

20 June 2008

Mr John Tamblyn
Chairman
Australian Energy Market Commission
Level 5, 201 Elizabeth Street
Sydney NSW 2000

By email: submissions@aemc.gov.au

Dear John,

EUAA Rule Change Proposal – WACC Parameters, Equity Beta and Gamma

Grid Australia is writing in relation to the Commission's notice of consultation dated 22 May 2008 concerning the Energy Users Association of Australia (EUAA) rule change proposal.

Grid Australia considers that the EUAA rule change proposal does not meet the criteria for consideration under section 95 of the National Electricity Law (NEL) - because it does not comply with the threshold requirements for consideration of a rule change proposal set out under section 94(1) of the NEL.

In particular, the rule change proposal is incomplete, lacking in substance and/or misconceived in at least the following related respects:

1. The proposal provides a substantially incomplete account of the likely costs and benefits of the proposed rule change, because it does not acknowledge that to give effect to it would undermine the current framework in the Rules for determining and applying the rate of return element of the transmission and distribution regulatory arrangements. This framework was designed by the AEMC to avoid frequent, repetitive and inefficient examination of substantially similar issues. By instigating a return to precisely the circumstances the Rules were designed to avoid, the EUAA request would have substantial negative implications for regulatory certainty, procedural efficiency and the administrative costs of market participants. The EUAA rule change request is incomplete, lacking in substance and misconceived because it neither recognises these consequences nor addresses the duplicated procedural and administrative costs to which it would give rise.
2. The proposal is misconceived and lacking in substance because it explicitly presupposes that the determination of the initial equity beta parameter made by the AEMC in order to establish the current framework did not reflect the best or unbiased estimate of the true value of the equity beta. A brief review of the AEMC's final determination of the current Rule indicates that it sought to adopt parameters that largely reflected current practice at that time.

The EUAA rule change proposal does not offer any credible, contemporaneous evidence that this was not the case;

3. The proposal is incomplete and lacks substance because a cursory review of the material submitted by the EUAA indicates that it has omitted any reference to a substantial body of alternative thought on the appropriate value for both of the rate of return parameters that it is seeking to amend. The EUAA rule change proposal does not provide any substantive treatment of the economics of the equity beta and the gamma and provides only limited and 'non-exhaustive' material on those elements.
4. The proposal is misconceived because it limits its consideration of changes to two rate of return parameters in a way that is disembodied from the framework in the Rules for considering all parameters. The EUAA rule change proposal explicitly recognises that there is a link between the approach for estimating and determining gamma and the equity premium, through the need for consistent concepts and measurement techniques between these two variables, but does not provide for a means to review the second of these parameters. The Commission cannot properly or adequately consider individual rate of return parameters in isolation from the requirements under the Rules that the overall rate of return be commensurate with the prevailing conditions in the market for funds.

In summary, the EUAA rule change proposal should not be considered under section 95 of the NEL because it does not meet the threshold criteria set out in section 94(1) of the NEL.

However, given that the Commission has initiated consultation under section 95 of the NEL, the attached submission provides a more detailed response to the EUAA rule change proposal.

Grid Australia considers that the material put forward by the EUAA is controversial, is not representative of the wide range of views that have been put forward on the relevant rate of return parameters, and so does not represent a balanced view on the appropriate values of these parameters. If the Commission was to consider the substantive matters of the EUAA proposal, a much more comprehensive review process would need to be established to allow sufficient time for interested parties to make submissions.

However, Grid Australia notes that the AER has released a proposed timetable for conducting its review of rate of return parameters under the Rules for electricity transmission and distribution businesses, to be completed by 31 March 2009.

For the reasons set out in the attached submission, Grid Australia submits that the National Electricity Objective would best be served by rejecting the EUAA rule change proposal, thereby allowing the AER review to proceed as intended.

Grid Australia would welcome the opportunity to discuss or clarify any aspect of this submission with the Commission or staff.

Yours sincerely,



Rainer Korte
Chairman
Regulatory Managers Group