

25 July 2007

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DATE RECEIVED

Mr M. Neck
 Queensland Competition Authority
 GPO Box 2257
 Brisbane QLD 4001



Dear Mr Neck

Electricity Distribution: Determination of Prescribed Services

Thank you for providing ENERGEX Limited (ENERGEX) with an opportunity to make comment on the Queensland Competition Authority's (QCA) proposed amendments to its *Electricity Distribution: Determination of Prescribed Services* of September 2000 (the Prescribed Services Determination).

Under the regulatory regime established in the 2005 Final Determination, costs associated with the provision of prescribed distribution services, comprising both distribution use of system (DUOS) and non-DUOS services, are used to determine the distribution businesses' revenue caps.

For a particular distribution service to be excluded from regulation under this framework, the Prescribed Services Determination places the onus on the distribution business to demonstrate that the service is conducted in a competitive marketplace. If this test is met successfully, that distribution service may then be subject to a more light-handed form of regulation.

ENERGEX agrees with the QCA that this framework needs to be reviewed in light of recent institutional and structural developments in the Queensland energy market.

It is anticipated that, under this new operating environment, distribution businesses will face a demand for non-DUOS services in excess of historically stable levels. A large number of these services are retailer requested services, the volumes of which are dictated by the retailer's specific practices and policies.

The likelihood of a stepped increase and future volatility in demand for non-DUOS services will have implications for the effectiveness of the revenue cap framework as a means of regulation since:

- the number of non-DUOS services to be provided in any given year will become difficult to forecast with any reasonable accuracy; and
- as the non-DUOS share of the revenue cap increases, all else equal, DUOS prices will need to fall so that the overall revenue cap limit is not breached. The operation of the unders-and-overs mechanism will re-enforce this perverse outcome over time.

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Accordingly, if the existing fixed revenue cap arrangement was to continue to operate in a competitive retail environment, then DUOS prices may no longer:

- be cost reflective. Customers would be paying a price less than the actual cost of network service provision;
- be free from cross subsidy. In particular, DUOS services would be cross-subsidised by non-DUOS services; and
- promote the efficient use of the network, since market signals would be impaired.

These undesirable regulatory consequences could be overcome by excluding non-DUOS services from regulation under the revenue cap. However, the QCA's current single criterion for exclusion is unable to accommodate such an arrangement.

In recognition of this limitation, the QCA is proposing to amend its Prescribed Services Determination. Under the changes proposed, the QCA could itself deem a candidate service as being excluded, on the basis of regard to matters set out in section 6.2.4(a) of the National Electricity Rules (the Rules). One key matter listed which seems relevant to the present set of circumstances is the effectiveness of the form of regulation in meeting efficiency objectives.

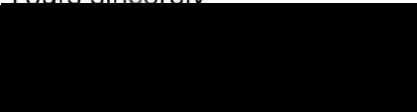
ENERGEX believes that this proposed broadening of the eligibility for exclusion criteria would have the potential to mitigate the shortcomings in the revenue cap regulatory framework that are anticipated to arise as the competitive retail market becomes established. In particular, the QCA could use its discretion to excise the costs and revenues associated with non-DUOS services from the revenue cap, and regulate them on the basis of an alternative more light-handed means. In doing so, DUOS prices would be effectively quarantined from the impact of uncertain movements in demand for non-DUOS services.

Accordingly, ENERGEX considers the amendments to the Prescribed Services Determination proposed by the QCA have merit, particularly given that:

- they allow a serious deficiency in the existing framework to be resolved swiftly through simple means;
- the transition to, and administration of, any new framework could be done transparently; and
- the approach is forward-looking to the extent that it is consistent with the approach to prescribed services contained in the National Electricity Rules

ENERGEX looks forward to working co-operatively with the QCA in any revision to the regulatory framework. Should you have any questions in relation to this matter, please refer them to Steve Williams, Regulatory Affairs Manager – Operations on (07) 3407 4354.

Yours sincerely



Louise Dwyer
Group Manager, Regulatory Affairs