



## **December 2007, edition 15.**

On 30 November 2007 the Victorian Government announced electricity price rises of between 12.8% and 17.6% from 1 January 2008. Gas prices are also expected to rise by between 5.2% and 7.5% next year. This follows price rises in other jurisdictions to come into effect from 1 January – including average increases of 15.7% for electricity in Tasmania, 11.4% in Queensland, 12.34% in South Australia and 5% for NSW. There is also talk of re-opening NSW's price path.

Governments have generally based these price rises on wholesale prices increases (the result of rising generation costs), a direct impact of the drought. Sustained high prices have had further impact on the profit base of retailers, who now wish to pass through these costs to consumers.

It is undoubtable that these price rises are going to have a significant impact on the budgets of many Australian households. Governments, energy retailers and the community sector need to work together to ameliorate the impact of such price rises and to ensure that all Australian households remain connected to energy services at an affordable price.

One interesting point of difference between the states is the process that was followed to reach these price increases. Rather than a transparent process involving consultation as occurs in most states, Victorian price increases were negotiated between government and the retailers.

We maintain that the deregulation of public services was supposed to lead to increased accountability and transparency, instead, these processes are being conducted without consultation, undermining consumer confidence and creating a lack of understanding of the costs involved.

While the Government recommends consumers switch to market contracts for better electricity deals, many consumers are still confused about what the competitive market means for them. Interpreting the plethora of competitive offers to determine the best one takes in many cases an excel spreadsheet and three days of work. For those that can't do this, or who are otherwise unable to participate in the market, affordable prices need to be guaranteed by government and retailers.

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### **1. Regulatory developments**

#### **1.1 Ministerial Council on Energy update**

The [Ministerial Council on Energy](#) (**MCE**) met for the 14<sup>th</sup> time on 13 December 2007, presided over by its new chair, Minister Martin Ferguson. A copy of the meeting communiqué can be found [here](#).

[Amendments to the National Electricity Law](#) have passed through [South Australian Parliament](#), whilst the new National Gas Law has been deferred until next year. The Electricity Law has become a priority, due to the need to begin the reviews of distribution pricing in NSW and the ACT next year.

These amendments, amongst other things, implement the national approach to energy access responding to the Expert Panel on Energy Access Pricing, implement the Ministerial Council on Energy's (**MCE**) decision on merits review, transfer distribution economic regulation to the national framework and implement an access disputes framework.

Also passed through the SA parliament is the [Consumer Advocacy Panel Bill](#), which amended the [Australian Energy Market Commission Establishment Act](#). A number of parliamentarians asked questions and proposed amendments to the Bill, including Kris Hanna MP, Mark Parnell MLC and Hon Denis Wood MLC. In particular, these parliamentarians raised the definition of "small to medium consumers" in the

regulations that accompany the bill – the definition would mean that many large businesses would have prioritised access to funding on the same basis as residential consumers. Many consumer advocates have previously argued that this is poor public policy – that large businesses should not be subsidised for undertaking advocacy and that funding should be prioritised for domestic consumers, who have the least power in the market. While proposed amendments were not agreed to in the South Australian parliament, consumer advocates continue to raise the issue with energy Ministers.

The MCE has also released the [National Electricity Rule amendments](#) which provide the detail of the new national economic regulation of distribution services. Until now, distribution pricing decisions have been made by jurisdictional regulators, but this will now move to the Australian Energy Regulator. The Rule amendments were provided to members of the South Australian parliament to accompany the debate on the amendments of the National Electricity Law. Transitional rules have also been prepared for the upcoming ACT/NSW distribution price determination.

The MCE has released a number of other Energy Market Reform Bulletins since our last edition, including:

- [Decision on smart meter functionality \(December 2007\)](#)
- [Passage of Amendments to National Electricity Law and Release of Draft NSW/ACT Transitional National Electricity Rules \(November 2007\)](#)
- [Regulations Accompanying the National Electricity Law \(November 2007\)](#)
- [Regulatory Impact Statement on the Separation of Generation and Transmission \(October 2007\)](#)
- [Report of the Joint Working Group on Natural Gas Supply \(October 2007\)](#)
- [Second Exposure Draft of Distribution National Electricity Rules Amendments \(October 2007\)](#)
- [Smart Meters Cost Benefit Analysis Phase 1 - National Minimum Functionality \(October 2007\)](#)
- [Australian Energy Market Operator Consultation Paper \(October 2007\)](#)

Further details of the Australian Energy Market Operator and Smart Meters are provided below.

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## **1.2 Australian Energy Market Operator**

Earlier this year, the MCE established the Market Operator Working Group (**MOWG**) to determine the operating structure for the new Australian Energy Market Operator (**AEMO**). In October, the MCE Standing Committee of Officials (**SCO**) released a [consultation paper](#) regarding the establishment of AEMO. The consultation paper

addresses issues relating to a new national framework for managing the market operation functions of both electricity and gas. In particular, the paper outlines issues and options on different functional, board selection, governance and ownership structures for the AEMO.

Focusing on ownership as a key concern, consumer groups believe that for AEMO to function effectively, its operations need to be aligned with government energy policy and, as such, it needs to be wholly owned by government. A joint submission from consumer and community organisations strongly opposed proposed industry ownership structure models.

Government ownership would reflect the role of NEMMCO today, retaining a regard for the interests of all end users, with a particular focus on issues relating to the supply of electricity and gas to businesses and households across the NEM. Many industry representatives are strongly advocating industry ownership which would significantly shift the balance of independence in favour of industry participants.

At the MCE meeting on 13 December, Ministers agreed to a detailed implementation plan for ensuring AEMO will commence its operations on 1 July 2009, with the board expected to be in place by mid 2008.

### **1.3 National smart meter rollout**

In February 2006, COAG committed to the progressive national roll-out of smart electricity meters from 2007 to allow the introduction of time of day pricing and to allow users to better manage their demand for peak power only where benefits outweigh costs for residential users.

The MCE has announced that this commitment will be facilitated by a two-phase cost-benefit analysis, which is being managed by the MCE SCO. Phase 1 is to define national smart meter minimum functionality, while Phase 2 will assess the case for a roll-out of smart meters across jurisdictions.

#### ***Phase 1***

Throughout October, NERA Economic Consulting hosted roadshows across Australia to engage stakeholders including distributors, retailers, consumer representatives, government representatives and smart meter vendors, to understand jurisdictional perspectives on the proposed mandated national smart meter rollout for Phase 1 and to present the current findings.

At the end of September, the MCE SCO released a [Regulatory Impact Statement](#) for public consultation on Phase 1 on the national minimum functionality for smart meters. The RIS was accompanied by over 600 pages of analysis from consultants.

The overwhelming output reflects the interests of the numerous stakeholders in the proposed smart meter rollout. It is proving to be a complex project with multiple perspectives on functionality alone. Issues highlighted with Phase 1 include the jurisdictional differences and legislative implications on import / export and remote connect / disconnect functions.

Consumer responses to the RIS included:

- [Consumer Utility Advocacy Centre, St Vincent De Paul and Alternative Technology Association joint submission](#);
- [Australian Council of Social Service](#);
- [Public Interest Advocacy Centre](#);
- [Griffith University Centre for Credit and Consumer Law](#);
- [Total Environment Centre](#);
- [Western Australian Council of Social Service](#); and
- [Consumer Action Law Centre](#).

At the MCE meeting on 13 December, the Ministers agreed that a national minimum functionality for smart meters is necessary to maximise their benefits. An initial list of functions has been approved for the [National Minimum Functionality](#), based on the cost-benefit analysis of functions and consultation with stakeholders. Additional functions have been referred for further work by a technical stakeholder group, to develop and advise on technical definitions, performance and service level requirements and relevant Rules.

The Ministers committed to facilitating a range of pilots and technical trials as a key part of the implementation plan. Importantly, Ministers agreed that a review of jurisdictional consumer protection and safety arrangements will be facilitated as an important part of any rollout.

## **Phase 2**

The draft findings of the Phase 2 Cost Benefit Analysis were presented to stakeholders on 5 December outlining the initial findings of the analysis.

Benefits and costs have been aggregated across all jurisdictions and work streams, resulting in an overall positive business case for the rollout. The analysis considered costs of smart meter infrastructure, avoided meter costs (business as usual), business efficiencies (avoided cost benefits) and demand response.

Consumer groups continue to be very concerned about the lack of focus on demand response and the pending costs to consumers that will be passed through from implementation and the proposed tariff structures. In particular, consumers are concerned about the issues associated with the rollout program, and believe that the

rollout of smart meters needs to be fully considered by the Smart Meter Working Group, particularly focusing on issues of consumer protections.

The Smart Meter Work Group, comprising officials from all state government energy departments and the Department of Resources, Energy and Tourism, will review the functionalities and some of the preliminary findings of the Phase 2 report during January before the Phase 2 report is released publicly.

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#### **1.4 National retail and non-economic distribution regulation**

In June 2007 a Composite Consultation Paper was released by the MCE's Retail Policy Working Group (**RPWG**) in relation to the proposed national framework for non-economic distribution and retail regulation following consultation on four working papers from December 2006 to March 2007 and the Supplementary Working Paper in May 2007.

Consumer Action additionally provided the RPWG with a detailed [Comparison Table](#) which compared retail consumer protections across NEM jurisdictions and gave an opinion about best practice. It is hoped that this document will be used by the RPWG in finalising the framework for national retail regulation.

Due to delays in finalising the economic regulatory package, and subsequently the non-economic package, the retail legislative package has now be scheduled for introduction to the South Australian Parliament by the 30 September 2009.

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#### **1.5 Australian Energy Market Commission update**

##### ***Victorian Competition Review - First Draft Report***

The [Australian Energy Market Commission](#) (**AEMC**) is currently reviewing the effectiveness of competition in the retail gas and electricity markets in Victoria, to be followed in South Australia in 2008 and New South Wales in 2010 (with tentative arrangements for ACT in 2010).

The [First Draft Report](#) found that there is evidence that effective retail competition can deliver 'efficiently priced, reliable and secure energy supply required by households and small businesses'. The AEMC relies upon figures from its commissioned consumer and retailer surveys that indicate that 79 per cent of domestic consumers believe that the introduction of retail competition has been a

positive development and that more than 70 per cent of households who have switched to market contracts had met their expectations.

Consumer and community advocates found the level of analysis in the report to be lacking and raised the following issues in their responses to the First Draft Report:

- Failure to undertake quality research: The AEMC had failed to undertake in-depth quality research on demand side outcomes. Although it has determined levels of switching, and that consumers are mainly switching for price related reasons, no research has been undertaken to determine whether consumers are receiving benefits after switching. Perception of benefit is not enough.
- Failure to understand problems with marketing: The AEMC has rejected evidence about marketing misconduct and problems with direct marketing channels, relying on an assumption that there is no problem with marketing due to low levels of complaints. This fails to understand that most consumers do not make complaints and complaint levels mask widespread consumer detriment in relation to marketing.
- Failure to engage with argument about regulation and competition: The AEMC begins with the assumption that once competition is effective, price regulation should be removed. It has not engaged with any of the arguments that the regulation of pricing has promoted competition and given confidence to the demand side to participate in the market. It has ignored evidence about the importance of default options in markets for essential services.
- Evidence provided by community groups that is ignored or rejected: The AEMC has relied on the results of the Wallis Group survey, rather than submissions provided by consumers and community groups.

Consumer groups also argued that the AEMC relied heavily on selective data, rather than relevant data. Specifically, the report did not include the following data, which can also be gleaned from the AEMC commissioned studies:

- Around half of domestic customers who received offers didn't understand them;
- 89 percent of customers who switched used one (most often the retailer they switched to) or no sources of information when making the decision;
- Only 5 percent of customers compared a new offer with their existing contract; and
- 90 percent of domestic customers have not approached an electricity retailer (ninety-six percent for gas) in the last five years.

Responses from consumer organisations included:

- [Alternative Technology Association](#)
- [Centre For Consumer And Credit Law](#)
- [Consumer Action Law Centre](#)
- [Consumer Utilities Advocacy Centre](#)
- [Public Interest Advocacy Centre](#)

- [St Vincent De Paul Society](#)
- [Victorian Council Of Social Services](#)

Consumer responses were accompanied by responses the South Australian Minister for Energy, The Hon Patrick Conlon, who questioned the balance of information reported by the AEMC, the actual level of competition in Victoria for industry and the levels of informed demand response.

Should the AEMC's First Final Report (due to be released 19 December) confirm the conclusion they have drawn in the Draft Report, they will recommend to the Victorian Government and the MCE the phasing out of current retail price regulation arrangements.

The AEMC will be presenting the findings of the Final Draft Report in Public Forums (details will be announced shortly in the 'Devil's Advocate').

### ***Review of Demand Management***

In October, the AEMC approached the MCE to advise them they would [investigate the potential for amendments to the National Electricity Rules in order to better facilitate demand side participation in the NEM](#). This decision has been based upon the AEMC identifying a range of issues relating to the effective participation of the demand side in the energy market.

The AEMC's work program will comprise:

**Stage 1** – review of demand side participation in relation to the AEMC's current work program in order to develop a number of recommendations that can be incorporated into the Commission's assessment of relevant Rule change proposals and reviews;

**Stage 2** – review of demand side participation in the context of the broader Rules subsequent to the finalisation of the national distribution and retail Rules in order to develop recommended Rule change proposals to be provided to the MCE; and

**Stage 3** – a final assessment of the Rules in order to identify any remaining gaps and make any necessary recommendations to the MCE on potential Rule changes.

Stage 1 will commence with an investigation into the role of demand side participation focusing on:

- [The Congestion Management Review](#);
- [The Reliability Panel's Comprehensive Review of Reliability](#); and
- [The National Transmission Planner](#) and related projects.



Related to this review, the [Total Environment Centre \(TEC\)](#) has submitted its own [rule change proposal](#), aimed at correcting the bias against demand management measures in the national electricity market, where specifically the current focus is on infrastructure expansion rather than avoidance.

The TEC proposal recommends:

- energy efficiency improvements;
- greater use of cogeneration; and
- fuel switching and load-shifting mechanisms.

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## **1.6 Australian Energy Regulator (AER) update**

### ***NSW/ACT Distribution price review– public forum***

The AER has begun consultations relating to the upcoming price reviews for the ACT/NSW electricity distribution businesses.

The AER is holding forums that will:

- Outline the AER's roles in administering chapter 6 of the NER and undertaking regulatory determinations for the ACT & NSW electricity distribution businesses for 2009-14
- Discuss the transitional requirements in the NER
- Discuss the milestones in the conduct of the regulatory determinations
- Discuss the development of guidelines required to conduct the regulatory determinations

### ***Service target performance scheme for transmission***

The AER has issued its fourth annual report into the market impacts of transmission congestion (**MITC**). The reports are used to develop the AER's service target performance incentive scheme for TNSPs.

The report also has the aim of:

- identifying the market impact and causal elements of constraints; and
- providing information to participants that will be used as a tool for guiding behavioural decisions, promoting efficient market participant behaviour.

In the report, the AER outlines the three measures it has developed in relation to the impact of congestion on the cost of electricity including, the cost of using a more expensive plant than would be used in the absence of congestion.

The total cost of constraints (**TCC**) and the outage cost of constraints (**OCC**) focus on the overall impact of constraints on electricity market outcomes, while the third measure the marginal cost of constraints (**MCC**) identifies which particular constraints have the greatest impact.

The measures aim to show how congestion raises the cost of producing electricity, taking account of the costs of each individual generator. Under the model, if the bidding of generators reflects their true cost position, the new measures will be an accurate measure of the economic cost of congestion and makes an appropriate basis to develop incentives to mitigate this cost. However, if market power allows a generator to bid above its true cost structure, then the measures will reflect a mix of economic costs and monopoly rents.

The AER has subsequently proposed a scheme which is designed to improve service standard incentives for electricity transmission companies. The AER proposes to introduce a new service standards incentive which rewards transmission companies for reducing the number and duration of outages that have a significant market impact. The scheme aims to provide transmission companies with improved incentives to time outages in off-peak periods, conduct live line work and better co-ordinate outages.

The AER will consult with all stakeholders in developing the incentive scheme and will consider submissions received on the proposed scheme before issuing a final determination in the first quarter next year

For more information, visit [www.aer.gov.au](http://www.aer.gov.au).

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## **2. Consumer advocacy and other information**

### **2.1 Coercion and harassment at the door, energy marketing in Victoria (Janine Rayner, Consumer Action)**

In response to numerous consumer complaints relating to energy marketing, Consumer Action Law Centre together with the Financial and Consumer Rights Council (**FCRC**) commissioned research into the experiences of consumers in relation to door-to-door energy sales and has produced a report [Coercion and harassment at the door](#).

The case study report identified numerous breaches of the Energy Retail Code and the Energy Marketing Code of Conduct and included cases of:

- Misleading conduct, for example, telling consumers that the retailer “is taking over the area”;
- Retailers switching customers without consent;
- Unconscionable conduct, particularly taking advantage of the lack of knowledge of elderly or non-English speaking consumers;
- Marketing to non-account holders; and
- Harassment, including refusal to leave when asked.

Instances of consumers signing multiple contracts and signing due to retailer inducements (such as free magazine subscriptions) also indicates that consumers are not always making choices that are in their best interests, which is important if the competitive market is to deliver efficient and appropriate outcomes.

The case study report also noted that consumer complaints reported to regulators or dispute handling bodies are only a small percentage of the actual incidence of marketing misconduct. The report has been provided to the AEMC and other energy regulators.

To coincide with the release of [Coercion and Harassment at the Door](#), Consumer Action has launched a Do Not Knock sticker campaign.



The sticker can be placed in front of a consumer’s residence and warns sales representatives that they are in breach of the law if they knock on a door to which the sticker is affixed. Door-to-door marketing continues to be a common complaint for

Victorian consumers in a number of industries, including energy, education and telecommunications.

The sticker is available for download on our website or by sending a stamped self-addressed envelope to Consumer Action Law Centre. It is also available from a range of community organisations around Victoria which are listed on our website at <http://www.consumeraction.org.au/get-involved-in-our-campaigns/>.

We have also made available template letters that consumers can use to make a complaint should a salesperson knock on a door where the sticker is clearly displayed.

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## **2.2 Increasing energy prices in Queensland (Tenzin Bathgate, Centre for Consumer and Credit Law)**

The start of Full Retail Competition (**FRC**) for electricity on 1 July 2007 (actually only partial FRC since, due to distribution charge zoning, it is not profitable for retailers to offer market contracts outside southeast Queensland) also marked the start of a new system for changing the regulated electricity tariffs each year.

Prior to FRC, the Minister changed the regulated tariffs by the CPI. The new system, introduced without any consultation with consumers, requires the Queensland Competition Authority (**QCA**) to calculate a percentage change in the cost of supplying electricity to whole state. This percentage is given to the Minister who may use it to adjust the regulated tariffs. The percentage is derived from the known cost in the current year and a forecast for the forthcoming year.

Each annual cost estimate is calculated in c/kWh but is confusingly called the Benchmark Retail Cost Index (**BRCI**). The calculations for 06-07 and 07-08 were undertaken by the QCA rather quickly due to lack of time and resulted in an increase of 11.4 percent which the Minister implemented. However, there was a commitment to consult with stakeholders before the start of the calculations for 07-08 and 08-09 to look at all aspects of the process, including the methodology.

The consultation process is now underway. In September, QCA issued an Interim Consultation Notice on which written submissions were sought. A stakeholder workshop was held on 31 October and a Draft Decision will be released in February 08 to be followed by written submissions and another workshop. The final decision will be in late April 2008.

The results of the consultation will have major long terms effects on consumers since there is a general desire and need to put in place a methodology which can be operated unchanged for many years.

Ignoring the absence of any corrections for forecast errors (assumed unnecessary due to self-correction if there is no forecast bias), the main issue being addressed in the consultations is how to estimate the cost of energy.

The legislation requires the QCA to focus on the long run marginal cost (**LRMC**) of energy. But, for a variety of reasons, in the last calculation the QCA also took account of the difference between the LRMC and the actual purchase cost of energy. The main reason for this was large increases in short-term wholesale electricity prices due to the drought and other factors. This decision also helped the QCA to take account of delegations from the Minister which require it to maintain the initial headroom (profitability of market contracts relative to regulated tariffs) and ensure that retailers do not incur a loss if customers switch from a market contract to a regulated tariff. (Unlike in other states, in Queensland each retailer is required to offer the regulated tariff if so requested by an existing customer.)

Current indications are that the likely result of the negotiations will be the use of a weighted average of the LRMC and the actual cost of energy. Assuming that the LRMC will normally be more stable than the actual cost, the weights use for each will greatly influence the likely annual variability in the BRCI and thus the annual percentage changes in the regulated tariffs. Also, depending on the relationship between the LRMC and the short-term cost of energy, there could be significant impacts on the short-term ability of retailers to offer market contracts competitive with regulated tariffs and the profitability of supplying at regulated tariffs, as well as on the timing of retailer profits and losses. Currently, since retailers are not offering market contracts outside the Energex area of SE Queensland, the latter are only issues for retailers in that area. However, the price stability issues will apply to consumers throughout Queensland and how much the regulated tariffs change each year will have massive implications for the government subsidies given to Ergon Energy to operate the regulated tariffs outside SE Queensland and for the cross subsidies from urban to rural consumers in the Ergon Energy area.

Yes - the Queensland system and processes for adjusting regulated tariffs are different to most other jurisdictions but at least the BRCI part of it is very transparent.

We will try to keep you up to date with developments and let you know how it all ends up.

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### **2.3 Climate change, energy efficiency and social equity (Tony Westmore, ACOSS)**

Climate change is one of the most pressing issues facing Australian society. Choice, ACOSS and ACF have joined forces to find fair responses to this challenge that benefit all Australian households, including those on low incomes. Many of these measures are already available and demonstrably effective.

Improvements to energy and water efficiency, for example, can significantly reduce consumption of energy and water, cut greenhouse gas emissions and reduce utility bills. The advent of an emissions trading scheme, likely to occur in the next decade, will affect other policies and programs. Gains in energy efficiency made before then will moderate the impact of a carbon price. Any investment in energy and water efficiency will pay dividends both in the short and long term. Our responses can and should begin immediately. These policy responses must ensure that all households are involved if we are to reduce the risk of further harm to our environment and mitigate the effects of climate change.

If governments introduced well-supported policies to improve energy efficiency in conjunction with a carbon price, appropriate tariffs and a safety net, no consumer should be worse off and greenhouse emissions should fall. Such a program should aim to retrofit five percent of existing homes a year and should include:

- Regularly evaluated education campaigns on the most effective means to achieving, and subsequent benefits of, energy and water efficiency.
- Home audits of energy and water use that result in recommendations for behaviour change and physical improvements and referral to sources of assistance.
- Financial and other assistance for low income households to implement measures that improve water and energy efficiency.
- Improved labelling on products and appliances so that initial and second hand purchasers can make informed decisions about energy efficiency at the point of purchase.
- Financial and taxation incentives to encourage landlords to retrofit properties to improve energy and water efficiency.
- Improving energy and water efficiency in public housing.
- Mandatory energy efficiency standards in all new buildings.

Financial assistance for low-income households is also essential.

A copy of the full statement '[Climate change, energy efficiency and social equity: responses that benefit all Australian households](#)' is available on the ACF website including a media release.

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## **2.4 Total factor productivity network regulation (Paul Fearon, Essential Services Commission)**

Recently the Consumer Utilities Advocacy Centre (**CUAC**) hosted a seminar on the Total Factor Productivity (**TFP**) approach to network regulation run by Paul Fearon CEO of the Essential Services Commission (**ESC**).

The Department of Primary Industries (**DPI**) are currently considering initiating a rule change to enable the Australian Energy Regulator (**AER**) to adopt a TFP index approach to X at the next Victorian electricity distribution review. This has great significance for consumers.

TFP-based approaches rely on the use of industry-wide productivity trends (or indexes) to determine the X-factor under a CPI-X approach to price caps. Once a sustainable start point is derived for each business (after assessing cost to serve) the Distributors' average prices are adjusted by the historical (generally 3-year rolling) TFP index – which since 1995 has averaged at around 2.15% pa. In this way regulation more faithfully mimics a competitive market – where prices adjust to changes in long run average unit costs for the industry. TFP-based approaches are increasingly being used overseas including in North and South America, New Zealand and Europe and are seen as a natural evolution of regulation from cost based approaches.

By contrast 'building blocks' approaches (as specified in the current the energy laws and rules) rely on forecasts of expenditure and demand to determine the DB's required revenue.

The ESC is very concerned with 3 things - "asymmetry of information", distorted incentives and a current process which is ripe for dispute, contention and endless and expensive litigation - all financed ultimately by exactions on the consumer.

Unlike Building blocks - TFP solves the principal dilemma facing all regulators namely the "rent – efficiency" trade-off. i.e. how to share efficiency gains with customers in a way that does not remove the incentive (keeping rent) for businesses to pursue ongoing efficiency. This is because it passes to consumers the benefits of aggregate productivity gains in the industry without attacking the incentive (of the individual business) to achieve the efficiency in the first place. Unlike building blocks, TFP breaks the circularity between a company's own costs and the prices it receives – just

like in competitive markets. The company no longer has an incentive to manipulate or misreport its own costs to achieve a higher price. It no longer has an incentive to hide its real cost efficiency and therefore have more of its gain "lost" to customers in the form of lower prices set by a regulator. Because TFP is calculated using aggregate industry data, no one company can distort the industry trend. Even under circumstances of collusion companies can not easily distort the industry trend. As the focus is removed from company costs the regulatory process can become lighter, more efficient, and less intrusive and be based on actual outcomes because the regulator no longer need to speculate on and second guess industry views on unknowable future costs, level of demand and energy distributed. Because TFP is "rule based" it doesn't rely on regulatory judgement and discretion – another source of controversy and disputation. Outcomes are exogenously determined without a regulator sitting in the middle trying to determine something between those who argue for low and those who argue for high – and something that is ultimately the least referable to an efficient outcome.

Unlike building blocks which focus on levels of costs, TFP is about trends and is thus not beset by the problem of cost allocations which draws regulators into increasingly intrusive and detailed examinations of costs reports and the maze of statutory accounts – even when they can get them.

Under TFP cost allocations are of much less importance and can enable the effective regulation of the monopoly network to happen without requiring formal legal ring fencing and therefore diminishing the benefit to the whole market of the distributors not being able to efficiently diversify into more competitive and non-regulated parts of the industry.

Apart from a better approach to regulating the natural monopoly networks TFP regulation is more consistent with complementing the overall energy market objectives established by COAG as it will positively incentivise distributors to pursue many of the new technologies that will contribute to solving greenhouse gas and environmental problems more generally.

Consumer advocates need to come to grips with TFP approaches to network regulation and determine whether consumer interests are served by this new approach or more traditional building block approaches. More information can be found on the ESC's TFP research project at its website [www.esc.vic.gov.au](http://www.esc.vic.gov.au)

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