 and 21.2 apply to the other NEM institution, including the AEMC.

2.4 Draft Recommendations 21.3 Representative Consumer Body

The MEU agrees that superficially this recommendation looks appealing. Large users – that pay the bulk of AEMO fees – are cautious about the proposal because of the view that the body could be costly in operation and an expensive approach to advocacy. Large users already participate in many of the reviews in the NEM through their own representative bodies with the assistance from the Consumer Advocacy Panel (CAP).

However, the major issue that the PC has overlooked, is that there is no way a single entity can adequately advocate for such a diverse range of consumer views. For example, currently supported by the CAP are consumer advocates representing environmental groups, vulnerable consumers, small business, local councils and large business. Interestingly, there are not energy advocates for non-vulnerable residential consumers or active advocates for small businesses and commercial enterprises. Even advocates for each of these major consumer sub-groups often have disagreements of the most appropriate approach or outcome required of their advocacy.

Certainly, consumer advocates with an environmental bias have quite clearly enunciated differing views to large and small businesses in a number of key aspects, although they have common views in other areas. This means that although for some advocacy groups representing other main

[2] These were the rule changes to mitigate generator market power and (as an extension to the AER network rule change proposal) on the optimisation of the regulatory asset base and use of used and useful assets.

constituencies can and do work together for some energy advocacy work, they have also had diametrically opposed views in many other areas.

The PC assessment of consumer advocacy is based on an erroneous assumption that consumer views are homogeneous. Nothing can be further from the truth. Because of this lack of homogeneity, regulators are keen to get a variety of consumer views to assist them in their regulatory roles.

Regulators also have a view that it is insufficient that just one consumer advocacy response will suffice, especially when the supply side of the energy markets have many voices (they are competitors). Often regulators will take a view on an issue by qualifying their conclusion with statements like "… the majority of respondents have commented …" If regulatory decisions are based on the volume of responses of certain views, it is beholden on the consumer advocacy responses to express a similar quantum of views to counteract the supply side responses.

The MEU considers that the assessment by the PC that consumer interests could be presented by one entity alone, is simply not feasible and shows a lack of understanding of what consumer advocacy is about.

2.5 Draft Recommendations Involving Role of Interconnectors and Efficient use of Interconnectors

The draft recommendations of the PC regarding interconnection are of concern because of the conclusion reached by the PC that there is no evidence that there has been insufficient investment in inter-connection. The MEU points out, in recent years, there has been considerable but unnecessary transfer of wealth from consumers to generators by the exercise of generator market power[3] which only exists because of inter-regional separation.

At its most fundamental, generators exercise market power when interconnectors are constrained. The frequency and extent of the market impact on consumers of such constraints has been identified by the ACCC as providing sufficient evidence that the NEM is in fact a series of interconnected regions and because of this they assess acquisitions of generators on this basis. The AEMC consultants assessing the generator market power rule change[4] agrees that, when carrying out a SSNIP test, that each region needs to be assessed in its own right.

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[3] The MEU notes that its has proposed a rule change to the AEMC regarding this issue and that the AER has supported the concept of a rule change to reduce this exercise of market power by generators

[4] NERA and available at http://www.aemc.gov.au/Media/docs/NERA-report-a1ffd670-8a15-456f-93cd-f404ba6bfa6b-0.PDF

The design of the electricity market is based on the concept of price signalling. Currently, prices are only signalled on a regional basis and are used to schedule dispatch of generators. When congestion occurs (intra-regional or inter-regionally) generators are dispatched out of merit order in order to relieve the congestion. Generators constrained on due to congestion can be reimbursed their costs. The Optional Firm Access concept supported by the PC is intended for generators constrained off by congestion, to fund network augmentation and allow them firm access to the NEM.

The price impact of relieving intra-regional congestion is a cost “smeared” over all consumers, but the congestion is identified by the regional TNSP for action. If the AER agrees there is a net benefit for this augmentation – based on the costs of relieving the congestion – the network augmentation is allowed to proceed.

Inter-regional connection has no single owner (as distinct from intra-regional connection) and requires the adjacent TNSPs to agree on the necessary infrastructure to allow increased flows. In fact each TNSP has to augment its own network to allow increased flows to another region – a point made by the PC in its report.

What is not made clear in the report is that because there is a regional price declared for each region, there is a price signal provided to the market to indicate the need for either increased generation in a region or for increased inert-connection capacity. High prices in one region and low prices in adjacent region indicate that inter-connection capacity is insufficient. – that there is a cost to consumers that increased inter-connection can resolve.

The PC has endorsed the concept of OFA whereby a generator will be permitted to fund network augmentation and by doing so gain a benefit of firm access by doing so. The PC also endorses the use of nodal pricing in the NEM. The purpose of providing nodal pricing is to provide price signals to generators to locate on the other side of a high price node, for consumers to relocate or reduce demand when connected to that node, and to provide an indication for investment in transmission to reduce the price at that node.

Regional prices are intended to provide an indication of new generation investment, yet they are not used to indicate a need to increased transmission capacity from another region to the high priced region. Intriguingly, network investment must be assessed on the lowest cost solution required to address the network problem – be that solution is a network investment solution or a non-network solution, yet when examining the need to address high regional prices, only generation investment is seen as a solution even when a lower cost network solution (ie increased interconnection) might provide a better outcome for consumers

The MEU remains concerned that market price signals are not allowed to be integrated into the RIT to quantify the cost to consumers of a congested inter-connector. By not using the market price signals which indicate a need for more interconnection in the Regulatory Investment Test (RIT), the rules discriminate against consumers. Consumers pay directly for all transmission costs except for entry costs which are applied to generators. For consumers to be required to pay high regional prices caused by insufficient inter-regional transfer but not be allowed to pay for increased interconnection which would reduce the cost to them of generation, is iniquitous and needs to be investigated further.

2.6 Concluding Remarks

Overall, the MEU consider the Commission has undertaken a very good review and most of its recommendations are supported, bar the following:

- Because the MEU sees that divestiture by governments of their network assets is unlikely, the MEU considers the Commission must address having a regime that has mixed ownership

- Benchmarking should incorporate related party transactions

- By canvassing the merits and demerits of separation of the ACCC and the AER the Commission has raised a view that separation might be beneficial. The MEU does not consider that the consumer dissatisfaction detailed by the AER is so much related to the governance of the AER but more to the rules the AER is required to apply. On balance, separation of the AER from the ACCC is not supported. If this issue is to be investigated further, analysing the concept of separation should be deferred until the completion of the review proposed under recommendations 21.1 and 21.2

- The need to include the other key NEM institution, such as the AEMC, for independent review as to its resourcing, capacity, performance, transparency, accountability and governance

- The MEU does not support the establishment of a single consumer body

- The MEU considers that the benefits of interconnector augmentation will be better identified if the Regulatory Investment Test incorporates the costs derived from market price signals

The MEU also considers there is a need to put a spotlight on the extent of government interventions in the electricity market,which are distorting consumption and investments and potentially negating the benefits of new

reforms in the electricity market, including those recommended by the Commission

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3. Requests for further information

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3.1 Ch5 – Incentive regulation and benchmarking

The PC seeks feedback on the benefits of harmonising the rules for transmission and distribution – effectively removing Chapter 6A.

The MEU notes that under the original National Electricity Code (NEC which was superseded in 2005 with the introduction of the Rules), the rules did not have separate sections for transmission and distribution. It was the decision of the AEMC to introduce Chapter 6A because it had changed the rules for transmission significantly from what had applied previously but did not have the authority to change the distribution rules.

The Standing Committee of Officials of MCE made considerable change to the distribution network rules (Chapter 6) but these, while based on the Chapter 6A rules did contain differences to Chapter 6A.

For many years the NEC was used by state regulators and the ACCC to apply network regulation and there was not considered to be a problem with the commonality of the NEC to regulating the different network elements. What has occurred with the use of different rules applying to similar elements, is increased confusion amongst stakeholders.

The MEU does not consider there is a need to retain both Chapters 6 and 6A and that harmonisation of all network regulation would be beneficial.

3.2 Ch10 – Technologies to achieve demand management

The MEU provides its views on the benefits of smart meters and their use in the network in section 4 responding to recommendation 10.1. The MEU notes that smart meters assist the distribution networks, their use to consumers in the wider context of all consumers (recognising that some consumers will use the outputs of smart meters to good use) is limited and that they impose a considerable cost on retailers should retailers elect to apply the detailed usage they provide when providing pricing to consumers.

3.3 Ch11 – Moving to time based pricing for the distribution network

The MEU is concerned that transitioning over time to time of use pricing by applying the new approach to larger users first, has the potential to create significant and unnecessary price pressures on larger users.

It is well recognised that the prime cause of “needle peak” demands (which cause the need for network investments that are used occasionally) are primarily related to the use of refrigerative air conditioners which are used

predominantly by commercial premises and residences – all of whom tend to be smaller users of electricity.

By applying time based pricing tariffs initially on large users will have a minimal effect on their usage as most operate continuously and are essentially unable to transfer their loads to other times. This will not lead to the outcome that the concept of peak pricing is intended to address but may result in network costs for large users to increase.

As demand is the driver of network investment, it must be demand that is used primarily to set network tariffs, regardless of the class of user. Until demand can be measured every each point of usage, it would be inappropriate to apply any peak demand based tariff more widely than already exists. Therefore to move to a time based pricing approach will not necessarily result in the same outcome as a move to peak demand pricing.

The MEU is of the view that the change should not be to time based pricing but to peak pricing where the bulk of the problem lies – that of the highest demands being incurred on a relatively few very hot days[5] in summer. To attempt to apply a generalised time of use tariff based on assumed times of the day or days of the year when higher demands are likely will lead to inequity just as great as currently applies as there is no certainty that, without being able to measure individual demands at such times that usage occurred in the ranges when higher time based pricing applied.

The MEU points out that in Victoria, for the transmission network tariffs, AEMO sets the peak demands on the 10 peak system days in a year and from this allocates the cost of the network to users reflect this usage. The MEU considers that such an approach more closely reflects the actual demand that each user places on the networks than the pricing systems used elsewhere.

The MEU therefore believes that only once demand can be measured accurately at every point of supply, that this is the time there should be a change to a peak pricing approach. To implement time base pricing is not seen as providing the most accurate outcome as demand base pricing better reflects the cost of the service provision.

3.4 Ch12 – Complementary reforms to support demand management

The MEU has been closely involved in the recent review by the AEMC of its demand side program DSP3. The MEU considers that many of its views on implementing DSP are well explained in its responses to that process.

[5] The MEU is a ware that peak demands can occur on cold days in Tasmania and NSW. In this regard it is recognised that the stress on the networks on cold days is significantly less than on hot days when the same peak demand occurs

Overall, the MEU considered that the recent draft report released by the AEMC on this program to quite well address the issues and proposing positive reforms. The major issue MEU had with the report was in relation to Distributed Generation and network pricing. The MEU comments from its response to this report[6] on this issue are included in appendix 1.

Other aspects that were specifically addressed related to cost reflective pricing being an essential element of maximising demand side participation

3.5 Ch15 – Transmission reliability

Much of the additional information sought is outside the MEU purview.

However, the MEU has been involved in the AEMC Transmission Framework Review and is of the view that the AEMC proposals in its draft reports relating to planning and implementation are sound and that the AEMC has developed a pragmatic solution to the issues of getting better planning and implementing. Whilst the PC model might include some improvements, the model is based on an assumption that all transmission will be privately owned. The AEMC process recognised that this change was an unlikely option and therefore addressed the approach on the basis of status quo ownership and what is achievable.

The MEU is of the view that changes in relation to planning, reliability, and augmentation are required now and that government ownership of much of the transmission network will continue to apply for the foreseeable future. To provide “improvements” based on private ownership is therefore considered to be premature

3.6 Ch17 – Role of Interconnectors

The MEU views on the impact of price separations are provided in section 2 above, and reflect the harm that consumers have incurred (most recently in SA and Tasmania) where the exercise of generator market power in those regions has resulted in considerable wealth transfer from consumers to generators.

As part of its Rule change to address the exercise of generator market power, the MEU has provided the AEMC with evidence that constraints on interconnectors have caused considerable harm to consumers when the constraint on transfers has allowed the dominant generator in a region to increase prices above the efficient level.

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[6] Available at http://www.aemc.gov.au/Media/docs/Major-Energy-Users-Inc-4931a878-fa7c-4125-8748-110d6032297c-0.pdf

The impacts on SA region consumers of this practice in 2008, 2009 and 2010 on hot summer days have been extensively documented by the MEU in various forums, but also by the AER in their reports on high regional prices and in their "State of the energy market" reports released annually. What is less well known is that constraints on interconnectors can be used to drive up prices in off peak times as well. For example, in Tasmania in the first half of 2012, off peak spot prices have averaged 20% higher than peak period spot prices despite demand being lower in off peak periods. That this can occur is a direct outcome of the exercise of market power and the fact that the interconnector was constrained.

If the cost to consumers of this unnecessary impost from the exercise of market power were to be included in the Regulatory Investment Test (RIT), then the decision of generators to exercise market power might be restrained as they would see that their continual use of the market power might result in network augmentation to limit this market power.

From a consumer viewpoint (a position all too infrequently used by regulators and rule makers), consumers would be indifferent to paying a price premium for their electricity supplies whether the cost came from network investment or generator opportunism.

3.7 Ch18 – Efficient use of interconnectors

There are few large loads that are predominantly located due to the price of electricity – most large load decisions are based on a number of inputs, diluting the impact of electricity pricing on that decision. Those that are influenced seek long term contracts for that supply before making that commitment. When considered from this viewpoint, the impact of the inter-regional hedging arrangements has a quite modest impact on such decisions.

Once located, the large load cannot move due to the sunk nature of its investment. However, once that locational decision is made and the long term contract has expired, a large load, especially one located close to a regional boundary might seek to benefit from lower prices in an adjacent region.

The concept of the inter-regional hedging market through the auction of residues has not proven to be all that beneficial to large loads as they have not been able to contract across regional boundaries and power prices (whether from a the spot market or via retail contracts) they have to pay are always based on hedges received from generators based in the same region.

3.8 Ch 19 – Identifying future transmission

The MEU is of the view that, just as competitive industry must carry out a cost benefit analysis of proposed investments, so too must electricity networks – the Regulatory Investment Test provides such a control mechanism. The MEU also considers that the regulatory environment should also reflect practices in competitive environments as closely as possible. From this viewpoint, the RIT-T should be applied to any investment, whether this is for the replacement of an existing asset or an augmentation of the network.

Historically, networks have always been seeking to increase the capacity of the network and with consistently rising demand and consumption, there has been no requirement to examine whether an existing asset is oversized for the duty it is undertaking. The NEM is now exhibiting falling demand and consumption. This then highlights a need to examine the actual duty of an existing asset and consider whether a smaller asset will achieve the same outcome. In the absence of the RIT-T there is no control on the network to assess whether the same sized asset is still required or whether it should be changed in capacity.

In addition to the falling demand and consumption, the price on carbon and the requirement to provide increasing amounts of power from renewable sources, is leading to some exiting electricity supply infrastructure reducing its output and, in some cases, being closed down. This will result in existing assets being effectively redundant or requiring much less carrying capacity. Again, applying a RIT-T will identify what needs to be used as a replacement for such assets.

On this basis the MEU considers that the environment has changed so much in recent years that the RIT should be applied to replacement of assets.

Using the same viewpoint as before, in a competitive environment, a firm uses the market place to assess whether there is a need for an investment and whether an adequate return will be achieved for that investment. In the case of a monopoly, this pressure does not apply. In practice, the actions of the regulator (in this case the AER) impose this control.

Not to gain the approval of the AER for a new investment or to have the AER accept that the investment proposed is the most effective, is to allow the network a high degree of freedom in its investment which a competitive firm does not have. The MEU considers that expanding the role in assessment of RIT-Ts is an essential part of good quality regulation.

When a 5-year regulatory proposal is provided to the AER, the network proposes a series of capital investments which are accompanied by

explanations as to why the investment is needed. There is some information provided supporting the amount of capex sought and this is (usually) assessed by a technical consultant employed by the AER. What is lacking is a clear and concise RIT proposal for larger investments which outline the various options for addressing the need and the derivation of the lowest cost to provide for the need. In contrast, competition drives a firm to carry out such a comprehensive analysis **before** funds are even assessed by the firm's Board. The Board will then assess the total amount of capital it is able to access, and with this knowledge decides which major capital projects can be accommodated within the capex available.

In contrast, a regulated firm is incentivised to seek as much capex as it can include in the regulatory approval process. Once determined, the firm gets a return on this amount approved, even if the capex is not used. The regulated firm then decides on what capital it can access and then prioritises what projects can be included within the available capex. It will then approve those projects it considers to be most appropriate.

When considered this way, it become essential that the RIT must be the basis for developing the capex allowance that regulator allows the firm to get a return on.

3.9 Ch 21 - Governance

The MEU has provided its views regarding the location of the AER in section 2 above. Amongst other issues, the MEU considers that retaining the AER within the purview of the ACCC provides greater security for consumers as there is less likelihood the AER will be "captured" by the supply side entities, including networks. With the greater contact between the AER and stakeholders recommended by the PC, the MEU considers that this greater contact can lead to "regulator capture" by the regulated networks. Of all the concerns the MEU has about an independent AER, regulatory capture is the greatest.

In this debate about the independence of the AER, it is often overlooked that the AER has many more functions that that of regulating networks. Many of these other tasks (as the PC points out) relate to supervising the energy markets and protecting consumer interests. Close collaboration with the ACCC is essential for the AER to perform these tasks.

Funding of the AER is currently out of the Federal government allocation to the ACCC – this means that tax payers (including the supply side entities of the market) are funding the AER. If the AER is funded by a levy on market participants (just as AEMO is) then the costs of the AER will be passed directly to consumers (just as the AEMO levy is).

The MEU considers that the AER provides more services than just regulation of networks and all of the supply side entities benefit from the activities of the AER. It is therefore appropriate that the supply side entities contribute to the costs of the AER and applying a levy will allow them to avoid paying their share of the AER costs which they currently do through corporate taxation.

As all tax payers are beneficiaries of a well run electricity supply, there is little difference from a consumer viewpoint whether the cost of the AER is funded directly or via taxation. Therefore, to ensure that the supply side of the market contributes to the operation of the AER, the MEU considers that the current arrangements should continue.

4. MEU comments on specific PC recommendations

The MEU has not responded to every recommendation at this time. This does not mean that the MEU does not have a view regarding the recommendation but that its view is reflected in the commentary in foregoing sections

Chapter	#	PC draft recommendation	MEU response
5	**5.1**	**The Australian Energy Regulator should develop an efficiency benefit sharing scheme to apply to capital expenditure that provides consistent incentives to reduce capital expenditure, both over time and when compared with operating expenditure.**	The MEU notes that the reforms proposed by the AEMC in the recently revised network regulation will go some way to limiting the continuing network claims for ever increasing ex ante capex allowances. Despite the AEMC recent rule changes, the MEU considers that more can be done in better controlling capex and supports the recommendation. Whilst the EBSS applying to opex has delivered some benefits, the absence of a similar scheme for capex has permitted an unrestrained escalation of capex.
	5.2	**The National Electricity Rules should specify the interdependent nature of the parameters used to estimate the weighted average cost of capital, and specify that any merits review must also consider the relevant rule in that light.**	The MEU notes that this recommendation is similar to that of the SCER Expert Panel commissioned to examine the limited merits review of network regulatory decisions. The MEU has supported the core recommendations of the Expert Panel relating to the limited merits review (although there were other aspects of the Expert Panel recommendations the MEU does not support. The MEU supports this recommendation
	5.3	**Estimates of the debt risk premium and risk free rate used in the calculation of the weighted average cost**	The MEU recognises that there can be short term variations in the movements of debt and risk free rates. The use of trailing averages for these parameters has both benefits and

		of capital should be calculated using long-term trailing averages.	detriments. There is a need that the debt allowances need to reflect future movements in debt rather than those movements in the past, as networks need to acquire their coverage of existing debt on future markets. New debt also has to reflect future trends. In contrast, using short term averages for debt and risk free rates can distort the allowances considerably. Except for one element (that of debt for government owned networks, the MEU considers that the new network regulation rules provides a good balance for setting debt and risk free rate allowances. See comment in section 2 above regarding debt allowances for government networks
	5.4	**Where, within a given regulatory period, a network business spends materially more capital than that allowed for in the Australian Energy Regulator's final ex ante regulatory determination, then its entire capital expenditure should be subject to an ex post prudency test:** • **Only spending that is deemed efficient and prudent, given the information available to the network business at the time, should be included in the Regulatory Asset Base at the end of the period, subject to the condition that:** – **the maximum disallowable expenditure is no more than the difference between the ex ante forecast and realised expenditure**	The MEU notes that the new network rules require the AER to review all past capex. The new rules also allow the AER to disallow capex which they consider is not prudent, provided that the disallowed capex exceeds the ex ante allowance for capex. The new rules would seem to have similar application to the draft recommendation. However the MEU is concerned that if the AER identifies that there is capex that is not efficient but if excluded would reduce the allowed capex to less than the ex ante allowance, consumers will be required to pay a premium in their network charges for the next 40 years of the asset life. This is unacceptable. The MEU considers that any capex that is inefficient must be excluded from the asset base. The NEO and NGO require that consumers only be required to pay efficient costs. To allow, knowingly, for inefficient costs in the asset base is not in the

		• **If a network businesses is aware that it is going to exceed pre-approved spending levels, it should be able to apply for pre-approval to avoid the ex post assessment.** **The prudency test should not apply to cost pass throughs and contingent projects permitted under chapters 6 and 6A of the National Electricity Rules.**	long term interests of consumers and therefore is contrary to the NEO/NGO It seems incomprehensible to the MEU that the PC should allow inefficient capex to be retained in the asset base. Whilst the argument provided is that regulatory certainty supports efficient investment in networks, to allow inefficient investment does not impose the pressure on networks to invest in the most efficient way.
	5.5	**The National Electricity Rules should be clarified to indicate that the Australian Energy Regulator is only required to test the reasonableness of the overall expenditure proposal. The Regulator should only be obliged to consider the reasonableness of a specific expenditure item if it could materially affect the judgment of the reasonableness of the total expenditure forecast.**	The MEU notes that this draft recommendation is similar to a view expressed by the SCER Expert Panel on LMR. There, the Expert panel identified that the AER should allow a set amount of revenue for the network (ie a "bucket of money") and the network should have freedom to use this in any way appropriate to provide the services. The MEU agrees with this view in principle, subject to the money being used efficiently. The MEU agrees that the allowance provided by the AER is holistically developed and that there are inter-dependencies of the many elements used in the development of the allowance. The MEU notes that the PC refers to the "reasonableness" of the overall allowance. As there is always a range to what is considered "reasonable", the MEU is concerned that the use of this term will lead to networks always getting the high end of the range and therefore receiving a greater allowance than is needed. The MEU considers that the allowance the AER develops should be the single value of the allowance that should be granted.
	5.6	**In cases where the Australian Energy Regulator**	The MEU agrees with this draft recommendation – see comments to draft recommendation 5.5

		considers that the National Electricity Rules constrain its capacity to make appropriate revenue determinations, it should publish its preferred estimate along with the final determination, explaining the differences. In any subsequent merits review of its determination, the Australian Energy Regulator should ensure that the reasons behind its preferred estimate are clearly communicated to the merits review body.	
7	**7.1**	**State and territory governments should privatise their state-owned network businesses.**	See MEU comments in section 2 above on this issue. .
	7.2	**If state and territory governments do not implement draft recommendation 7.1, then they should promote more efficient outcomes for their state-owned network businesses by ensuring that:** • **directors are appointed on merit, following a transparent selection process** • **ministerial directions are publicly disclosed at the time they are made and disclosed in the annual report** • **directors and officers are subject to the obligations under the Corporations Act** • **governments review objectives currently given to network businesses and:** – **remove those that would be more**	The MEU agrees that government owned networks should have these controls applied.

		appropriately allocated to other agencies – **remove those that are non–commercial and make it clear that the board is expected to deliver a dividend payout and rate of return on the equity invested in the network business that would be considered acceptable by an independent investor** – **where conflicting objectives remain, provide publicly transparent guidance on how to prioritise them.**	
8	**8.1**	**The Australian Energy Regulator should regularly undertake aggregate benchmarking of the performance of network businesses, including of their:** • **multifactor productivity — the output of services for given inputs** • **separate productivity of capital, labour and intermediate inputs.** **The results should control, to the best extent available, for any significant variations in the operating environments of the businesses, including customer requirements, and the capital vintage of relevant assets.**	The MEU agrees with the draft recommendation. In particular the MEU considers that the cost of capital should be benchmarked against cost of capital achieved by firms in the competitive sector. The major inputs to the final cost of the service is based on the amount of investment already made, the new investment allowed, cost of materials and labour and the cost of capital To exclude benchmarking of the cost of capital removes benchmarking of one the major inputs used in developing the overall allowance granted to a network
	8.2	**Subject to compliance and other costs (draft recommendation 8.12), the Australian Energy**	The MEU supports this draft recommendation

		Regulator should accompany aggregate analysis with detailed benchmarking of particular aspects of the performance of the businesses, including: • **the rate of investment relative to the age-weighted capital stock by asset class** • **the efficiency of major maintenance activities** • **the adoption rate of best-practice commercial processes and equipment, including the use of customer panels and surveys, outsourcing, demand management, information technologies, financial controls, procurement practices, occupational safety, and project management.** **In determining relevant benchmarking performance and control variables, the Australian Energy Regulator should consult with:** • **network businesses, generators, retailers and network equipment suppliers** • **customer representatives** • **relevant experts within Australia and internationally.**	
	8.3	**The Australian Energy Regulator should periodically assess the comparative performance of network business units within particular sub-regions of the National Electricity Market, where:** • **those sub-regions share similar physical**	The MEU supports this draft recommendation

		operating environments • **the costs and informational requirements of doing this are not too great (draft recommendation 8.12).** **The comparisons should relate to business units within a particular business, as well as comparable business units in different businesses. The Australian Energy Regulator should place most emphasis on comparisons of the efficiency of distribution networks in different metropolitan areas.**	
	8.4	**The Rules should be changed to allow the Regulator to have the discretion to initiate a three-way negotiation of a mutually acceptable settlement, involving itself, the business, and a representative and qualified customer group similar, or identical, to that identified in draft recommendation 21.3.** • **Negotiation would only be triggered if the Australian Energy Regulator judged that the divergence between aggregate benchmarking estimates of forecast spending and the business's proposal were sufficiently narrow.** • **Where an arrangement was successfully negotiated using this process, the Australian Energy Regulator should not be obliged to go through the current formal draft/final determination processes.**	Whist the MEU supports the general thrust of this draft recommendation, the MEU is concerned with the concept of negotiation with "a representative and qualified customer group". After nearly 20 years of involvement in energy regulation, the MEU and its affiliates have identified that there is no single customer advocacy group capable of representing the needs of all customer groups. Whilst there are many elements (but not all) of the regulatory process where all customer groups have a similar view, the various customer groups have different weightings on issues and therefore tend to bias their views to reflect these different weightings. There are also elements of the regulatory process where different customer classes have different (even opposing) views. The MEU does not consider that there can be a single entity that can adequately and competently represent all the views of all customers.

			The MEU is therefore of the view that this draft recommendation needs to be modified to require the AER to seek the views of all customers and allow representation from each customer class into these negotiations. Despite the involvement of customer representatives in such negotiations, the MEU does not consider that the AER should be relieved of its obligations to go through the assess/draft/final determination process, although an expedited process (similar to those used by AEMO for non-controvertible rule changes could be implemented.
	8.3	**In any of the next rounds of regulatory determinations, the Australian Energy Regulator should not use aggregate benchmarking as the exclusive basis for making a determination. Instead, the Australian Energy Regulator should use such aggregate benchmarking results as a diagnostic tool in responding to business cost forecasts.** **However, if the processes proposed in draft recommendations 8.9 to 8.11 led to sufficiently robust benchmarking, then:** • **a business would continue to make a detailed cost proposal, but if the overall proposal were divergent from the regulator's benchmarking estimate, the onus of proof would be for a network business to provide quantitative evidence demonstrating why its cost forecast was preferable in meeting the National**	The MEU supports this draft recommendation

		Electricity Objective • **the Australian Energy Regulator's efficiency threshold applied to firms should be set close to, but below, the level of the most efficient firm.**	
	8.6	**The Australian Energy Regulator should develop and maintain appropriate benchmarking databases and in-house expertise for the technical analysis required to undertake sophisticated benchmarking.**	The MEU supports this draft recommendation
	8.7	**The Australian Energy Regulator should make all benchmarking input data publicly available (recognising that the businesses being benchmarked are regulated monopolies) except where the data can be demonstrated to be genuinely commercial-in-confidence.** **Where the latter holds, the Australian Energy Regulator should still make the full datasets available to:** • **independent researchers who are using the results for non-commercial purposes** • **the consumer group involved in any negotiations described under draft recommendation 8.4** – **but subject to statutory requirements for non-disclosure of information**	The MEU supports this draft recommendation but with some qualification. The MEU recognises that all of the regulated entities are not in competition with each other and therefore the amount of commercially sensitive information applying to each network is very small. Public divulgence of information by one network which would make another network provide better and/or lower cost service to customers should be make publicly available, as this will assist in achieving the NEO/NGO.

		predetermined as commercially-in-confidence, drawing on existing models for data protection.	
	8.8	**When making its revenue allowance determinations, the Australian Energy Regulator should make judgments about capital expenditure forecasts that take account of any discrepancy between the Australian Energy Market Operator's top-down peak and average demand forecasts and the aggregate of distribution businesses' bottoms-up peak and average demand forecasts.** **The Australian Energy Regulator should use benchmarking of the discrepancies between previous expenditure forecasts and actual outcomes by different parties to inform that process.**	The MEU supports this draft recommendation
	8.9	**The Australian Energy Regulator should collaborate with other leading regulatory agencies, academic experts and global commercial benchmarking specialists to enable robust meta-analysis of electricity network benchmarking results from individual country (and where credible, multi-country) studies. The collaboration should include cooperation in developing:** • **the most meaningful measures of performance** • **consistent data collection**	The MEU supports this draft recommendation

		• **consistent reporting of results** • **best-practice analytic frameworks**	
	8.10	**The Australian Energy Regulator should submit its major benchmarking analyses of electricity networks for independent expert peer review to establish their ongoing relevance, scientific validity, adoption of best-practice, and to gauge the degree of uncertainty in the results.**	The MEU supports this draft recommendation as it reflects good regulatory practice. The MEU is concerned that in implementing this work there should not be any delays in providing to benefits of benchmarking in performance for use in regulatory reviews at the earliest time
	8.11	**The Australian Energy Regulator should make its benchmarking results publicly available, with:** • **accessible reporting of the results to inform consumer groups, network businesses, and others** • **disclosure of the importance of factors outside the control of businesses, but that may be controllable by governments** • **publication of the modelling strategy used to produce the results** • **the sensitivity of the results to changes in key assumptions** • **the performance of any statistical models against accepted scientific standards, including confidence intervals, parameter stability, and specification testing.**	The MEU supports this draft recommendation, as it reflects good regulatory practice

	8.12	**The Australian Energy Regulator should periodically examine its detailed benchmarking methodologies and processes to assess their compliance costs for businesses and the costs for the Australian Energy Regulator. It should compare these costs with the likely benefits when determining the appropriate frequency and type of detailed benchmarking. In undertaking such assessments, the Australian Energy Regulator should consult closely with network businesses. The Australian Energy Regulator should make all such assessments publicly available.** **The overall costs of benchmarking should be subject to independent review after five years.**	The MEU supports this draft recommendation, as it reflects good regulatory practice. The MEU considers that the AER should be required to consult with customers as part of the analysis of cost/benefit of producing such information. The MEU is concerned that by not consulting more widely than just with networks, the benefits of the work might be under-rated and prematurely cease. The independent review should require wide consultation so that the benefits of the information are properly and comprehensively assessed
10	**10.1**	**Distribution businesses should implement the roll-out of advanced metering infrastructure — so called smart meters — on a region-by-region basis within their network.** • **Before any roll-out, the Australian Energy Regulator, drawing on the proposal and supporting evidence from the distribution business, should assess the net present value of costs and benefits, and be required to consider demand management options that do not rely on smart meters.** • **When the Australian Energy Regulator determines the optimal start date of the roll-**	The MEU considers that the costs to the benefits of smart meter roll out have not been proven. While in principle, better information to all customers should lead to better utilisation of assets, this assumption is not proven. In particular, it has been demonstrated that in Victoria, the roll out of smart meters should make the acquisition of individual usage data by networks and retailers easier, there is evidence from large customers that the better usage data does not lead to more efficient pricing of network services or electricity supplies. The ability to utilise the more accurate usage data by retailers will result in a barrier to entry of new retailers in the “small customer” class. Prices from retailers to small but contestable customers do not

		out, the relevant distributor must submit a costing to the Regulator for approval and agree to an appropriate timeline for implementation. • **Mandatory time-based network charges to retailers (draft recommendation 11.3) should be implemented once smart meters are installed, appropriate customer consultation and education has taken place, and retail price regulation is removed (draft recommendation 12.3).**	now reflect their usage pattern so there is concern that retailer pricing to very small users (such as residential customers) will not reflect their usage but reflect the customer class as a whole. Unless there is network pricing which better reflects the usage pattern of individual customers (down to usage by residential customers) then the benefit of smart meters will be minimal. Smart meters being rolled out in Victoria do not provide residential customers with useful information. Until both the data is available to small customers and the effect of their usage is reflected in the pricing decisions both in energy and network costs they receive (and hence the total cost of the service), usage patterns will not change.
11	**11.1**	**The Standing Council on Energy and Resources should be tasked with overseeing the progressive implementation of cost-reflective, time-based pricing for electricity distribution network services, predicated on the long run marginal costs of meeting peak demand. Amongst other things, the Council should:** • **following consultation with key stakeholders, set timelines for the various steps in the development and implementation process, having regard to:** – **the Commission's specific proposals in relation to this process (draft recommendations 11.2 to 11.7)**	The MEU supports this draft recommendation in principle, providing that instead of time based pricing, demand based pricing is implemented (also possible with smart meters), but sees that the implementation of either will be extremely challenging. In the absence of accurate timing of usage and demand data being made available to customers (especially small customers) the development of cost reflective time or demand based pricing is unlikely to provide a benefit to small customers. Currently networks only provide pricing on peak/off peak times and meter both separately in the absence of smart meters (although in NSW shoulder periods are also defined). AEMO in Victoria has attempted to set its transmission pricing on the usage made by customers on the 10 peak system days,

		– **progress in making necessary changes elsewhere in the system** • **monitor compliance with those timelines** • **address any areas where greater engagement between key stakeholders (distribution businesses, retailers, state and territory governments, the Australian Energy Regulator and customer representatives) would assist the expeditious implementation of the new pricing regime** • **if and as necessary, take specific steps to address implementation delays.**	yet there is massive resistance to this approach being used in other jurisdictions – in fact the AEMC is seeking to force Victorian transmission pricing to consistency with other jurisdictions because the Victoria approach makes it impossible for the AEMC to set rules for transmission which achieve other goals. For example, the attempts to set inter-regional TUoS pricing for power transfers between regions requires greater consistency in transmission pricing than is presently available. This to achieve this draft recommendation requires changes in many other elements of the network pricing approaches.
	11.2	**The Standing Council on Energy and Resources should initiate a process to establish a uniform set of licence conditions for all transmission and distribution network businesses in the National Electricity Market. The Council should task the Australian Energy Market Commission to undertake a framework review to assist that process.** **The development of a uniform set of licence conditions should have regard to the Commission's proposed changes to the reliability framework (draft recommendations 15.1 and 16.1) and should not in any way conflict with, or impede, the implementation of that framework.** **The uniform licence conditions should be included in**	The MEU supports this draft recommendation, as it reflects good regulatory practice and consistency. In this regard, the MEU sees that a failure to comply with licence provisions is supposed to result in a loss of licence. In practice, to remove a licence is seen as essentially impossible as the licence holder retains all of the assets needed to provide the service. The MEU considers that there should be a scale of penalties that apply to licence holders should they fail to meet various licence conditions.

		the National Electricity Rules and replace the current state and territory licence conditions. **It may not be immediately feasible to develop standardised provisions governing technical standards and safety, though these should ultimately be encompassed in the national set of licence conditions.** **The justification for any jurisdiction-specific conditions included in the new licensing regime should be clearly and cogently spelt out in the supporting framework review.** **Before incorporation into national licence conditions, preparatory work would be needed to develop a common approach to the identification of customers in need of special support to meet their electricity bills or pay for smart meters (draft recommendation 11.6), but:** • **pending agreement on appropriate national criteria and approaches to funding, each state and territory government should continue to be responsible for targeted financial support to address affordability.** **The Australian Energy Regulator should be responsible for ensuring compliance with the new conditions and would have the authority to:** • **issue and retract licences** • **seek advice from relevant agencies on any**	

		technical matters relating to compliance assessment. **Provision could also be made in the Rules for the Australian Energy Regulator to delegate responsibility for assessing compliance with particular licence conditions to a relevant state-level regulator.**	
	11.3	**When the process of implementing cost-reflective, time-based prices for distribution network services is sufficiently advanced to reasonably allow for a tightening of relevant clauses in the National Electricity Rules:** • **clause 6.18.5(b)(1) should be amended so as to ensure that time-based tariffs are determined by (rather than 'take into account') a reasonable estimate of the long run marginal cost for the service concerned** • **clause 6.18.3(d)(1) should be amended so as:** – **to ensure that the grouping of customers for the purposes of setting time-based tariffs is based on economic efficiency (rather than 'having regard to' it)** – **to make it explicit that significant differences in the long run marginal cost of meeting peak demand between locations and across customer groups should be**	The MEU supports this draft recommendation. The MEU queries why this approach should only apply to the distribution pricing. Other than in Victoria, transmission pricing is not time based to reflect the peak demand in the transmission system. The transmission rules allow the TNSP to determine the basis on which they will price their services in relation to peak demand times, as the rule allow the TNSP the option to approach pricing on peak system days (as Victoria does) or averaging over all days *(as all other TNSPs do). The MEU considers that the PC draft recommendation should be expanded in relation to peak period pricing to include transmission services as well as distribution services.

		reflected in network pricing structures.	
	11.4	**When the process of implementing cost-reflective, time-based prices for distribution network services is suitably advanced, the requirements governing assessments by the Australian Energy Regulator of pricing proposals by distribution network service providers should be amended such that the regulator:** • **can only approve a distribution business's peak demand forecasts if they include reasonable forward estimates of the likely demand response to time-based pricing** • **subject to the above condition, must approve any reasonable estimate by a distribution business of the long run marginal costs of meeting peak demand.** **To support these changes, the Australian Energy Regulator should develop a capacity to model demand responsiveness to time-based pricing.**	The MEU supports this draft recommendation and considers that it should equally apply to transmission
	11.5	**Clause 6.2.8(a)(3) of the National Electricity Rules should be amended to:** • **require the Australian Energy Regulator to publish guidelines on the methodology or methodologies that are appropriate for estimating the long-run marginal costs of**	The MEU supports this draft recommendation and considers that it should equally apply to transmission

		meeting peak demand, and the factors that should be encompassed in those estimates • **give the Australian Energy Regulator the authority to publish binding guidelines about efficient, time-based tariff structures, including definitions of 'peak' pricing events.** **These guidelines should be developed in consultation with the relevant stakeholders and should be improved over time as the implementation of time-based pricing progresses.**	
	11.6	**The implementation of cost-reflective, time-based pricing for distribution network services should be accompanied by assistance for vulnerable consumers, which should target those who:** • **are potentially exposed to large price increases and who do not have reasonable opportunities to switch their demand to non-peak periods** • **will potentially face significant difficulty in meeting the charges used to recover the costs of smart meters.** **The Standing Council on Energy and Resources should develop common criteria for identifying who should receive such assistance, and when it should be delivered through electricity specific mechanisms rather than through the Australian Government's tax and transfer system. These criteria should be based**	Whilst the MEU agrees that vulnerable consumers need assistance, it does not consider that such assistance should be through distorting the electricity rules. The electricity rules should apply equally to all customers based on their usage of the services. In this regard, the principle of cost reflective pricing is structured to ensure there is equity across all consumers and there are no cross subsidies. Assistance to vulnerable customers should be from other sources to maintain the integrity of the electricity rules to be non-discriminatory

		on the outcomes of a review commissioned by the Council of Australian Governments of concessions for utility services across all levels of government (consistent with recommendation 8.1 of the Productivity Commission's Urban Water Sector Inquiry report). **These criteria, and a commitment to transparent funding of the electricity sector-specific support should then be reflected in the new National Electricity Market-wide licence conditions for network businesses (draft recommendation 11.2).**	
	11.7	**The Australian Energy Regulator should require:** • **distribution network businesses to demonstrate that they have actively engaged with retailers very early in the development of new time-based pricing structures, including on ways to incorporate those charges in retail prices to clearly signal to customers the costs of meeting peak network demand** • **distributors and retailers to demonstrate that they have engaged with, and educated, customers prior to the introduction of smart meters, and again prior to the introduction of new time-based customer tariffs.** – **Such engagement should occur sufficiently early to ensure that customers have the**	While supporting the principle behind this recommendation, the MEU has reservations about it as a matter of practice. Retailers do not represent the interests of consumers and have consistently not done so since the start of network regulation. Whilst retailer might have some information that will assist networks, they cannot speak for the interests of consumers. The MEU considers that the principles of time based pricing needs active consumer input. To achieve this the MEU considers that the AER should convene joint meetings of consumer representatives and networks to develop principles for time based pricing which the AER then ensures are applied by networks. Whilst this recommendation appears to have some attraction in concept, in practice, it is not really feasible. Retailers have not demonstrated a strong desire to be "teachers" to consumers about the energy markets and to try and impose this on them

		knowledge and time to respond appropriately to time-based pricing (including of the various means to manage their peak demand); are aware of the implications for their electricity bills; understand the way in which advance warning of critical peak pricing events will be communicated; and are aware of the support mechanisms in the event that the new pricing regime creates financial difficulties for them.	at this stage is likely to be unsuccessful. The only pressure that the AER can impose on retailer to carry out this function is through their licence and would require the imposition of a new licence condition. The MEU is unsure how the AER could police this licence condition.
12	**12.1**	**Coinciding with the gradual roll-out of smart meters to allow more cost-reflective network pricing, revenues from all distribution network 'standard control services' should be subject to regulated weighted average price (not revenue) caps. This should not apply to transmission businesses, which, given the complexities and lower net-benefits, should continue to be subject to revenue caps.**	The MEU does not support this recommendation and is unsure why price caps should be mandated. As a matter of principle, price caps encourage networks to seek to increase consumption of electricity as this increases their revenue above the revenue determined by the regulator to be efficient. It is recognised that by increasing consumption, lower costs might apply because the same revenue is spread over a larger base (and therefore utilises assets more efficiently) if the increased usage is at peak times, then more investment is required increasing network revenue requirements. This recommendation would act in direct contradiction of other government policies which seek to reduce consumption (to reduce carbon emissions). Certainly imposing price caps will not encourage networks to support reductions in consumption.

	12.2	**Where retail price regulation exists, the Australian Energy Market Commission should review the market for effective competition.** • **In jurisdictions where the Australian Energy Market Commission advises that retail price regulation should be removed, the relevant state or territory government should remove retail price regulation as soon as practicable.** • **Where the Australian Energy Market Commission advises that there is strong evidence that competitive pressures would be weak with the removal of the regulation, and could not be addressed by consumer awareness measures:** – **it should suggest any structural reforms that would be necessary to develop workable competition. These reforms should be promptly progressed by the relevant jurisdictions, and retail price regulations should be removed by no later than 2015.**	
13	**13.1**	**Governments should, as soon as practicable, discontinue subsidies for rooftop photovoltaic units and other forms of distributed generation delivered via feed-in tariffs, and the small-scale component of the Renewable Energy Target scheme.** **State and territory governments should change the**	The MEU supports this draft recommendation. The premiums that are paid have imposed considerable price pressure on all consumers (other than those which receive the subsidies). Being uncapped, the small scale renewable energy target scheme (SRES) has quickly outpaced the cost to the large RET scheme (LRET) and caused considerable harm to all

		way small-scale distributed generators are reimbursed for exporting power into the grid. This would involve: – **feed-in tariffs that approximate the wholesale price of electricity at times of peak and non-peak demand** – **arrangements that provide for direct payments from distribution businesses to distributed generation providers, which reflect the network value of their distributed generation capacity and output.** **To provide a transition to the new arrangements, current feed-in tariff schemes should continue for existing customers until the end of their contract period or until those schemes expire (whichever is earlier), but be closed to new entrants one year from governments' formal acceptance of this recommendation. Prior to that date, state and territory governments should develop replacement feed-in schemes with tariffs that approximate the wholesale price of electricity.**	consumers for little benefit. Adding the premium feed-in tariffs paid has considerably distorted the RET scheme. The MEU considers that the recommendation should go further and should seek to remove all government distortions to the electricity market. As far as it goes, the MEU supports this recommendation.
14	**14.1**	**The Australian Energy Market Operator should commission and pay the Australian Bureau of Statistics to undertake regular, detailed, disaggregated surveys based on best practice methodologies to reveal the value of reliability for**	The MEU supports this draft recommendation – it supports the views that the MEU has put to both AEMO and AEMC on the issue of reliability.

		different categories of customers, with the methodologies and results made public. **The Australian Energy Market Operator should commission suitably qualified experts to consider and measure the costs of interruptions not likely to be captured in the Australian Bureau of Statistics surveys. This should include the costs associated with citywide disruptions, including to telecommunications, water services and public transport, and the resulting loss of international reputation from lower reliability. The Australian Energy Market Operator should use these measures to supplement the results of the surveys.**	
15	**15.1**	**The Standing Council on Energy and Resources should, in consultation with the Australian Energy Market Operator and the Australian Energy Market Commission, develop a National Electricity Market-wide reliability framework in which reliability settings would be determined by customer preferences.** **This framework should replace all jurisdiction-specific reliability settings.**	The MEU supports this draft recommendation – it supports the views that the MEU has put to both AEMO and AEMC on the issue of reliability.
	15.2	**Drawing on the current Victorian experiences, the Australian Energy Market Operator should carry out transmission planning for all transmission networks**	The MEU supports this draft recommendation – it supports the views that the MEU has put to both AEMO and AEMC on the issue of reliability. The MEU considers that each TNSP should carry out its own

		in the National Electricity Market. The Operator should: • **use Values of Customer Reliability (as obtained through draft recommendation 14.1)** • **use best practice probabilistic processes in its cost-benefit analysis of network and non-network options to address reliability issues and/or constraints** • **describe its full cost-benefit analysis as part of its process for the Regulatory Investment Test for Transmission** • **make public all methodologies, parameters, data and other inputs used in the analysis** • **work closely with each of the transmission companies concerned to make sure that their experience and input is fully understood and where mutually agreed, appropriately incorporated into the analysis** • **use its best estimate of peak demand forecasts, having sought input from all relevant stakeholders** • **ensure that planning decisions are consistent with National Electricity Market-wide efficiency objectives** • **not carry out the 'procurer' role currently done in Victoria until it can be demonstrated that the benefits of such an approach exceed the**	procurer role rather than apply the process used in Victoria. SP Ausnet should be responsible for augmentations in Victoria, rather than AEMO.

		costs in the Australian National Electricity Market environment.	
	15.3	**In consultation with the transmission network businesses, the Australian Energy Market Operator should specify the details of the network or non-network solution to an identified constraint.** **If the cost of the solution is less than an appropriate threshold, then:** • **the Australian Energy Market Operator and the network business should negotiate and agree on the required expenditure. If there is no agreement, the Australian Energy Regulator should determine the allowable spending.** **If the costs exceed the above threshold, then:** • **the transmission business should submit detailed and final costings to the Australian Energy Regulator** • **with advice from the Australian Energy Market Operator, the Australian Energy Regulator should determine the allowable expenditure.** **The Australian Energy Regulator should automatically include the relevant agreed allowable expenditure in the revenue allowance for the transmission business.** **At the next regulatory reset, the actual capital spent on such projects should be included in the**	The MEU supports this draft recommendation – it supports the views that the MEU has put to AEMC during the transmission frameworks review.

		transmission business's Regulated Asset Base.	
	15.4	**The Australian Energy Regulator should ensure that, in the Australian Energy Market Operator's role as a transmission planner, its public reporting and planning processes are adequate, transparent and meet the National Electricity Objective.**	The MEU supports this draft recommendation
	15.5	**The Australian Energy Market Operator should review and, where necessary improve, the technical aspects of its probabilistic processes, particularly those relating to low-probability, high risk events. In undertaking the review, the Australian Energy Market Operator should closely consult with network businesses and seek independent peer review of its technical methods.**	The MEU supports this draft recommendation
	15.6	**If the Standing Council on Energy and Resources does not accept draft recommendations 15.2 and 15.3, then it should implement a second best option in which:** • **transmission businesses would retain the function of planning and making augmentation decisions** • **the Australian Energy Market Operator would set hybrid standards for connection points every five years, with standards that could fall**	The MEU does not support this recommendation in its entirety. It runs counter to the transmission frameworks review recommendations. The MEU does support sub-recommendations at the third and fourth dot points (AER to use AEMO demand forecasts and AER to accept AEMO preferred network and non-network options as a default position)

		as well as rise, and would provide advice on efficient investment to meet those standards • **in consultation with network businesses, the Australian Energy Market Operator would develop peak demand forecasts. The Australian Energy Regulator would use these demand forecasts in its regulatory determinations in accordance with draft recommendation 8.4** • **the National Electricity Rules should be amended to allow the Australian Energy Regulator to accept the Australian Energy Market Operator's advice on the preferred network and non-network options and their cost as the default proposal, requiring the transmission business to show why its alternative was more efficient** • **the Victorian Government should not be required to relinquish its current planning framework, with the adapted hybrid model only applying to other jurisdictions. Other jurisdictions should be free to adopt the Victorian planning model.**	
	15.7	**Where necessary, the Australian Energy Market Operator should assist the Australian Energy Regulator in its compliance and auditing of**	The MEU supports this draft recommendation

		transmission networks, to ensure that the agreed projects are completed and intrinsic network reliability is maintained.	
	15.8	**The Australian Energy Market Operator should act as the planner of last resort where it considers that underinvestment could expose the network to serious reliability problems, with the right to direct investment should the Australian Energy Market Operator believe that not to do so could seriously compromise the reliability of the National Electricity Market. The Australian Energy Regulator would act as an arbitrator in any disputes.**	The MEU supports this draft recommendation. This reflects a recommendation from the transmission frameworks review by AEMC
	15.9	**The Australian Energy Regulator should review the Service Target Performance Incentive Scheme for Transmission to ensure the incentives and targets are consistent with the new National Electricity Market-wide reliability framework.**	The MEU supports this draft recommendation. The MEU notes that the AER is currently refining its STPIS and this could be integrated into that review
	15.10	**Transmission businesses not already using this approach should transition to dynamic capacity ratings on all critical equipment.**	The MEU supports this draft recommendation. The MEU notes that the current draft of the STPIS is seeking to better reflect the ability of the transmission network to support the needs of all users at times of greatest need
16	**16.1**	**The Standing Council on Energy and Resources should specify that reliability requirements for distribution businesses be included in the Australian**	The MEU supports this draft recommendation The MEU has made the point during the AEMC review of reliability that jurisdictional reliability settings are imposing

		Energy Regulator's Service Target Performance Incentive Scheme, replacing all existing jurisdiction-specific reliability settings. • **The reliability requirements should reflect the preferences of customers by using the estimated values of customer reliability, as spelt out in draft recommendation 14.1, and should be specific to the distribution business.**	unnecessary costs for little benefit in distribution networks
	16.2	**The Australian Energy Regulator should also make the following amendments to the Service Target Performance Incentive Scheme:** • **reliability performance targets for the system average interruption duration index, system average interruption frequency index and momentary average interruption frequency index should be adjusted annually, according to rolling five-year average annual performance** • **revenue at risk should be negotiated as part of the Australian Energy Regulator's revenue determination process** • **the reporting and information component of this scheme should require distribution businesses to report their reliability performance at the zone substation level. Worst performing feeders should be identified**	The MEU supports this draft recommendation, although it notes that the AER review of STPIS for transmission is already looking at shorter period rolling averages and for adjusting targets to cover two year periods. The MEU is supportive of the proposed AER changes to STPIS for transmission and considers that the same approaches could be used for STPIS for distribution.

		as part of this process • **reporting by all distribution businesses of performance against the parameters in the scheme should be published annually and be at least as detailed and comprehensive as current reporting mechanisms for distribution businesses in Victoria.**	
	16.3	**Where a distribution business can show that they are unable to technically comply with one or more parameters of the Service Target Performance Incentive Scheme, and where satisfied that the benefits exceed the costs, the Australian Energy Regulator should:** • **approve the required revenue for the distribution business to install the necessary equipment** • **require compliance as soon as possible.**	The MEU supports this draft recommendation
18	**18.1**	**In the absence of any unintended consequences identified during current consultation processes, the Australian Energy Market Commission's 'optional firm access' package for generator access to the transmission network should be implemented.** • **It should operate for a period of at least 10 years.** • **It should be monitored by the Australian**	In principle, the MEU supports this draft recommendation. However, the MEU notes that the implementation of the optional firm access concept may be quite challenging. With this in mind, the draft recommendation may require some modification to ensure that there are no unintended consequences

		Energy Market Operator for its effects on network planning and performance and, in concert with the Australian Energy Regulator, changes in observed patterns of generator bidding behaviour. Monitoring results should be made public annually.	
	18.2	**After the optional firm access package has been operational for 10 years, a cost-benefit analysis should be conducted, with particular regard to the structure of the National Electricity Market at the time, the views of consumers, and any remaining barriers to the introduction of nodal pricing.** • **If the analysis finds net benefits are likely, and no significant and insurmountable barriers or risks are identified, nodal pricing (including financial transmission rights) should be introduced with appropriate transitional arrangements and arrangements for disadvantaged consumers.**	The MEU has advised the AEMC Transmission Framework Review that Optional Firm Access (OFA) provides a better outcome than the current arrangements although there is expressed a major concern about the implementation of OFA by many stakeholders, including TNSPs. The MEU notes that OFA is still only in its concept phase and to assume that it will be a solution (even partial) to relieving congestion, is still unproven. The MEU points to the experience of the inter-regional transmission pricing (IRTUoS) proposal developed by the AEMC in 2009 and proposed as a rule change in 2010 by the MCE. This proposal is a much simpler concept than OFA but its implementation has raised many incongruities in its refinement. IRTUoS is still being investigated and assessed some 2½ years on and is still to be proven to provide a method for implementation, is becoming increasingly more complex and expensive to implement, and still has to demonstrate it provides an overall benefit to consumers. With this experience in mind, the MEU counsels caution to the PC about this assumption that the OFA can ever be implemented The MEU notes the PC view that a transition to nodal pricing

			should be investigated within 10 years. The MEU notes that as with the IRTUoS, nodal pricing, whilst sound in concept, has proven over the years to be an extremely complex issue and that the benefits of it do not yet demonstrably show the benefits outweigh the costs of and complexity of its implementation.
19	**19.1**	**The Regulatory Investment Test for Transmission should not be amended to include indirect effects of investment decisions.** **In combination with the adoption of probabilistic reliability planning (draft recommendation 15.3), the Regulatory Investment Test for Transmission should be changed so that reliability is only assessed as a component of overall benefits and not as a separate criterion.**	The MEU considers that the RIT needs to reflect the prices seen in the market. The entire concept of the market is that prices are provided so that there is a financial indication of need. Currently prices are used as indications for investment for all aspects of the market except inter-regionally. Intra-regionally, congestion pricing is used to substantiate network investment to relieve congestion, yet congestion pricing seen at inter-regional connection points is not used to signal network investment. The MEU considers that market price signals should be used to signal network investment at interconnectors.
21	**21.1**	**There should be an independent review of the resourcing and capacity of the Australian Energy Regulator to undertake all its functions, including whether there are impediments to its performance and options for improvement.**	The MEU supports this draft recommendation. In particular the MEU notes that the recent network rule changes proposed by the AEMC will impose a greater involvement by the AER than it currently has. A number of the PC recommendations will also increase the AER workload. Resourcing of this additional work is critical to ensure the AER can carry out its tasks effectively.
	21.2	**The Australian Energy Regulator should have greater control over, and accountability for, the resourcing and management of its functions. It should:**	The MEU supports the general thrust of these recommendations as there is a need for greater resourcing of the AER resulting from the recent changes to the rules

		• **have its own separate budget sufficient to meets its role** • **submit a separate annual report of its performance** • **publicly reveal its strategy for improving its performance** • **have an independent capacity to negotiate resource sharing arrangements with a range of agencies, not just the Australian Competition and Consumer Commission** • **ensure that it establishes and retains the necessary specialist expertise to competently carry out its role, in accordance with draft recommendation 8.6** • **develop a program for regular ongoing communication and interaction with network businesses, their customers and other relevant stakeholders, with those interactions not just confined to periods of regulatory determinations.**	regarding network regulation. See comments made in section 2 above regarding governance. The MEU considers that these recommendations should be deferred until completion of all reviews of NEM institutions.
	21.3	**There should be adequate ongoing funding of a single but broadly representative consumer body with expertise in economic regulation and relevant knowledge and understanding of energy markets. This body would:** • **represent the interests of all consumers during**	The MEU sees that this draft recommendation superficially might have some merit. The MEU has addressed this recommendation in more detail in section 2 above.

		energy market policy formation, regulatory and rule-making processes, merit reviews, and negotiations with providers of electricity networks and gas pipelines • **subsume the role of the existing Consumer Advocacy Panel into its broader functions** • **be funded through a levy on market participants, drawing on the approach used to currently fund the Consumer Advocacy Panel** • **have a governance structure that involved a board of members appointed on merit, and an advisory panel to give the board advice on the needs of the mix of customers concerned.**	
	21.4	**The National Electricity Law should be amended to expedite the making of Rules arising from any appropriately conducted independent review relevant to the National Electricity Market and that are agreed by the Standing Council on Energy and Resources. This should be achieved by giving the:** • **Australian Energy Market Commission the power to expedite Rule requests and** • **South Australian Minister a broader power to make Rules.**	The MEU is of the view that there are quite deep concerns regarding these recommendations. Whilst there should be the ability to expedite uncontroversial changes quickly through the system, the MEU is concerned that some rule changes might be progressed in this way that should have received greater attention from stakeholders. On balance, the MEU considers that this draft recommendation should be deferred for deeper analysis on completion of a review of NEM all institutions, including of the AEMC itself.

Appendix 1

MEU comments to AEMC draft report on DSP3 regarding distributed generation and network pricing

Distributed generation and network pricing

The one area that the MEU considers needs considerably more attention, relates to the barriers to embedded generation and the network pricing associated with it.

The MEU is concerned that much of the discussion on embedded generation (distributed generation – DG) is focused on how the DNSPs might utilise DG rather than the way a DNSP responds to applications from end users to implement their own self generation. As a result, the draft report does not provide solutions to issues faced by self generating end users

One of the main problems facing self generation by end users is that no generation plant is 100% available and therefore for short periods of time, the self generator will import the maximum site demand. Network charging is based on peak annual demand (except in NSW where it is based on peak monthly demand). This means that even if the site demand is at its maximum for a limited time, the full network demand charge is applied as if it occurred all the time. In practice, a self generator can schedule the down time of its plant to periods when there is low network demand and so the full benefit to the network of the self generation can be provided when it has the most value at times of peak network utilisation.

The draft report discusses at some length the need for time related network pricing and proposes that the network pricing rules be modified to encourage users away from using electricity at times when the networks are most loaded. The MEU sees that this is a good step forward. But such a proposal does not address two key MEU concerns:

Firstly, it does not provide guidance that if a self generating end user structures its generation down time to periods when the network is not heavily loaded, then the network demand charge should be related to the peak site demand when the generation plant is operating. This removes one of the major barriers to embedded generation being implemented. One way of implementing this would be to apply the Victorian AEMO approach that a user's demand will be assessed as that demand which occurs at time when the network demand is at its peak, such as the time 2pm to 6 pm on hot summer days as is proposed by SP Ausnet (draft report box 7.1) as the critical network periods.

Secondly, it does not provide network pricing relief if an end user voluntarily sheds demand when the spot price is high. To a degree, high spot prices and high network demands are often coincident, but not always. If a user reduces demand at high network demand times, there is a benefit to the network that should be recognised.

The MEU considers that network supply tariffs should reflect usage at the time when there is the most stress on the network. It is well recognised that maximum demand on networks coincides with the wide spread use of refrigerative air conditioners on hot days. This means that there needs to be an impost on those users when their normal demand increases significantly when the networks are least able to manage the increase in demand. Conversely there needs to be an incentive (by lower network charges) for those consumers who maintain or reduce their demand when the network demand is otherwise increasing. This aspect is not addressed well in the section on network pricing.

The MEU considers that the draft report needs to provide greater direction to the AER regarding network pricing to encourage embedded generation and discourage increasing demand on those few hot days. In particular, the involvement of the AER in arbitrating disputes between networks and end users involving embedded generation needs to be mandated.