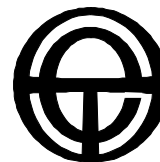


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9 June 2006

Dr John Tamblyn
Chairman
Australian Energy Marketing Commission
PO Box H166
Australia Square 1215

Dear Dr Tamblyn,

Re: Transmission revenue regulation

The AEMC published a Rule Proposal report for the regulation of revenue in February 2006. Unfortunately, due to resource limitations we were unable to respond by the deadline. We understand that there will be the possibility for further input when the AEMC issues a Draft Determination on regulation of revenue in June/July of this year, and that there will be a Rule Proposal report for pricing released in July. However, in the meantime we wish to raise a number of points for your consideration.

- The Draft Proposal seeks to align the, “incentives for TNSPs to invest in, and operate, transmission networks in a way that delivers efficient outcomes for the electricity market, market participants and consumers.” TEC has consistently argued for the explicit acknowledgement of the potential for demand management (DM) to deliver these efficient outcomes, but DM has again been largely overlooked.

We recommend that in the final proposal DM and other non-network solutions be explicitly mentioned for their potential to contribute towards efficient outcomes.

- The Draft Proposal seeks to increase, “clarity, certainty and transparency of economic regulation so as to provide a more certain regulatory environment for efficient long-term investment.” A major barrier to investment in DM initiatives is the lack of certainty about the treatment of costs. The Draft Proposal falls short of improving this situation.

We recommend that certainty within the NEM be improved through the clarification of regulatory mechanisms for the recovery of network investment in DM.

- The Draft Proposal provides a mechanism for re-opening the revenue cap on transmission cost recovery for “prudent, unforeseen capital expenditure”. Again, it can be difficult within the current regulatory climate to argue the prudence of DM expenditure. Furthermore, a shortfall in predicted DM savings may leave a TNSP at risk of carrying the full capital cost of an alternative (supply-side) means for meeting its reliability requirements.

We recommend that the eligibility of DM-related capital expenditure under this mechanism should be made explicit. As a complementary measure, in the event that expected DM resources do not materialise as planned, the eligibility of capital expenditure undertaken to implement supply-side solutions where needed should also be made explicit.

We recommend also that, since TNSPs are not yet fully experienced in DM measures, the AEMC pursue the feasibility of a transitional mechanism. The aims would be to remove risk, such as by allowing TNSPs to become familiar with DM techniques for meeting time and load targets, and develop strategies for maintaining service and reliability requirements wherever DM does not meet the required targets. This could include milestones for TNSPs to develop DM implementation plans as well as exit strategies to allow alternative measures to be undertaken. Such a transitional mechanism could include procedures for the TNSP to interact with the AER in finding solutions for such situations on a case-by-case basis.

- The Draft Proposal seeks to provide, “incentives for improving reliability at times of high system value”. DM can improve reliability, particularly through direct load shedding arrangements with large end users.

We recommend that there should be explicit acknowledgement in the final proposal of the potential for DM to contribute to reliability. NEMMCO has been attempting to set up arrangements with some users, but the AEMC could equally perform a useful role. For instance, the AEMC could develop a methodology for assessment of the reliability impacts of DM (and other network and non-network solutions) at an appropriate level of accuracy. These reliability impacts should also be explicitly incorporated into the assessment of capex and opex.

- The Draft Proposal establishes an operating cost efficiency benefit sharing scheme. As DM costs are often drawn from opex, recovery of network investments could be at risk if regulators limit DM recovery to capex investments.

We recommend that the AEMC ensures that decisions to engage in DM that increase opex do not disadvantage the NSP in this scheme.

- The Draft Proposal expresses increased interest in commercial arrangements in the provision of network services. The status of DM aggregation is uncertain within the NEM, presenting yet another barrier to its uptake.

We recommend that the AEMC considers the benefits of allowing DM aggregation as a service outside Prescribed and Negotiated Transmission Services. The AEMC could also consider whether DM aggregation should be regulated under Chapter 6 of the Rules.

We look forward to your response, and would be more than happy to meet with you to discuss our concerns.

Yours faithfully,

Jeff Angel
Director