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Mr J Martin
Energy Commissioner
Australian Competition and Consumer Commission
Level 35 The Tower
360 Elizabeth Street
MELBOURNE VIC 3000

Dear Mr Martin

Utility Regulators' Forum on Network Access Regulation

AusCID appreciates the opportunity to provide comments on the discussion paper "Comparison of Building Blocks and Index-Based Approaches", which was prepared by Farrier Swier Consulting in June 2002 on behalf of the Utility Regulators' Forum. AusCID congratulates the Regulators Forum for the work on alternative regulatory regimes given the problems which have been raised in regard to the "building blocks" model and the proposals for change reflected in the work of the Productivity Commission.

Comments that have been raised by our members on the above report relate to practical considerations as well as conceptual issues, such as the information intensity of both the building blocks and the difficulties involved in setting the x-factor generally. The key issues that AusCID would like to bring to the Forum's attention are that:

- The report downplays the Productivity Commission's concerns with the "building blocks" approach in terms of investment impacts, micro-management impacts and the high cost of the approach. The Commission argued that a business could go to a productivity based approach after it had been through two price reviews as its costs would be close to efficient;
- It is based on a false premise as pointed out by the Productivity Commission's Final Report that "regulators should give priority to developing the external productivity approaches, noting that, in evaluating success of such approaches, the benchmark should not be whether they lead to fully efficient outcomes (like the FSP) but whether they could deliver an acceptable level of improvement on the (likely) unregulated outcome"¹.

¹ Productivity Commission, Review of the National Access Regime, September 2001, p. 346

- There is no appreciation of the likely low level of technological change in gas distribution and in electricity distribution, and the fact that the technology change may be cost increasing (due to, for example, problems of voltage variation with wind farms and embedded generation). Without an appreciation of technological change regulators are in the dark over setting x factors.
- It questions the data availability for setting the TFP x factor without mentioning the guesswork related to setting x in the "building blocks" approach or the model produced x factors which have no relation to productivity and are only related to smoothing the depreciation profile.
- It states that regulators should determine when it is used rather than policy makers and is generally supportive of the building block approach.
- Benchmarking has been performed in the past using inappropriate models and there are substantial problems in relying on either static or dynamic benchmarking methodologies. Implementation of a benchmarking approach with any regulatory pricing approach would require careful consultation with distributors on the data used and a detailed appreciation of the dynamic aspects of benchmarking.

In conclusion, AusCID appreciates the Forum's efforts to ensuring transparency in the regulatory process by offering industry players the opportunity to comment on the various regulatory alternatives that are currently under consideration.

In AusCID's view the paper is a major advance in providing utilities with appropriate incentives for investment and improving efficiency however there is a need to undertake a more extensive analysis to cover the points expressed above.

Yours sincerely



Dennis O'Neill
Chief Executive Officer