SA Power Networks, CitiPower and Powercor Australia

JOINT RESPONSE TO AEMC DRAFT DETERMINATION

ERC0134/ERC0135

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1. INTRODUCTION AND EXECUTIVE SUMMARY

SA Power Networks,[1] CitiPower and Powercor Australia (**Businesses**) are pleased to provide this submission in response to the Australian Energy Market Commission (**AEMC**) *Economic Regulation of Network Service Providers, Draft Rule Determination* of 23 August 2012 (**Draft Determination**). The Businesses will respond to the AEMC's *Consultation Paper on Savings and Transitional Arrangements* of 14 September 2012 in a separate submission.

The Businesses welcome many of the AEMC's proposed changes to the National Electricity Rules (**Rules**). However, the Businesses are concerned that the AEMC is proposing to dramatically increase the level of discretion on the part of the Australian Energy Regulator (**AER**) (particularly with regards to estimating the rate of return and in respect of the capital expenditure (**capex**) incentives) without offering adequate protection for investors. Regulatory certainty and predictability are critical to fostering efficient investment in electricity networks. Improving the level of regulatory certainty currently provided for in the draft rules would ensure the incentives for efficient investment are maintained, and thus better promote the national electricity objective (**NEO**) and meet the revenue and pricing principles (**RPPs**).

The Businesses detailed response to the AEMC's Draft Determination is set out below. By way of summary the Businesses make the following submissions:

- **Rate of return:**
  - o Allowed rate of return objective: The Businesses consider that the draft 'allowed rate of return objective' creates the potential for unanticipated changes to regulatory practice and interpretation. The Businesses suggest that replacing the words 'must correspond to' with the words 'is to be commensurate with' would result in greater stability as it is consistent with the language in the National Gas Rules and the RPPs.
  - o Matters to which regard must be had in estimating the rate of return: The Businesses are concerned that proposed clause 6.5.2(d)(1) is unclear (and potentially flawed) and, in any event, is unnecessary. The proposed requirement that the AER have regard to interrelationships between estimates of financial parameters (proposed clause 6.5.2(d)(2)) would require the AER to have regard to internal inconsistency between parameters and thus addresses the concerns raised.
  - o Evidence required before a change in the approach to estimating the rate of return: The Businesses are extremely concerned that the AEMC is proposing to significantly increase the AER's discretion in estimating the rate of return and at the same time proposing to remove all evidentiary thresholds from the AER's decision making. Estimating a rate of return which promotes the NEO and meets the RPPs is inherently uncertain. Increasing regulatory discretion therefore creates a significant potential source of variability in regulatory determinations. The Businesses consider it essential that the final determination more appropriately balance the need for flexibility with the need for investor certainty. In particular, the Businesses consider the AER should be required to provide reasons *and evidence* in making changes to its 'Rate of Return Guidelines' and in departing from the applicable Rate of Return Guidelines at the determination stage.

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[1] In September 2012, ETSA Utilities changed its name to SA Power Networks.

- Clause 6.12.3(f): Similarly, the Businesses do not agree that the proposed amendments to clause 6.12.3(f) to carve out the allowed rate of return are required or appropriate. The clause does not limit the AER to assessing a rate of return proposal on the basis proposed by the network service provider (**NSP**) and retaining it would improve regulatory certainty and predictability.

- Rate of Return Guidelines: The Businesses submit that changes are required to the 'Rate of Return Guidelines' provisions to improve regulatory certainty and predictability and to allow meaningful consultation on rate of return issues. Specifically, the Businesses consider that:

  - the applicable Rate of Return Guidelines should be those in force at the time the framework and approach paper is published;

  - the period of consultation on all proposed Rate of Return Guidelines should be increased from 30 business days to 60 businesses days; and

  - the Rules should specify with greater precision what must be included in the Rate of Return Guidelines. In particular, the AER should be required to set out in detail the way in which it proposes to estimate the rate of return and include estimates of the return on equity, return on debt, gearing and value of imputation credits that would be applied if a determination was being made at the time the Rate of Return Guidelines are published.

- **Return on debt:**

  - Level of guidance provided for under the Rules: As in the case of the overall rate of return provisions, the Businesses are concerned that the draft rules offer the AER almost complete flexibility without offering adequate regulatory certainty to promote efficient investment. As NSPs develop their financing risk management practices based on the return on debt methodology provided for in the regulatory framework, any change to the methodology for estimating the return on debt could lead to NSPs gaining extra revenue or losing revenue as it unwinds its existing financing arrangements. Given this, there should be a higher level of prescription in the Rules than is currently contemplated by the AEMC. The Rules should set out the form of debt (BBB+ 10-year Australian corporate bonds) and should include more directly relevant criteria against which to assess the proposed methodology. In addition, as noted above the Rules should require the AER to include more detail in its Rate of Return Guidelines.

  - Managing changes to the methodology for estimating the return on debt: To avoid the risks associated with changes to the return on debt methodology, the Businesses consider that the AER should be required to accept an NSP's proposed methodology where it meets the relevant criteria, and if the AER does not accept the proposed methodology, it should be required to adopt the methodology previously adopted for that NSP.

- **Capex and operating expenditure (opex) allowances:**

  - Expenditure forecasting methodology: The Businesses support the general intent of the proposed rules regarding the standard expenditure forecasting methodology.

Under the current Rules, there is little engagement on issues of forecasting methodology until a draft determination is published and the Businesses agree that earlier engagement on these issues would benefit all parties to the review process. However, the Businesses:

- believe that it is fundamental to the operation of the regulatory approach set out in the Rules that NSPs retain the primary responsibility for the development of expenditure forecasts, including the methodology adopted; and

- consider that the AER should finally determine the basis on which it will prepare substitute forecasts at the framework and approach paper stage.

The Businesses submit that where the AER rejects an NSP's forecasting methodology, the forecasting methodology applied by the AER to determine a substitute amount should be either the methodology put forward by the NSP in its current regulatory proposal or the methodology outlined by the AER in its framework and approach paper. This would ensure early engagement in the issues of forecasting methodology and provide for greater regulatory certainty.

- Benchmarking: The Businesses have no objections to the AEMC's proposal to provide for the preparation of annual benchmarking reports. However, the Businesses are deeply concerned that the AEMC is proposing to remove all guidance for the AER in undertaking benchmarking as part of its regulatory determination. As demonstrated by the benchmarking errors in the AER's recent determinations regarding CitiPower and Powercor Australia, the AER is not immune to errors in this regard. These errors can have significant implications for revenue allowances and the Businesses consider that the AER should expressly be required to have regard to the relevant circumstances of the distribution network service provider (**DNSP**).

- Capex and opex factors: The Businesses consider that the AER should be required to identify any additional capex and opex factors at the framework and approach stage. Integrating this step into the review process (rather than requiring only that the AER advise the NSP in writing prior to the regulatory proposal being submitted) would mean that parties other than the NSP to which the determination applies would be aware of the additional factors that the AER is proposing to take into account and would ensure appropriate consultation on any proposed new factors.

- Clause 6.12.3(f): The Businesses consider that AEMC should retain the requirement that if the AER refuses to approve a total opex or capex forecast, it should be required to determine a substitute amount on the basis of the current regulatory proposal and amend that value only to the extent necessary to enable it to be approved in accordance with the Rules. This is consistent with a recognition that an NSP's proposal will include the most detailed and relevant evidence for the purposes of considering proposed capex and opex.

- **Capex incentives:**

  - Power to remove capex from the regulatory asset base (**RAB**): While the Businesses are in favour of strengthening capex incentives generally, given the previously accepted risks associated with ex post reviews of capex, the Businesses are surprised that the AEMC has concluded that the extreme response of an ex post review is required in order to deter inefficient capex. It is particularly surprising given:

  - the AEMC has concluded that nothing in the current regulatory framework provides NSPs with an incentive to overspend their allowances; and
  - the AER has not yet sought to strengthen the incentives through the introduction of an ex ante incentive scheme.

  The Businesses consider that a well-designed capex efficiency benefit sharing scheme is a far less intrusive and less costly means of ensuring efficiency of capex and would better promote the NEO and meet the RPPs.

  In the event the AEMC gives the AER the power to conduct ex post reviews of capex, the Businesses request that it be made clear in the Rules an ex post review may be conducted only in the event the 'overspending requirement' is met. The costs (both to NSPs and the AER) associated with a review of capex incurred would far outweigh any conceivable benefit in circumstances where there is no overspend (and thus no power to remove capex from the RAB for reasons of inefficiency). Consistent with this, the Businesses submit that the AER should be required to make statements about the efficiency of past capex only where a review of capex incurred is conducted. Finally, in the interests of maintaining investor confidence in the stability of regulation under the Rules, the Businesses consider that any power to conduct an ex post review of capex should only exist where the relevant Rules were in force for the entire period over which the review is to be conducted.

- <u>Criteria for the capex incentive scheme:</u> The Businesses support the criteria for the development of a capex efficiency benefit sharing scheme as outlined in the joint expert report for the Energy Networks Association (**ENA**).

- <u>Capital Expenditure Incentive Guidelines:</u> The Businesses consider that changes are required to the proposed capex incentives regime to improve regulatory certainty and thus ensure that NSPs are not deterred from undertaking efficient and prudent capex. In particular, the regime to be applied should be known by NSPs at the time the relevant expenditure is incurred or the relevant arrangements are entered into. Where there is overspend, the 'Capital Expenditure Incentive Guidelines' in force at the beginning of the review period should be applied and in the case of margins, the Guidelines in force at the time the arrangements were entered into should be applied. The AER should be required to make a final decision regarding the application of the Capital Expenditure Incentive Guidelines for future matters (i.e. the decision to apply depreciation based on actual or forecast capex and the form of any ex ante capex incentive regime) at the framework and approach paper stage.

- **Uncertainty regime:**

  - <u>Cost pass through provisions:</u> The Businesses support the proposed amendments to allow the AER to extend the timeframe for considering cost pass through applications but maintain that the 1% threshold for cost pass through applications is excessive. The Businesses consider that a $1 million threshold in a regulatory year should be imposed. In the event that a 1% of annual revenue materiality threshold is maintained by the AEMC, then further consideration should be given to the treatment of multiple events where the combined impact passes this threshold, and the total impact (i.e. including cost and revenue impacts) on the NSP should be considered.

- Capex reopeners: The Businesses do not object to the proposed capex reopener provisions. The AEMC is correct in concluding that there is no basis for distinguishing between distribution and transmission networks in respect of the risk of unforeseen events that will result in significant capex and capex reopener provisions would ensure the reliability and security of distribution systems in such cases.

- Contingent projects: The Businesses maintain that a contingent projects regime is not suited to the distribution context. In contrast to transmission networks, distribution networks have a large number of smaller assets and require regular investments to facilitate new connections, system augmentation and asset replacement. If the monetary threshold for contingent projects is set such that the contingent projects regime has ready application in the distribution context, the Businesses are concerned that the AER may seek to 'micro-manage' their networks. As it has done in the transmission context, the AER may be encouraged to go into the minute detail of each of the projects proposed by DNSPs and remove those projects that are not (in the AER's view) certain to go ahead in the next regulatory control period. This would adversely impact on the incentives of the CPI-X regime, removing the benefit associated with unanticipated cost reductions but leaving the DNSP to absorb unanticipated cost increases and would thereby magnify the risk of regulatory error, contrary to the NEO and the RPPs.

- **Small-scale incentive schemes:** The Businesses are strong supporters of incentive regulation and welcome the AEMC's proposed draft rule to provide for small-scale incentive schemes. To allow the incentive properties of proposed schemes to be properly tested, the Businesses consider that the AER and the Businesses should be able to agree upon higher potential penalties and rewards than is currently proposed.

- **Regulatory process:** In general, the Businesses are supportive of the proposed amendments to the regulatory process. However, the Businesses have concerns with the following aspects of the proposed changes.

  - Cross-submissions process: The Businesses consider that the cross-submissions process ought to be mandatory and that the AER should not be permitted to dictate the issues in respect of which submissions can be made. Giving the AER a discretion not to run a cross-submissions process incorrectly assumes that the AER will be in a position to immediately identify the issues arising from the submissions that are of importance to parties to the review process. There is no basis for such an assumption. The matters raised may be quite new to all parties and the implications may be unfamiliar to the AER. Further, the draft rules fail to recognise that the purpose of the cross-submissions process is to provide an opportunity for stakeholders to comment on matters that are significant to them. A more robust consultation process enshrined in the Rules reduces the risk of regulatory error, thereby promoting the NEO and the RPPs. A more appropriate limitation would be to provide for 'cross-submissions' only in respect of the matters raised in the submissions on the draft determination or revised regulatory proposal.

- Publication of AER analysis: The Businesses strongly support the requirement for the AER to publish the analysis on which it proposes to rely prior to the final determination. However, the Businesses are concerned that the 'best endeavours' requirement would not achieve the objective of advance publication of AER analysis (which is to provide interested parties with an opportunity to identify major errors before the AER relies on the analysis in its final decision). The Businesses' experience is that section 16 of the National Electricity Law has not ensured this opportunity in the past and the Businesses suggest a 'hard' deadline of 10 business days prior to the final determination would maximise the probability of major errors being identified before the AER's final determination is published.

The remainder of this submission addresses each of these points in turn, after briefly highlighting the significance of regulatory discretion and certainty in the context of the AEMC's rule change decision.

2. REGULATORY DISCRETION, CERTAINTY AND THE NEO AND THE RPPS

In moving to a national framework for the regulation of electricity and gas, the relevant State and Territory and Commonwealth governments agreed the institutional framework would include:[2]

- the AEMC as the body responsible for rule-making; and
- the AER as the body responsible for regulation and compliance with the rules.

In recommending this separation of functions to the Council of Australian Governments, the Ministerial Council on Energy (**MCE**) noted that the AEMC would have no regulatory enforcement responsibilities, while the AER would exercise its regulatory powers under a new national energy legislative framework including the National Electricity Law and the National Electricity Code (the predecessor to the Rules).[3] The MCE observed that '[t]he making of market and regulatory rules aims to provide reasonable stability to market participants, while ensuring that the rules can evolve to meet challenges that will inevitably arise'.[4]

In developing the economic framework set out in the Rules, the AEMC recognised that a general principle of law making and good regulatory practice is that parties who are required to comply with the law are entitled to clearly know in advance what is expected of them.[5] Accordingly, the AEMC considered that the role of the Rules is 'to provide regulators and market participants clear advance guidance about the content of the regulatory framework and how regulatory functions should be carried out as a result.'[6] The AEMC noted that insufficient specification in the Rules can lead to uncertainty and inconsistency which can impact adversely on long term investment, while insufficient

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2 Australian Energy Market Agreement at [5.1].

3 MCE, *Report to the Council of Australian Governments: Reform of Energy Markets*, 11 December 2003, pp8-9.

4 MCE, *Report to the Council of Australian Governments: Reform of Energy Markets*, 11 December 2003, p7.

5 AEMC, *Rule Determination, National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18*, 16 November 2006, p30.

6 AEMC, *Rule Determination, National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18*, 16 November 2006, p30.

discretion can limit the ability of the regulator to respond flexibly to the different market and commercial circumstances of individual regulated businesses.[7]

The AEMC considered that the regime then proposed for transmission (similar in many key respects to the current Rules):[8]

> strikes an appropriate balance between codification of methodology and decision making criteria and the exercise of guided regulatory discretion. These features of good regulatory design will, over time, increase the predictability and consistency of regulatory decision making and facilitate the promotion of the NEM objective.

The Businesses are concerned that the AEMC is now proposing to dramatically increase the level of discretion on the part of the AER without providing adequate guidance to the regulator to ensure regulatory certainty and predictability. As previously recognised by the MCE and the AEMC, regulatory certainty and predictability are critical to fostering efficient investment in electricity networks. The proposed changes are therefore contrary to the NEO and the RPPs. In addition, the Businesses observe the amendments are inconsistent with the MCE's deliberate policy decision to separate the rule-making and regulatory and enforcement functions.

The level of flexibility and corresponding level of regulatory certainty provided for in the current Rules, the AEMC's Draft Determination and the Businesses' proposal as set out in this submission are shown in Figure 1 below. The Businesses submit that the AEMC's final determination ought to be a more moderate response to the concerns raised, allowing for flexibility but at the same time providing greater certainty and predictability, thereby preserving incentives for efficient investment in networks in the national electricity market.

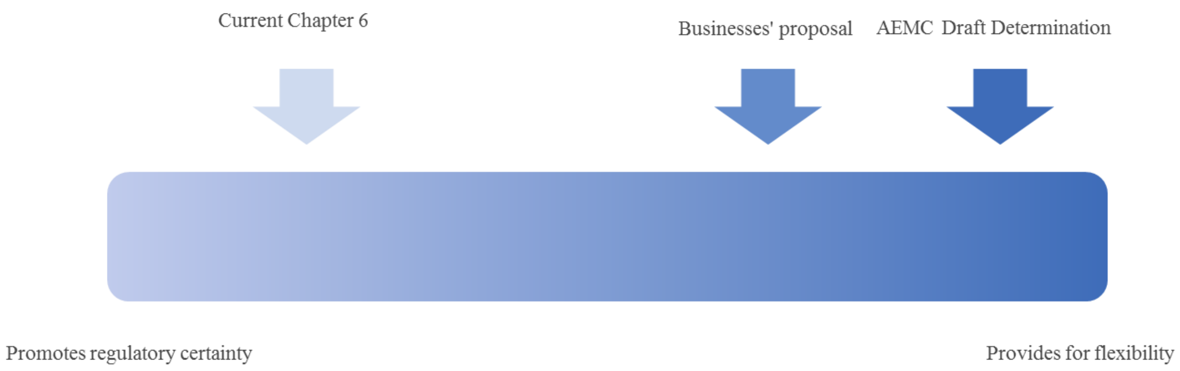

Figure 1 Comparison of current and proposed provisions

3. RATE OF RETURN

The AEMC is proposing extensive amendments to the rate of return provisions which would leave the decision as to the best approach to determining the rate of return to the AER's judgement. Under the draft rules, the AER would be required to determine (at the time of the distribution determination) an allowed rate of return that achieves the 'allowed rate of return objective'. The proposed allowed rate of return objective is as follows (proposed clause 6.5.2(b)):

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7 AEMC, *Rule Determination, National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18*, 16 November 2006, p34.

8 AEMC, *Rule Determination, National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18*, 16 November 2006, p35.

> The *allowed rate of return* for a *Distribution Network Service Provider* must correspond to the efficient financing costs of a benchmark efficient entity with a similar nature and degree of risk as that which applies to the *Distribution Network Service Provider* in respect of the provision of *standard control services*[.]

Under the draft rules, the allowed rate of return for a regulatory year would be a weighted average of the return on equity for the relevant regulatory control period and the return on debt for the regulatory year, where the weights applied would reflect the gearing ratio of an efficiently financed benchmark efficient entity with a similar nature and degree of risk as that which applies to the DNSP in respect of the provision of standard control services (proposed clause 6.5.2(c)(1)). In determining the allowed rate of return, the AER would be required to take into account relevant estimation methods, financial models, market data and other evidence (proposed clause 6.5.2(c)(3)) and have regard to (proposed clause 6.5.2(d)):

- the desirability of using an approach that leads to the consistent application of any estimates of financial parameters that are relevant to the estimates of, and that are common to, the return on equity and the return on debt; and

- any interrelationships between estimates of financial parameters that are relevant to the estimates of the return on equity and the return on debt.

The draft rules also include specific provisions governing the estimation of the return on equity and return on debt (proposed clauses 6.5.2(e)-(i)). The return on debt provisions are discussed in section 4 below.

The AEMC proposes to require the AER to publish 'Rate of Return Guidelines' at least every three years (proposed clauses 6.5.2(j)-(o)). The Guidelines are not proposed to be binding and are not proposed to constitute a formal basis for the distribution determination. In contrast to the current Rules, the AEMC is not proposing:

- to require the AER, in preparing the Rate of Return Guidelines, to have regard to the need for persuasive evidence before adopting a credit rating level or value for, or a method for calculating that parameter that differs from the previously adopted credit rating level, value or the method of calculation (compare current clause 6.5.4(4)(ii)); or

- to include a rule that a distribution determination must be consistent with the Rate of Return Guidelines unless there is persuasive evidence justifying a departure, in the particular case, from a value, method or credit rating level set in the Guidelines (compare current clause 6.5.4(g)).

The Businesses have concerns with the following elements of the draft rules:

- the 'allowed rate of return objective';

- the matters to which regard must be had in estimating the rate of return;

- the evidence required before there is a change in the approach to estimating the rate of return;

- the proposed amendments to clause 6.12.3(f); and

- the provisions governing the preparation and application of the Rate of Return Guidelines.

These matters are discussed further below. The Businesses' submissions regarding the proposed return on debt provisions are set out in the section 4 below.

Allowed rate of return objective

By requiring the rate of return to 'correspond to' the efficient financing costs of the benchmark entity, the draft allowed rate of return objective is somewhat unprecedented, which means that it creates the potential for unanticipated changes to regulatory practice and interpretation. The Businesses suggest that replacing the words 'must correspond to' with the words 'is to be commensurate with' would result in greater stability because this would be consistent with the language in the National Gas Rules (clause 87(1)) and the RPPs (specifically the principle in section 7A(5)).

Matters to which regard must be had in estimating the rate of return

The Businesses agree with the AEMC that regard should be had to any interrelationships in determining the allowed rate of return. However, the Businesses are concerned that proposed clause 6.5.2(d)(1) is unclear (and potentially flawed) and, in any event, is unnecessary.

The clause would require the AER to have regard to:

> the desirability of using an approach that leads to the consistent application of any estimates of financial parameters that are relevant to the estimates of, and that are common to, the return on equity and the return on debt[.]

The proposed operation of the clause is unclear. For instance, on one view, it may be said that the 'consistent application of any estimates of financial parameters' is a driver of the selection of the 'approach' to determining the return on debt. The justification for such an outcome is unclear. On another view, the clause may be said to require the AER to have regard to the desirability of applying the *same* estimates of the financial parameters in both the return on equity and the return on debt. This may not always be appropriate. For example, adopting the same risk free rate in estimating the cost of equity and in estimating the cost of debt may not result in the efficient financing costs of a DNSP in the circumstances of the DNSP, contrary to the NEO and the RPPs. For instance, it may be more appropriate to apply risk free rates sourced from different time periods, or to derive one estimate (e.g. the cost of equity) using a risk free rate and the other estimate (e.g. the cost of debt) without using a risk free rate.

In describing the proposed introduction of clause 6.5.2(d), the AEMC refers in its Draft Determination only to the need to ensure internally consistent approaches and to take into account interrelationships between estimates of financial parameters.[9] This objective would be achieved by proposed clause 6.5.2(d)(2) (i.e. the requirement that the AER have regard to any interrelationships between estimates of financial parameters that are relevant to the estimates of the return on equity and return on debt). This provision would require the AER to have regard to internal consistency between parameters and proposed clause 6.5.2(d)(1) is unnecessary.

Evidence required before a change in the approach to estimating the rate of return

The Businesses are extremely concerned that the AEMC is significantly increasing the AER's discretion in estimating the rate of return and at the same time removing all evidentiary thresholds from the AER's decision-making. Estimating a rate of return which promotes the NEO and meets the RPPs is inherently uncertain.[10] Increasing regulatory discretion therefore creates a significant potential source of variability in regulatory determinations. The AEMC's Draft Determination offers almost full flexibility to the AER with little regard to the need for regulatory certainty and predictability, which is critical to fostering efficient investment in networks and thus required to

9 Draft Determination, pp50, 57.

10 This is recognised in the current Rules (see, for example, clause 6.5.4(e)(4)) and throughout the Draft Determination.

promote the NEO and to meet the RPPs, particularly given the uncertainty in estimating the rate of return.

The Businesses do not accept that the publication of the Rate of Return Guidelines offers sufficient regulatory certainty. The Guidelines are no more than an indication of how the AER might determine the allowed rate of return. While the AEMC indicates that 'in practice' the regulator would be expected to follow the guidelines unless there had been some genuine change in the evidence, under the Draft Determination the AER is free to depart from the Guidelines, the only requirement being that it state its reasons for departing from the Guidelines.

The Businesses consider it essential, particularly in light of the uncertainty associated with estimating the rate of return, that the regime more appropriately provide for regulatory certainty by including some guidance to the AER in departing from an existing or proposed approach to estimating the allowed rate of return. Specifically, the Businesses consider that the AER should be required to provide reasons *and evidence* to justify:

- in preparing its Rate of Return Guidelines, any departure from the values or methods for calculating the rate of return set out in the existing Rate of Return Guidelines; and
- in making its distribution determination, any departure from the applicable Rate of Return Guidelines.

The Businesses observe that this proposal would enshrine in the Rules the intention of the AEMC with regards to the evidence required before a change in approach in adopted. It would also meet the AEMC's objective of allowing the estimation of the rate of return to evolve over time, while at the same time offering greater certainty to investors, better balancing the two competing objectives.

Clause 6.12.3(f)

Similarly, the Businesses do not agree that the proposed amendments to clause 6.12.3(f) to carve out the allowed rate of return are required or appropriate.

The clause does not, as the AEMC suggests,[11] limit the AER to assessing a rate of return proposal on the basis proposed by the NSP. The Tribunal's comments in the Victorian review proceedings do not establish this. The Tribunal in those proceedings held that the AER had erred in giving 25% weight to the yields from a bond issued by the Australian Pipeline Trust to calculate the debt risk premium (together with giving 75% weight to the Bloomberg extrapolated fair value yield).[12] The Tribunal concluded that it is not appropriate for the AER (which is charged with estimating the 'Australian benchmark corporate bond rate') to focus its consideration on corporate bonds issued by individual businesses.[13] That is, the driver of the Tribunal's decision was that the AER had erred in the methodology applied, not clause 6.12.3(f). Indeed, in subsequent decisions (where the AER was found to have made a similar error), the Tribunal expressly contemplated alternative methods to reliance on the Bloomberg extrapolated fair value yield.[14] The Tribunal has also accepted (in the

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11 Draft Determination, p61.

12 *Application by United Energy Distribution Pty Limited* [2012] ACompT 1 at [427]-[442].

13 *Application by United Energy Distribution Pty Limited* [2012] ACompT 1 at [427].

14 *Application by Envestra Limited (No 2)* [2012] ACompT 3 at [95]; *Application by Envestra Limited (No 2)* [2012] ACompT 4 at [98]; *Application by APT Allgas Energy Limited (No 2)* [2012] ACompT 5 at [97].

context of expenditure forecasts), the AER has the power to adopt different methodologies where it has concluded that the proposed estimate does not meet the relevant criteria.[15]

If retained in its current form, clause 6.12.3(f) of the Rules would require the AER to consider what amendments to an NSP proposal are be required in order for the allowed rate of return to meet the allowed rate of return objective. Given the uncertainty associated with estimating the rate of return, and in light of the significant increase in flexibility proposed to be given to the AER, such a requirement would improve regulatory certainty and predictability and thereby promote the NEO and the RPPs.

Rate of Return Guidelines

In addition to the issues described above, the Businesses have three concerns with the proposed provisions regarding the Rate of Return Guidelines.

First, under the AEMC's Draft Determination, it is not clear which Rate of Return Guidelines are to apply to a distribution determination. Given the relatively high frequency with which Rate of Return Guidelines would be reviewed under the AEMC's draft rules (i.e. every three years), a new Rate of Return Guideline could be introduced during the review process.

NSPs should have some certainty as to which Rate of Return Guidelines will apply to the AER's assessment of their regulatory proposal and underpin the final determination. As regulatory proposals are prepared by NSPs on the basis of the framework and approach paper, the Businesses consider that the applicable Rate of Return Guidelines should be those Guidelines in force at the time the framework and approach paper is published. This would improve regulatory certainty and predictability and thereby better promote the NEO and the RPPs. To the extent evidence justifying a departure from those Guidelines arises subsequent to the framework and approach paper, on the Businesses' proposal, it would be straight forward for the AER to set out any reasons and evidence to justify the departure at the time of the distribution determination.

Second, the Businesses consider that the proposed period for consultation on Rate of Return Guidelines (30 business days) is too short. The complexity of the issues involved (particularly as the draft rules give the AER a high level of discretion) and the importance of the rate of return to ensuring efficient investment in the network mean that NSPs require longer to meaningfully respond to any proposed guidelines. For instance, NSPs would need to engage independent third party experts to consider the AER's proposed guidelines, to consider the guidelines internally and to prepare a submission to the AER on the basis of these considerations. The Businesses consider that the period of consultation on proposed Rate of Return Guidelines should be increased from 30 business days to 60 business days, both for the first Rate of Return Guidelines and for all Guidelines after that.

Third, the Businesses consider that the Rules should specify with greater precision what must be included in the Rate of Return Guidelines. On the draft rules, the AER would be required to set out:

- the methodologies that the AER proposes to use in estimating the allowed rate of return, including how those methodologies are proposed to result in the determination of a return on equity and a return on debt in a way that is consistent with the allowed rate of return objective; and

- the estimation methods, financial models, market data and other evidence the AER proposes to take into account in estimating the return on equity, the return on debt and the value of imputation credits.

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15 *Application by EnergyAustralia and Others* [2009] ACompT 8 at [253]-[256].

Despite the AEMC's comments on how the provisions should operate,[16] it appears the AER could offer very little by way of insight into how it proposes to estimate the allowed rate of return and still satisfy these requirements. The Businesses consider that the AER should be required to set out in detail the way in which it proposes to estimate the allowed rate of return and include estimates of the return on equity, return on debt, gearing and value of imputation credits that would be applied if a determination was being made at the time the Rate of Return Guidelines are published (see also the further discussion below in respect of the return on debt). Unless such details are provided, the Rate of Return Guidelines would not offer the regulatory certainty required to promote the NEO and meet the RPPs.

Summary - Rate of return

The Businesses are extremely concerned that the AEMC is proposing to significantly increase the AER's discretion in estimating the rate of return and at the same time proposing to remove all evidentiary thresholds from the AER's decision making. Estimating a rate of return which promotes the NEO and meets the RPPs is inherently uncertain. Increasing regulatory discretion therefore creates a significant potential source of variability in regulatory determinations. The Businesses consider it essential that the final determination more appropriately balances the need for flexibility with the need for investor certainty. In particular, the Businesses consider the AER should be required to provide reasons *and evidence* in making changes to its 'Rate of Return Guidelines' and in departing from the applicable Rate of Return Guidelines at the determination stage. Similarly, the Businesses also consider that the AEMC should continue to apply clause 6.12.3(f) to the allowed rate of return. The clause would not prevent the AER from estimating a rate of return consistently with the AEMC's draft rules, but would promote regulatory certainty and predictability.

The Businesses consider that the draft 'allowed rate of return objective' creates the potential for unanticipated changes to regulatory practice and interpretation. The Businesses suggest that replacing the words 'must correspond to' with the words 'is to be commensurate with' would result in greater stability as it is consistent with the language in the National Gas Rules and the RPPs. In addition, the Businesses submit that changes are required to the draft rules on the development and application of the Rate of Return Guidelines to improve regulatory certainty and predictability and to allow meaningful consultation on rate of return issues.

4. RETURN ON DEBT

The AEMC has proposed to give regulators flexibility to determine the best approach to estimate the return on debt due to 'the difficulties in designing one unambiguously superior approach'.[17] The AEMC has proposed that the return on debt be estimated in a way that is consistent with the allowed rate of return objective and has proposed a range of criteria to which regard must be had in determining whether the return on debt is estimated in a way that is consistent with that objective (proposed clause 6.5.2(h))).

The Businesses understand the AEMC's desire to give the AER adequate flexibility in estimating the return on debt. However, as in the case of the overall rate of return provisions, the Businesses are concerned that the draft rules offer the AER almost complete flexibility without offering adequate regulatory certainty or predictability. In particular the draft rules:

- offer little guidance to the AER and NSPs on the estimation of the return on debt; and

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16 Draft Determination, pp77, 91.

17 Draft Determination, p63. See also pp90-91.

- do not address the significant risks associated with changing the return on debt methodology over time.

Each of these matters is addressed below.

Level of guidance provided for under the Rules

As evidenced by NSPs' practices to date, the return on debt provisions have the potential to directly affect the longer-term financing decisions taken by NSPs. While the Businesses appreciate that some flexibility on the part of the regulator is desirable in the estimation of the return on debt, more guidance in the Rules than is currently contemplated by the AEMC is required to ensure financing decisions that are prudent and efficient in the longer term are not undermined.

The Businesses consider that it would improve regulatory certainty but not adversely compromise the flexibility of the regulator if the Rules set out the form of debt to be used in estimating the return on debt. These matters are not NSP-specific and are stable such that they can be determined by the AEMC in the Rules.

Specifically, the Rules should specify that the return on debt should be based on BBB+ 10-year Australian corporate bonds. The AER has consistently defined the benchmark bond in this way since it commenced regulation under the Rules and the Businesses maintain this is the form of debt the return on which would be consistent with the allowed rate of return objective and NEO. As per the Businesses' previous submissions,[18] in estimating the return on debt, the AER should have regard to a wide range of data, which may include BBB+ bonds with maturities of less than 10 years, floating rate bonds and bonds with ratings other than BBB+ with maturities close to 10 years.

As described above, the Businesses consider that the AER should be required to set out in detail the way in which it proposes to estimate the allowed rate of return in the Rate of Return Guidelines. In the context of the cost of debt, this would include setting out (if not specified in the Rules) the benchmark gearing, credit rating level and new issue maturity for debt costs, as well as estimates of the resulting return on debt that would be applied if a determination was being made at the time the Rate of Return Guidelines were published and the basis on which market evidence as to the debt risk premium for the specified credit rating and maturity will be gathered. Requiring the material to be included in the Rate of Return Guidelines would better promote the NEO as it would improve regulatory certainty and predictability. The AER would still have flexibility under the Businesses' proposal to depart from the applicable Rate of Return Guidelines at the distribution determination as the AER could do so if it provided reasons and evidence to justify the departure.

Finally, the criteria included in the draft rules could be improved. The AEMC has indicated that the factors to which the AER must have regard are intended to ensure there is transparency and accountability in the regulators' consideration of the approach to estimating the return on debt.[19]

The Businesses are concerned that the criteria set out in the draft rules offer no real guidance. For example, the 'likelihood of any significant differences between the costs of servicing debt of a benchmark efficient entity' appears to support a trailing average approach, whereas 'the incentive effects of inefficiently delaying or bringing forward capital expenditure' appears to support an approach based on opportunity cost or spot rate. Further the 'the impact on electricity consumers' factor is confusing. On the one hand, if it is intended to reflect the NEO, it is unnecessary. On the

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18 *Joint response to AER and EURCC Rule Change Proposals (ERC0134 / ERC0135)*, 8 December 2012, p145; *Joint response to AEMC Directions Paper (ERC0134 / ERC0135)*, 13 April 2012, p22.

19 Draft Determination, pp73, 91.

other hand, if it is intended to introduce a concept that goes beyond the NEO, this may potentially result in greater emphasis on the short term price impact on consumers of return on debt decisions, contrary to the NEO (which is clear that it is the long term interests of consumers, including with respect to price, quality, safety, reliability and security of supply, that is important).

The Businesses consider that the key criteria for the estimation of the return on debt are as follows:

- the return on debt methodology should provide for recovery of an NSP's prudently incurred debt finance costs over the life of the relevant assets; and

- the return on debt should reflect the financing practices that would be adopted by a prudent operator in the circumstances of the NSP.

The Businesses submit that replacing the AEMC's draft criteria with these criteria would better promote the NEO.

Managing changes to the methodology for estimating the return on debt

As recognised by SFG Consulting, NSPs are likely to change their risk management positions in response to a change in the return on debt provisions and it may not be possible for NSPs to easily exit existing positions.[20] The result is that any change in methodology for estimating the return on debt could lead to an NSP gaining extra revenue or losing revenue as a result of unwinding its arrangements. Accordingly, SFG Consulting concluded that appropriate transitional arrangements must be put in place when changing the approach to estimating the return on debt.[21]

While the AEMC has proposed 'the impact of changing the methodology for estimating the return on debt across *regulatory control periods*' as one factor to which the AER must have regard in estimating the return on debt, the Businesses are not satisfied this will provide sufficient stability. Rather, the Businesses consider that greater transparency, certainty and predictability ought to be enshrined in the Rules.

Specifically, NSPs are best placed to propose a return on debt methodology that would give them the ability to closely match actual debt servicing costs to the regulatory allowance for the return on debt. As recognised by the AEMC, this is in the interests of consumers as it may reduce the required return on equity and might be expected to strengthen incentives for efficient capex.[22] The Businesses consider that the AER should be required to accept the return on debt methodology proposed by an NSP where it meets the relevant criteria (which the Businesses have proposed above). Where the AER does not accept the Businesses' proposed methodology, the Businesses consider that the AER should apply the methodology applied in the previous period. The Businesses note that if the AEMC adopts this or a similar position in the final determination, then amendments to clause 6.12.3(f) would be required.

Summary - Return on debt

As in the case of the overall rate of return provisions, the Businesses are concerned that the draft rules offer the AER almost complete flexibility without offering adequate regulatory certainty to promote

20 SFG Consulting, *Rule change proposals relating to the debt component of the regulated rate of return, Report for AEMC*, 21 August 2012, p19.

21 SFG Consulting, *Rule change proposals relating to the debt component of the regulated rate of return, Report for AEMC*, 21 August 2012, p7.

22 Draft Determination, p74. See also SFG Consulting, *Rule change proposals relating to the debt component of the regulated rate of return, Report for AEMC*, 21 August 2012, pp6-7.

efficient investment. As NSPs develop their risk management practices based on the return on debt methodology provided for in the regulatory framework, any change to the methodology for estimating the return on debt could lead to NSPs gaining extra revenue or losing revenue as it unwinds its existing financing arrangements. Given this, there should be a higher level of prescription in the Rules than is currently contemplated by the AEMC. The Rules should set out the form of debt (BBB+ 10-year Australian corporate bonds) and should include more directly relevant criteria against which to assess the proposed methodology. In addition, as noted above the Rules should require the AER to include more detail in its Rate of Return Guidelines.

To avoid the risks associated with changes to the return on debt methodology, the Businesses consider that the AER should be required to accept an NSP's proposed methodology where it meets the relevant criteria, and if the AER does not accept the proposed methodology, it should be required to adopt the methodology previously adopted for that NSP.

5. CAPEX AND OPEX ALLOWANCES

Expenditure forecasting methodology

The Businesses support the proposed requirements for the AER to:

- establish periodically a 'standard expenditure forecasting methodology' (proposed clause 6.4.5); and

- set out in the framework and approach paper the methodology that is to be used for the preparation of expenditure forecasts in the regulatory proposal (which may be the standard expenditure forecasting methodology or some other methodology) (proposed clause 6.8.1(2)(viii)).

Under the current Rules, there is little engagement on issues of forecasting methodology until a draft determination is published. The proposed rules would encourage issues around forecasting methodologies to be resolved sooner rather than later in the regulatory review process, which the Businesses agree would benefit all participants in the process. However, the Businesses:

- continue to believe that it is fundamental to the operation of the regulatory approach set out in the Rules that NSPs continue to retain the primary responsibility for the development of expenditure forecasts, including the methodology adopted; and

- the AER should finally determine the basis on which it will prepare substitute forecasts (where it does not propose to prepare a substitute forecast based on the methodology proposed by the NSP) at the framework and approach paper stage.

The Businesses consider that where the AER rejects an NSP's forecasting methodology, the forecasting methodology applied by the AER to determine the substitute expenditure in the final determination should be either:

- the methodology put forward by the NSP in its current regulatory proposal; or

- the methodology outlined by the AER in its framework and approach paper.

Such an approach:

- recognises that the concept of a 'standard forecasting methodology' is not applicable in all circumstances and the individual circumstances at the time of each determination will require specific consideration;
- would ensure high levels of engagement in respect of the expenditure forecasting methodology at the framework and approach paper stage, thereby maximising efficiency of the review process; and
- would provide regulatory certainty in respect of the proposed approach to be adopted by the AER.

The Businesses understand the AEMC's intention is that Businesses should be free to submit forecasts based on methodologies other than those outlined in the framework and approach paper (provided forecasts using the methodology outlined in the framework and approach paper are also submitted). The Businesses are concerned this intention is not sufficiently clear on the face of the current draft rules and submit the draft rules should be clarified in this regard.

Benchmarking

The Businesses have no objections to the AEMC's proposal to provide for the preparation of annual benchmarking reports.

However, the Businesses are deeply concerned that the AEMC is proposing to remove all guidance for the AER in undertaking benchmarking for the purposes of its determination. The Businesses consider it would be useful if some, albeit high level, guidance were provided to the AER. For example, the AER should be required to have regard to 'the benchmark [capex/opex] that would be incurred by an efficient *Distribution Network Service Provider* over the relevant *regulatory control period,* **having regard to the relevant circumstances of the *Distribution Network Service Provider*'** (suggested additions to proposed clauses 6.5.6 and 6.5.7 in bold).

The AEMC considers that there appears to be little doubt about how the AER should undertake a benchmarking exercise, including the circumstances that should be taken into account. However, the AER is not immune to errors in this regard. For example, in considering the AER's distribution determinations for 2011-15 regarding CitiPower and Powercor Australia, the Australian Competition Tribunal found on review that the AER's benchmarking of CitiPower's and Powercor Australia's proposed unit rates for vegetation management opex was erroneous because it failed to pay proper regard to differences between the networks and differences between the way in which the businesses were going about achieving compliance with the relevant regulations.[23] This error on the part of the AER, shown in Table 1 below, resulted in opex significantly lower than the amount the AER deemed prudent and efficient upon undertaking benchmarking after the Tribunal's decision.

[23] *Application by United Energy Distribution Pty Limited* [2012] ACompT 1 at [666].

	CitiPower	Powercor Australia
AER final determination (October 2010)	9,127	56,425
AER final determination after correction for error (August 2012)	16,460	72,810
Difference	7,333	16,385

Table 1 Comparison of opex step change allowances for vegetation management ($000, real 2010)

This example demonstrates that a failure to have regard to relevant circumstances in conducting a benchmarking exercise can have significant consequences for revenue allowances. The additional wording proposed for inclusion in relation to benchmarking would not be an 'inappropriate constraint' on benchmarking, rather, it would remind the AER to have regard to those of the DNSP's circumstances that are relevant to any benchmarking exercise, thereby ensuring DNSPs are provided with an opportunity to recover efficient costs consistent with the NEO and the RPPs.

Capex and opex factors

The AEMC has proposed to expressly include as one of the capex and opex factors (to which regard must be had in determining whether the capex and opex criteria are met):

> any other factor the *AER* considers relevant and which the *AER* has notified the *Distribution Network Service Provider* in writing, prior to the submission of its *regulatory proposal* under clause 6.8.2, is [a capex or opex factor],

(proposed clauses 6.5.6 and 6.5.7).

Rather than occurring independently of the regulatory review process (and potentially in a piecemeal fashion), the Businesses consider that the AER should be required to identify any additional capex or opex factors in its framework and approach paper. Such a requirement has the following advantages:

- The process would be integrated into the existing regulatory review process, improving administrative certainty and simplicity.
- Parties other than the NSP to which the determination applies will be aware of the capex and opex factors that the AER is proposing to take into account. On the current drafting, only the relevant NSP need be advised by the AER.
- The framework and approach paper process would ensure appropriate consultation on any AER proposed capex and opex factor. On the current drafting, there is no scope for consultation on proposed new factors to which the AER proposes to have regard in considering capex and opex forecasts.

Clause 6.12.3(f)

The Businesses consider that AEMC should retain the requirement (in clause 6.12.3(f)) that if the AER refuses to approve a total opex or capex forecast, it should be required to determine a substitute amount on the basis of the current regulatory proposal and amend that value only to the extent necessary to enable it to be approved in accordance with the Rules. This is consistent with a recognition that an NSP's proposal will include the most detailed and relevant evidence for the purposes of considering proposed capex and opex.

Summary - Capex and opex allowances

The Businesses support the general intent of the proposed rules regarding the standard expenditure forecasting methodology. However, the Businesses believe it is fundamental to the operation of the regulatory approach set out in the Rules that NSPs retain the primary responsibility for the development of forecasts, including the methodology adopted, and consider that the AER should finally determine the basis on which it will prepare substitute forecasts at the framework and approach paper stage.

The Businesses also have no objections to the AEMC's proposal to provide for the preparation of annual benchmarking reports. However, the Businesses are deeply concerned that the AEMC is proposing to remove all guidance for the AER in undertaking benchmarking as part of its regulatory determination. Errors in benchmarking can have significant implications for revenue allowances and the Businesses consider that the AER should expressly be required to have regard to the relevant circumstances of the DNSP.

The Businesses consider that the AER should be required to identify any additional capex and opex factors at the framework and approach stage. Integrating this step into the review process (rather than requiring only that the AER advise the NSP in writing prior to the regulatory proposal being submitted) would mean that parties other than the NSP to which the determination applies would be aware of the additional factors that the AER is proposing to take into account and would ensure appropriate consultation on any proposed new factors.

The Businesses consider that AEMC should retain the requirement that if the AER refuses to approve a total opex or capex forecast, it should be required to determine a substitute amount on the basis of the current regulatory proposal and amend that value only to the extent necessary to enable it to be approved in accordance with the Rules. This is consistent with a recognition that an NSP's proposal will include the most detailed and relevant evidence for the purposes of considering proposed capex and opex.

6. CAPEX INCENTIVES

While the Businesses are in favour of strengthening capex incentives generally, the Businesses are alarmed at the proposed amendments to the capex incentives regime. In particular, as previously recognised by the AEMC, the power to remove actual capex incurred from the RAB in establishing the opening RAB in a regulatory determination creates a disincentive to efficient and prudent capex. The Businesses consider that a well-designed capex efficiency benefit sharing scheme is a far less intrusive and less costly means of addressing the issue of ensuring efficiency of capex and would better promote the NEO and be consistent with the RPPs.

In the event the AEMC gives the AER power to conduct ex post reviews of capex, the Businesses consider that it should be made clear in the Rules that an ex post review of capex can be conducted by the AER only in the event the 'overspending requirement' is satisfied. The costs (both to NSPs and the AER) associated with a review of the efficiency of capex would far outweigh any conceivable benefit in circumstances where there is no overspend. Further, the Businesses consider that any power to conduct an ex post review of capex should only arise where the relevant Rules were in force for the entirety of the period over which the review is to be conducted.

The Businesses also have concerns with the criteria proposed to govern the development of a capex efficiency incentive scheme. The Businesses consider that the criteria for the development of a capex efficiency benefit sharing scheme as outlined in the joint expert report for the ENA would better promote the NEO.

Finally, the Businesses consider changes are required to the proposed regime to improve regulatory certainty and thus ensure that NSPs are not deterred from undertaking efficient and prudent capex. In particular, the regime to be applied should be known by NSPs at the time the relevant expenditure is incurred or the relevant arrangements are entered into. The AER should also be required to make a final decision regarding the application of the Capital Expenditure Incentive Guidelines for future matters (i.e. the decision to apply depreciation based on actual or forecast capex and the form of any ex ante capex incentive regime) at the framework and approach paper stage.

The above matters are discussed in more detail below.

Power to remove capex from the RAB

In its 2006 determination, the AEMC did not provide for an ex post review of capex because:[24]

- it undermines the incentive properties of the ex ante cap and contributes to investment uncertainty (thereby creating a risk that NSPs may be deterred from incurring capex required to maintain the safety and security of their networks); and
- is, by its very nature, an intrusive form of regulation.

The AEMC's proposal to give the AER power to remove actual capex incurred from the RAB is thus a fundamental shift away from the regime initially established by the AEMC. The Businesses are surprised that the AEMC has concluded that the extreme response of an ex post review of capex is required to deter inefficient capex in circumstances where:

- it has concluded that nothing in the current regulatory framework provides NSPs with an incentive to overspend their allowances;[25] and
- the AER has not yet sought to strengthen capex efficiency incentives through the use of its existing powers to introduce an ex ante incentive scheme.

The AEMC has justified the change on the following grounds:[26]

- The risk of an inability to recover for inefficient capex provides an incentive for NSPs to avoid inefficient capex. Ex ante incentives, while effective, do not ensure that NSPs never undertake inefficient capex.
- It should assist the AER in determining an appropriate ex ante allowance by allowing it to better understand how efficient an NSP has been in the previous period, what projects it has undertaken and will improve the AER's understanding of overspends.

The Businesses support the AEMC's original findings. First, the risk of an inability to recover capex provides an incentive to avoid not only inefficient but potentially efficient capex. By introducing the

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24 AEMC in its *Rule Determination, National Electricity Amendment (Economic Regulation of Transmissions Services) Rule 2006 No. 18*, 16 November 2006, pp97-100.

25 Draft Determination, pp122-123.

26 Draft Determination, pp136-137.

opportunity for the AER to exercise discretion to reduce the RAB in certain circumstances, the AEMC's proposed changes weaken the certainty associated with expenditure recovery, with a corresponding increase in the potential for inefficient deferral of capex. Contrary to the AEMC's suggestion that a well-run NSP should have nothing to fear from an ex post review of capex, it is clear that any time the AER exercises discretion, there is a risk of regulatory error and thus regulatory uncertainty. While the Businesses agree that limiting the amount that can be removed from the RAB to an amount equal to any overspend goes some way to giving Businesses certainty, there will be cases where efficient expenditure is required over and above the allowance and in these cases an incentive not to incur that expenditure will remain.

Second, an ex post review of capex is a very intrusive form of regulation. The AER would second-guess DNSPs' decisions as to the most prudent and efficient course, with significantly adverse consequences for the DNSP if the AER disagrees. This is contrary to the theory underpinning CPI-X regulation, which is that regulated businesses are best placed to determine how best to manage their networks. As described further below, while the Businesses accept that the incentives in respect of capex are weak under the current regime, they can be strengthened through the use of ex ante incentives, which to date have not been tested by the AER.

Contrary to the AEMC's findings, the Businesses observe that the power to remove capex from the RAB does not, in and of itself, assist the AER to determine an appropriate ex ante allowance going forward. Unlike in the case of opex, historic capex (with the exception of customer connections capex) is unlikely to be indicative of required capex going forward. For instance, growth in peak demand and the ageing of the asset base will often result in changing capex requirements over time. A forward looking assessment is a more reliable indicator of capex required going forward.

In addition to the above, the Businesses observe that an ex post review of capex would involve considerable time and effort on the part of the AER and the DNSPs, which would not be in the long interests of electricity consumers. Where the AER has not yet sought to develop an ex ante regime to strengthen the efficiency incentives, the Businesses do not consider this additional (and not insignificant) cost and effort is justified. In the event the AEMC provides for an ex post review in the Rules, the provisions should be clarified to ensure that the AER can conduct an ex post review of capex only where the 'overspending requirement' is satisfied. The Businesses are concerned that the AER will not limit itself to reviews where there is overspend with the result that unnecessary time and cost will be incurred in responding to AER information requests as to the efficiency and prudency of expenditure even where there is no basis for removing that expenditure from the RAB. For the reasons outlined, there is no corresponding benefit to consumers associated with the additional work required in the event of such a review.

Consistent with this, the Businesses submit that the AER ought only be required to include a statement with supporting reasons as to the extent to which the roll forward of the RAB contributes to the capex incentive objectives where it conducts an ex post review (contrary to proposed clause 6.12.2(b)). For the reasons outlined a requirement in the Rules that all capex incurred be rolled into the RAB in and of itself promotes the NEO and is consistent with the RPPs as it ensures incentives to incur efficient capex are maintained. On the current drafting, the role of the AER in ensuring the 'capital expenditure incentive objective' is met only arises in the event the 'overspending requirement' is met and the AER conducts an ex post review of capex incurred. Accordingly, the AER should be required only to prepare a statement on the RAB in those circumstances.

Further, if the power to conduct an ex post review of capex is introduced, in the interests of maintaining investor confidence in the stability of regulation under the Rules, the Businesses submit that the power to remove capex incurred from the RAB (for any reason) should only exist where the relevant Rules were in place over the entirety of the period over which the review is being conducted. Not only would this be consistent with good regulatory practice, it would be consistent with the National Electricity Law, which states that an amendment of a provision of the Rules does not affect the previous operation of the provision or affect a right, privilege or liability acquired, accrued or incurred under the provision.[27] To give effect to this, the AEMC could amend proposed clause S6.2.2A(b) as follows: 'The *AER* may only make a determination under paragraph (a) if **this clause S6.2.2A was in force over the entire review period** and any of the following requirements **are** satisfied…' (suggested amendments to proposed clause S6.2.2A(b) in bold).

In light of the above, and for the reasons outlined in the Businesses previous submissions,[28] retaining the existing capex incentive options for the AER (including a capex incentive scheme) would better promote the NEO and the RPPs.

Criteria for the capex incentive scheme

The AEMC has proposed 'capital expenditure sharing scheme principles' that the AER must take into account in developing a capex incentive scheme.

The Businesses support the criteria for the development of a capex efficiency benefit sharing scheme as outlined in the joint expert report for the ENA *Capital and Operating Expenditure - Response to the AEMC Directions Paper*, 16 April 2012 (Attachment C to the ENA's submission).[29] Most notably, the criteria developed by NERA Economic Consulting (**NERA**) and PricewaterhouseCoopers (**PwC**) include the following (absent from the AEMC's proposed criteria):

- a requirement that the method provide a continuous incentive, defined as an incentive that is equal in each year; and

- a requirement that rewards for improvements and penalties or a decline in efficiency, where improvement or decline of equal size (in absolute terms) would accrue the same reward or penalty (in absolute terms).

Regarding the need for a continuous incentive, the AEMC itself maintains that in most cases a continuous incentive is preferable to a declining incentive. While the AEMC indicates '[a] principle of this nature could discourage some schemes which are appropriate',[30] the Businesses cannot foresee any circumstances in which this could be the case.

As noted by NERA and PwC, it is only where a scheme provides for a continuous incentive and is symmetric scheme (in the sense of the same reward/penalty in absolute terms for the same improvement/decline in absolute terms), can it ensure that:

- the incentive to make efficiency gains is the same in all years of a regulatory control period; and

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27 Section 33(1) of Schedule 2 to the National Electricity Law. Schedule 2 applies equally to the Rules by reason of section 3 of the Law.

28 See, for example, the Businesses' *Joint response to the AEMC Directions Paper (ERC0134 / ERC0135)*, 13 April 2012, pp26-28.

29 See pp30-38.

30 Draft Determination, p131.

- the NSP faces the same incentives to make efficiency gains, irrespective of whether it is expected to spend more or less than the ex ante forecasts,

and thereby deliver the most robust and consistent incentives for NSPs with respect to capex efficiency. The Businesses therefore maintain that these principles are key to ensuring that an ex ante capex efficiency incentive scheme achieves the objective of ensuring efficient capex.

The Businesses are particularly concerned about the potential for an asymmetric efficiency scheme given the AEMC's 'clarification' as to the powers of the AER in substituting capex and opex forecasts. If the AER is freed from its perceived constraints in the setting of substitute forecasts, there may be additional risk of the AER reducing capex forecasts below prudent and efficient levels. If the capex sharing scheme applies to capex incurred relative to allowances, NSPs overspending those allowances could be penalised for regulatory error on the part of the AER in setting substitute forecasts. While the 'capital expenditure sharing scheme principles' provide that penalties should not be imposed on DNSPs that undertake capex in an efficient manner (proposed clause 6.5.8A), the AEMC has expressly stated that it intends only that the regulator have regard to such principles, that is, the AEMC 'does not intend that the regulator's approach to capex incentives must be done in a way that necessarily achieves the principles'.[31] Additional certainty needs to be offered to DNSPs that they will not be penalised for undertaking efficient capex.

Capital Expenditure Incentive Guidelines

If the AEMC gives the AER near complete flexibility to determine the capex incentives as it is proposing to do, the Businesses consider the following amendments are necessary to improve regulatory certainty and thus better promote the NEO and the RPPs.

The Businesses consider that the basis on which the AER will assess and reduce any actual capex incurred (for any reason) should be known to NSPs at the time the relevant expenditure is incurred or the arrangements for the relevant expenditure are entered into. Such a requirement is fundamental to an effective incentive regime. In the absence of certainty as to the applicable regime, efficient capex may be further deterred. Even if the Businesses' submission that the ex post review of capex should only occur if the relevant provisions are in force at the time the capex is incurred is accepted, this would not be the case on the current drafting because:

- it appears the AER would apply the Capital Expenditure Incentive Guidelines that are in force at the time of the distribution determination in determining any reduction in the value of the RAB (which Guidelines may not be in force at the time the DNSP is incurring the expenditure or entering into the relevant arrangements); and

- the proposed requirements as to what must be included in the Capital Expenditure Incentive Guidelines would not require sufficient detail.

The Businesses submit that the AER should be required (in the absence of DNSP consent otherwise):

- in conducting a review of capex following an overspend, to apply the Capital Expenditure Incentive Guidelines in force at the beginning of the relevant 'review period' (defined in proposed clause S6.2.2A(c)(3)); and

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31 Draft Determination, p127.

- in conducting a review of margins, to apply the Capital Expenditure Incentive Guidelines in force at the time the relevant arrangements were entered into.

By contrast, the Businesses consider that the Capital Expenditure Incentive Guidelines in force at the time the framework and approach paper is published should be applied for future matters (i.e. the decision to apply depreciation based on actual or forecast capex and the form of any ex ante capex incentive regime). Further, the Businesses consider that the AER should be required to make a final decision regarding the application of the Capital Expenditure Incentive Guidelines on these issues at the framework and approach paper stage, rather than the distribution determination stage. Unless the Businesses know the manner in which the AER will apply the Capital Expenditure Incentive Guidelines, the Businesses cannot ensure appropriate information is included in a regulatory proposal.

The Businesses observe that the proposed drafting regarding what the AER is required to address in the Capital Expenditure Incentive Guidelines with respect to margins referable to arrangements that do not reflect arm's lengths terms is unclear. The Businesses consider that the AER should be required to set out the manner in which it will:

- determine whether a margin is referable to arrangements that do not reflect arm's length terms; and

- if it determines margins are referable to arrangements that do not reflect arm's length terms, how the expenditure referable to those arrangements will be assessed,

and that this requirement should be enshrined in the Rules. The Businesses observe that a simple way for the AER to achieve this would be for the AER to assess margins consistently with its assessment of margins included in expenditure forecasts for the purposes of the distribution determination.

Other amendments

The Businesses observe that the AEMC's proposed drafting of clause S6.1.1(6)(i) is problematic in that it requires DNSPs to separately identify for each regulatory year 'margins paid or expected to be paid by the [DNSP] in circumstances where those margins are referable to arrangements that do not reflect arm's length terms'. The Businesses only enter into related party arrangements that they consider to be efficient and on arm's length terms. The obligation should be clarified so that it relates to the information intended to be captured (presumably, margins paid to related parties).

Summary - Capex incentives

While the Businesses are in favour of strengthening capex incentives generally, given the previously accepted risks associated with ex post reviews of capex, the Businesses are surprised that the AEMC has concluded that the extreme response of an ex post review is required in order to deter inefficient capex. The Businesses consider that a well-designed capex efficiency benefit sharing scheme is a far less intrusive and less costly means of addressing the issue of ensuring efficiency of capex and would better promote the NEO and be consistent with the RPPs. The Businesses support the criteria for the development of a capex efficiency benefit sharing scheme as outlined in the joint expert report for the ENA.

In the event the AEMC gives the AER power to conduct ex post reviews of capex, the Businesses consider that it should be made clear in the Rules that an ex post review of capex can be conducted by the AER only in the event the 'overspending requirement' is satisfied. The costs (both to NSPs and the AER) associated with a review of the efficiency of capex would far outweigh any conceivable benefit in circumstances where there is no overspend. In addition, the Businesses consider that any power to conduct an ex post review of capex should only exist where the relevant Rules were in force for the entire period over which the review is to be conducted.

Finally, the Businesses consider changes are required to the proposed regime to improve regulatory certainty and thus ensure that NSPs are not deterred from undertaking efficient and prudent capex. In particular, where there is overspend, the Capital Expenditure Incentive Guidelines in force at the beginning of the review period should be applied, and in the case of margins, the Guidelines in force at the time the arrangements were entered into should be applied. The AER should be required to make a final decision regarding the application of the Capital Expenditure Incentive Guidelines for future matters (i.e. the decision to apply depreciation based on actual or forecast capex and the form of any ex ante capex incentive regime) at the framework and approach paper stage.

7. UNCERTAINTY REGIME

Chapter 6 of the Rules is premised on CPI-X regulation whereby DNSPs may receive a proportion of the benefits of any unanticipated cost reductions and also absorb any unanticipated cost increases.[32] As they can retain the benefit of unanticipated cost reductions, DNSPs have an incentive under CPI-X regulation to reduce controllable expenditure. However, DNSPs operate in a dynamic and uncertain environment and thus an 'uncertainty regime' (which allows for the recovery of costs over and above expenditure allowances in defined circumstances) is required to manage significant changes in the DNSPs' operating environment to ensure that prudent and efficient expenditure can be incurred and recovered in response to such changes.

Chapter 6 currently includes a cost pass through regime, which allows for the pass through of significant increases (or decreases) in costs resulting from certain categories of unexpected events that may occur during a regulatory control period. The AEMC is proposing changes to that regime and is also proposing to supplement the existing uncertainty regime in Chapter 6 by introducing:

- capex reopener provisions; and
- a contingent projects regime,

analogous to the capex reopener provisions and contingent projects regime for transmission network service providers (**TNSPs**) (with proposed amendments to the AER's decision-making timeframes in both).

Cost pass through provisions

The Businesses support the proposed amendments allowing the AER to extend the time for considering cost pass through applications. The Businesses maintain, however, that a materiality threshold of 1% of a DNSP's annual revenue requirement for each pass through application is contrary to the NEO and the RPPs. The RPPs provide that NSPs should be provided with a reasonable opportunity to recover their efficient and prudent costs, regardless of whether the costs were foreseeable. The proposed materiality threshold is overly onerous, significantly increasing the risk to DNSPs of costs associated with unanticipated events, which (unless provided for in their regulated revenues) is contrary to the intent of the pass through regime and the RPPs and puts the quality, safety

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32 As described, for example by the AEMC in its *Rule Determination, National Electricity Amendment (Economic Regulation of Transmissions Services) Rule 2006 No. 18*, 16 November 2006, p93.

and reliability of supply at risk, contrary to the NEO. The Businesses submit that a materiality threshold of $1 million would increase the certainty for stakeholders as to what is a 'material' event for the purposes of the cost pass through provisions and would alleviate the need for the AER to form a view as to what is material in specific circumstances, meeting the AER's stated concerns with the existing Rule provisions. Such a threshold would also avoid the adverse cost recovery consequences of the AEMC's proposed threshold, thereby promoting the NEO and the RPPs.

In the event that a 1% of annual revenue materiality threshold is maintained by the AEMC, then further consideration should be given to the treatment of multiple events where the combined impact passes this threshold, and the total impact (i.e. including cost and revenue impacts) on the NSP should be considered.

Capex reopeners

The Businesses do not object to the proposed capex reopener provisions. The provisions will ensure the reliability and security of distribution systems in cases where unforeseen events (that do not constitute pass through events) result in adverse consequences that will require significant capex to rectify. Under the draft rules, a distribution determination would only be reopened where it can be shown that the DNSP cannot reduce capex in other areas to avoid the adverse consequence without materially adversely affecting the reliability and security of the distribution system. The AEMC is correct in concluding that there is no basis for distinguishing between transmission networks and distribution networks in respect of such risks.

Contingent projects

The Businesses maintain that a contingent projects regime is not suited to the electricity distribution context.[33] In contrast to transmission networks, which are made up of a small number of large assets, distribution networks have a large number of smaller assets and require regular investments to facilitate new connections, system augmentation and asset replacement. Therefore, whereas capex forecasts put forward by TNSPs may be significantly impacted by individual projects, capex forecasts put forward by DNSPs are not. If the monetary threshold is set such that the contingent projects regime has ready application in a distribution context it would not promote the NEO or be consistent with the RPPs because:

- the administrative burden associated with the regime would be much higher than in a transmission context as a larger number of trigger events would need to be specified at the time of the distribution determination and a larger number of 'triggered' contingent projects would need to be considered during the course of a regulatory control period; and

- there would be increased risk that prudent and efficient capex would not be recovered by a DNSP as the AER would have to be satisfied that the event falls within the definition of the defined 'trigger event' and that the forecast capex meets the monetary threshold (in addition to the expenditure being reasonably required for the purposes of undertaking the contingent project).

Further, and more significantly, in such circumstances, the Businesses are concerned that a contingent projects regime may lead the AER to seek to 'micro-manage' their networks. The Businesses observe

33 See the Businesses' *Joint Response to AER and EURCC Rule Change Proposals*, 8 December 2011, p74-76 and *Joint Response to AEMC Directions Paper*, 13 April 2012, pp30-31.

that under the equivalent transmission provisions, the AER has transferred capex amounts from proposed capex to contingent projects.[34] Under a contingent projects regime with low monetary thresholds, the AER may be encouraged to go into the minute detail of each of the projects proposed by DNSPs and remove those projects that while probable are not (in the AER's view) certain to go ahead in the next regulatory control period. This would adversely impact on the incentives of the CPI-X regime under which DNSPs retain a proportion of unanticipated cost reductions and absorb unanticipated cost increases. Specifically, it would remove any benefit associated with unanticipated cost reductions, but leave the DNSP to absorb unanticipated cost increases, thereby magnifying the risks of regulatory error. The cost pass through and proposed capex reopener provisions do not remedy this problem given the relatively narrow range of events to which they apply.

In addition, the Businesses observe that, under the existing regime, an AER decision regarding the incremental revenue required in respect of a contingent project would not be subject to merits review.[35] This further increases the risk of DNSPs not being provided with an opportunity to recover prudent and efficient capex, contrary to the NEO and the RPPs.

The Businesses therefore consider that no contingent projects regime should be introduced in respect of distribution networks. In the event a contingent projects regime is to be imposed in the distribution context, the Businesses consider that it would better promote the NEO and the RPPs if the AER was not permitted to:

- have regard to whether proposed opex or capex should 'more appropriately be included as a *contingent project*' (as it would be required to do under proposed clauses 6.5.6(e)(9A) and 6.5.7(e)(9a)); or

- propose its own contingent projects by transferring opex or capex proposed in a regulatory proposal to a contingent project.

Such measures would ensure that the AER could not be tempted to micro-manage distribution networks. Rather, the AER would either be satisfied that proposed capex reasonably reflects the capex criteria (in which case it must accept the forecast), or not be so satisfied (in which case it would reject the forecast and substitute its own that does).

In addition, the Businesses observe that any contingent projects regime should apply only to capex related to very large individual projects. To ensure this objective is achieved, the Businesses submit that:

- rather than being linked to the size of the DNSP's annual revenue requirement, the monetary threshold for contingent projects should be a specified dollar amount, which is consistent with a very large and significant project in the distribution context. Such an approach would ensure that only very large projects are subject to the contingent projects regime, rather than projects of varying size depending on an individual DNSP's revenue requirement for a particular year; and

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34 See for example, AER, *Final Decision, Powerlink Transmission Determination 2012-13 to 2016-17,* April 2012, p45.

35 The decision would not fall within the definition of reviewable regulatory decision in section 71A of the National Electricity Law. It is not a 'network revenue or pricing determination that sets a regulatory period' and is not prescribed in the National Electricity Regulations (regulation 9).

- the Rules should expressly state that the contingent projects regime applies only to capex related solely to an individual project and not capex that is related to more than one identifiable project.

With regards to the threshold amount, the Businesses wish to clarify that they have not 'proposed' a threshold of $5 million for contingent projects as surmised by the AEMC.[36] Rather, the Businesses simply observed that the AER's proposal for a threshold of $10 million was inconsistent with the $5 million threshold proposed for the application of the regulatory investment test for distribution. The observation was made in the context of the Businesses' submissions to the AEMC that the proposed contingent projects regime could not be considered adequate to address the disincentive to incur efficient capex under the AER's proposal to include only 60% of capex incurred over the capex allowance in the RAB because the threshold proposed by the AER was too high to have application in practice. The Businesses have consistently maintained that a contingent projects regime is not suitable to a distribution context and should not be applied to DNSPs. If a regime is introduced, the Businesses consider the monetary threshold proposed by the ENA should apply.

Summary - Uncertainty regime

The Businesses support the proposed amendments to allow the AER to extend the timeframe for considering cost pass through applications but maintain that the 1% threshold for cost pass through applications is excessive. The Businesses consider that a $1 million threshold in a regulatory year should be imposed. In the event that a 1% of annual revenue materiality threshold is maintained by the AEMC, then further consideration should be given to the treatment of multiple events where the combined impact passes this threshold, and the total impact (i.e. including cost and revenue impacts) on the NSP should be considered.

The Businesses do not object to the proposed capex reopener provisions. The AEMC is correct in concluding that there is no basis for distinguishing between distribution and transmission networks in respect of the risk of unforeseen events that will result in significant capex and capex reopener provisions would ensure the reliability and security of distribution systems in such cases.

The Businesses maintain that a contingent projects regime is not suited to the distribution context. In contrast to transmission networks, distribution networks have a large number of smaller assets and require regular investments to facilitate new connections, system augmentation and asset replacement. If the monetary threshold for contingent projects is set such that the contingent projects regime has ready application in the distribution context, the Businesses are concerned that the AER may seek to 'micro-manage' their networks. As it has done in the transmission context, the AER may be encouraged to go into the minute detail of each of the projects proposed by DNSPs and remove those projects that are not (in the AER's view) certain to go ahead in the next regulatory control period. This would adversely impact on the incentives of the CPI-X regime, removing the benefit associated with unanticipated cost reductions but leaving the DNSP to absorb unanticipated cost increases and would thereby magnify the risk of regulatory error, contrary to the NEO and the RPPs.

8. SMALL SCALE INCENTIVE SCHEMES

As the AEMC would be aware, the Businesses are strong supporters of incentive regulation and welcome the AEMC's proposed draft rules to provide for small-scale incentive schemes. The Businesses consider, however, that the Rules should provide for small-scale incentive schemes that provide for rewards or penalties of up to an agreed percentage of the annual revenue requirement.

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36 Draft Determination, p196.

The Businesses note in this regard that the incentive properties of a scheme can really only properly be tested if there are adequate financial incentives.

9. REGULATORY DETERMINATION PROCESS

Overall, the Businesses support the AEMC's proposed adjustments to the regulatory determination process. In particular, the Businesses:

- welcome the proposed six month extension of the review process. Such an extension would provide all parties involved with much needed additional time to review and comment on the complex issues raised;
- agree an overview paper for consumers to be submitted with the regulatory proposal (proposed clause 6.8.2(c1)) would assist consumers to understand the regulatory proposal and its implications for them, thereby promoting consumer engagement in the regulatory determination process;
- welcome the proposed rule changes to provide for comments on submissions made on the draft determination and revised regulatory proposal (i.e. the establishment of a 'cross-submissions' process) (proposed clause 6.10.4); and
- strongly support the proposed requirement on the AER to publish analysis on which it proposes to rely a reasonable time before the making of the distribution determination (proposed clause 6.11.1(c)).

The Businesses have some concerns with the proposed cross-submissions process and the proposed requirement in respect of publication of analysis.

Cross-submissions process

The Business have three concerns with the proposed cross-submissions process:

- under the Draft Determination, the AER would have the discretion, but would not be required, to invite comment on the submissions on the draft determination and revised regulatory proposal;
- the AER would have the power to invite submissions only where the AER invites submissions on the revised regulatory proposal; and
- the AER must specify the matters in respect of which submissions are invited.

The AEMC has indicated that giving the AER discretion to introduce a cross-submissions process would:[37]

- reduce the risk that NSPs treat the stage as an opportunity to submit a late revised regulatory proposal; and
- give the AER the option to dispense with the process if it considers that it would be unnecessary and to better utilise resources in preparing the final determination.

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[37] Draft Determination, p178.

The Businesses' respectfully disagree with the AEMC's reasoning.

First, there is no risk that NSPs will treat the stage as an opportunity to submit a late revised regulatory proposal. The Rules are clear that the revised regulatory proposal must be submitted within the specified period and that the original regulatory proposal may only be varied so as to incorporate the substance of any changes required by the draft determination or the AER's reasons for it (clause 6.10.3). This would be further emphasised under the AEMC's proposed rules as AER would be required to make available on its website a summary of any 'out of scope' revisions (proposed clause 6.11.1A(a)). There is also limited risk that NSPs will use the process to 'withhold' certain information or argument from the revised regulatory proposal. This is because there is no guarantee that interested parties will make submissions on any particular point, and if the point is not responsive to a submission made there is a risk the AER will not take the submission into account.

Second, giving the AER the option to dispense with the process if it considers it unnecessary misses the point in that the purpose of the cross-submissions process is to provide an opportunity for stakeholders to comment on matters of importance to them, and not for the regulator to dictate the matters that can be the subject of submissions. It assumes that the AER will be in a position to immediately identify the issues arising from the submissions that will impact on all parties to the regulatory review process. There is no basis for such an assumption, as the matters raised may be quite new to all parties, and the implications may be unfamiliar to the AER. A more robust consultation process enshrined in the Rules reduces the risk of regulatory error, thereby promoting the NEO and the RPPs.

The Businesses consider the AER should be required to invite submissions on the submissions made both on the draft determination and revised regulatory proposal (this could be completed in a single process). Accepting that some limitation is appropriate, the Businesses propose that parties should be limited to responding to issues raised in the relevant submissions.

Publication of AER analysis

As noted, the Businesses strongly support the proposed requirement that the AER publish the analysis on which it proposes to rely a reasonable time before the making of the distribution determination (proposed clause 6.11.1(c)). However, the Businesses are concerned that the fact it is a 'best endeavours' clause would mean in practice that the AER does not publish its analysis with sufficient time for the intended effect of the clause to be achieved, namely, to provide NSPs with an opportunity to identify any major errors in the AER's analysis before it is relied upon in the final determination.

The Businesses observe that while the AER has provided them with the opportunity to consider novel analysis in some instances (for example, in moving away from its approach in the draft determination to determining debt risk premium in the Victorian distribution price review), section 16 of the National Electricity Law has not always resulted in the AER providing NSPs with its analysis in advance of the final determination. In particular, the Businesses observe that the AER's analysis of CitiPower's and Powercor Australia's vegetation management opex step change amounts was not provided to CitiPower and Powercor Australia until the matter was taken on review in the Australian Competition Tribunal.

The Businesses submit that a 'hard' deadline of 10 business days prior to the publication of the determination would maximise the probability of major errors being identified before the AER's final determination is published.

Summary - Regulatory determination process

In general, the Businesses are supportive of the proposed amendments to the regulatory process. However, the Businesses have concerns with two aspects of the proposed changes.

First, the Businesses consider that the cross-submissions process ought to be mandatory and that the AER should not be permitted to dictate the issues in respect of which submissions can be made. Giving the AER a discretion not to run a cross-submissions process incorrectly assumes that the AER will be in a position to immediately identify the issues arising from the submissions that are of importance to parties to the review process. There is no basis for such an assumption. The matters raised may be quite new to all parties and the implications may be unfamiliar to the AER. Further, the draft rules fail to recognise that the purpose of the cross-submissions process is to provide an opportunity for stakeholders to comment on matters that are significant to them. A more robust consultation process enshrined in the Rules reduces the risk of regulatory error, thereby promoting the NEO and the RPPs. A more appropriate limitation would be to provide for 'cross-submissions' only in respect of the matters raised in the submissions on the draft determination or revised regulatory proposal.

Second, the Businesses strongly support the requirement for the AER to publish the analysis on which it proposes to rely prior to the final determination. However, the Businesses are concerned that the 'best endeavours' requirement would not achieve the objective of advance publication of AER analysis (which is to provide interested parties with an opportunity to identify major errors before the AER relies on the analysis in its final decision). The Businesses' experience is that section 16 of the National Electricity Law has not ensured this opportunity in the past and the Businesses suggest a 'hard' deadline of 10 business days prior to the final determination would maximise the probability of major errors being identified before the AER's final determination is published.