

25 October 2012

Mr Richard Khoe
Project Leader,
Economic Regulation of Network Service Providers Rule Change
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

via email: aemc@aemc.gov.au

Dear Mr Khoe

Consultation Paper – Savings and Transitional Arrangements (Draft National Electricity and Gas Amendment Rules 2012)

The Energy Networks Association (ENA) welcomes the opportunity to respond to the Consultation Paper on Savings and Transitional Arrangements released by the Australian Energy Market Commission (AEMC) in respect of its Draft Determination on the *Economic Regulation of Network Service Providers*. ENA has also greatly valued the opportunities provided to ENA and its members to discuss these proposed arrangements in more detail with staff and the Commission Chair since the publication of the Consultation Paper.

The network sector wishes to raise two interconnected issues relating to the proposed transitional arrangements. The first issue is establishing the most appropriate principles for achieving a smooth, workable transition to new energy regulatory rules in a way that is consistent with maximising investment certainty and the national energy objectives. Second, industry wishes to highlight the critical need to, consistent with these principles, avoid the retrospective application of regulatory rules in the implementation of the proposed *ex post* review of capital expenditure.

Context for industry response

Any transitional rules will involve complex considerations, and invariably will directly and substantially impact on the legitimate interests of the businesses and the stability of the commercial, investment and regulatory environment facing network businesses. Many aspects of the application of the new regulatory framework will impact on networks' environments differently based on factors such as their location in the existing regulatory process timetable, exposure to multiple overlapping electricity or gas reviews, and existing financing arrangements.

ENA and its members have – as noted at recent workshops – actively participated in constructive detailed discussions with the Commission, AER and other affected stakeholders regarding alternative broad models for transitional rule arrangements. Many individual and jurisdictionally-based meetings have occurred, and a number of alternative models which seek to account for

considerations of procedural fairness, certainty, transparency and simplicity have been under active discussion.

The next stage of the transitional rule process will be critical to ensuring these alternatives and shared aspirations for transitional and savings provisions are practically achieved by the detailed technical rule amendments proposed. ENA considers a critical step in this process should be for selected regulatory and legal staff of affected businesses to have access to a revised proposed rule which incorporates the models and options that have emerged over the past weeks of consultation. This could be achieved through a short workshop process focusing on establishing that the AEMC's intended arrangements have been translated into detailed (in some cases potentially business-specific rules). It is not proposed that this stage would be an opportunity for any stakeholders to query the policy intent. Rather, the process would be focused on avoiding any unintended risks, errors, or uncertainties.

To enable such a process to occur, and due to the need for careful deliberation of the complex issues involved in finalising the transitional arrangements, ENA urges deferral of the publication of the final proposed transitional and savings rules by 30 days. This deferral would be in recognition of the substantial evolution in both industry and Commission thinking and models for transition that have occurred over past weeks, and the need to ensure all stakeholders had sufficient time to consider detailed implementation considerations and rules.

Principles for transitional arrangements

Recognising the individual circumstances of network businesses, ENA has focused on development of four principles which it considers should be taken into account in the transitional arrangement process. These principles are:

1. **Prospectivity in application** - Law, rules, guidelines and schemes should only apply prospectively, from when they are known to the network to be made subject to them. That is, the conduct of the network, and compliance with rule requirements, must be judged against the rules actually in force at the time.
2. **Certainty** - Where regulatory review processes, including detailed preparations to lodge regulatory proposals, have begun these should continue and be assessed under the current rules unless a variation to such processes are voluntarily agreed with the network firm.
3. **Adaptability to individual firm circumstances** - Network businesses should be able to 'opt in early' to new arrangements on a voluntary basis, and AER resourcing considerations should not be the sole or primary consideration in determining the future sequence of regulatory periods.

A significant issue under consideration by the Commission has been flow-on changes to the timing of future regulatory periods. ENA's view is that the timing of regulatory control periods arises by historical accident, and these periods themselves form no basis on which networks should face relative disadvantage or discrimination in terms of having the opportunity to understand the rules which are to be applied to their conduct, prepare a complete regulatory proposal, and avoid retrospective application of amended rules.

- 4. Holistic consideration against the rulemaking test** - Each element of the rule change needs to be considered separately, to ensure it is feasible, procedurally fair, and otherwise serves the NEO/NGO to apply it at any particular time. In particular, the timing of the application of transition rules is a matter that must also satisfy the NEO/NGO, and this analysis will be distinct from whether the rule package as a whole is 'preferable' to existing rules.

ENA considers that these principles suggest that the AEMC should provide the option of alternative arrangements to the form of one year transition determinations contemplated in the Consultation Paper. This should involve a roll forward of current arrangements where feasible, followed by some form of net present value neutral 'true up' process, rather than the full review of prices and revenues for one year. This is because even one year determinations will necessarily incur disproportionately high 'fixed' costs - costs of a magnitude similar to a full five year review.

Application of ex post review of proposed capital expenditure rules

ENA reiterates our serious concerns with any retrospective application of this mechanism which we have raised in discussions with the Commission. The network sector considers the most significant potential violation of the principles described above would be the final transitional rules providing scope for retrospective application of the *ex post* capital expenditure review mechanism.

Application of the *ex post* review mechanism to capital investment decisions already made and to the early stages of regulatory periods which are themselves close to their expiration would be a fundamental breach of appropriate rule-making principles, raising significant regulatory and investment risks.

The application of this mechanism retrospectively to affect decisions made under a prior set of regulatory rules is a step fundamentally different in kind to the proposed prospective application of the rule, which ENA has provided a separate response to in earlier submissions.

Such a move would place the AER in a position of assessing capital expenditure decisions made by firms under a different set of binding rules and against forecasts made on a different basis. It would expose regulated firms to a risk that was not taken into account in approved regulatory rates of return. These rates of return assessments, as the AER acknowledges, were in part based on the key features of the overall regulatory compact provided by the *National Electricity Rules* as they applied at the time of each determination currently in force, including provision for rolling forward of the capital base with actual capital expenditure added.

In its original rule change application, the AER eschewed any potential for retrospective application of its proposed '60/40' capital expenditure penalty mechanism. The AER has also indicated that it has not sought the power to conduct *ex post* reviews of capital expenditure undertaken. This position makes clear that any proposed 'preferable' rule allowing for the AER to effectively reassess the prudence of capital expenditure to 2009 in circumstances where the relevant businesses were operating under a different set of capital expenditure mechanisms and rules would be a radical departure from the original rule proposed.

Finally, to the extent that the AEMC considers the proposed associated capital expenditure guideline is required to provide network businesses with real guidance on the potential application

of the AER's discretion in relation to this mechanism, allowing such a rule to potentially impact on past investment decisions would also represent a selective, discriminatory and procedurally unfair step.

For these reasons ENA considers transitional arrangements should avoid implementation of this aspect of the proposed rule change package, with such rules applying only prospectively from the first full five-year determination process which is applied to each network firm.

If you have any questions regarding these matters, or ENA can be of further assistance to the Commission on these important issues, please contact Garth Crawford, Principal Advisor, Economic Regulation on 02 6272 1555.

Yours sincerely

A handwritten signature in black ink, appearing to read 'M Roberts', written in a cursive style.

Malcolm Roberts
Chief Executive Officer