25 October 2012

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: aemc@aemc.gov.au

Re: ERC0134/ERC0135/GRC0011

Dear Mr ~~Pierce~~, John,

ActewAGL Distribution welcomes this opportunity to respond to the Australian Energy Market Commission (AEMC)'s *Consultation Paper on Savings and Transitional Arrangements*[1] released on 14 September 2012.

The upcoming review by the Australian Energy Regulator (AER) in respect of the next regulatory control period (2014-19) is the second review in succession of ActewAGL's electricity distribution network to be undertaken under a cloud of regulatory uncertainty. Network service providers (NSPs) in the ACT and NSW are yet to have a regulatory determination under the National Electricity Rules that has not been subject to transitional arrangements. In light of this, we are particularly concerned at the hurried approach taken by the AEMC in implementing the proposed new electricity rules, and propose that the review of the ACT distribution network currently underway by the AER should proceed as scheduled.

In its consultation paper, the AEMC seeks comments on specific issues relating to individual service providers that may need to be taken into account in transitioning them to the new arrangements.[2] It is our opinion that there are a number of circumstances that distinguish ActewAGL Distribution from other network service providers (NSPs).

Firstly, the revisions to the regulatory timetable proposed by the AEMC will present a significant resourcing problem for ActewAGL Distribution. It would worsen not improve our functional capability to respond to regulatory compliance obligations. With the access arrangement for the ActewAGL Distribution gas distribution network (2015-20) due for submission on 1 July 2014, any delay in the electricity network determination process would adversely impact our preparations for the gas access arrangement. The workload associated with running two major network regulatory reviews concurrently would be substantial for a small multi-utility that is reliant on economies of

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[1] AEMC, 2012, *Consultation Paper on Savings and Transitional Arrangements, Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, Draft National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012*, 14 September

[2] AEMC, 2012, 14 September, p.2.

scope in most efficiently applying its skilled regulatory resources across multiple competing regulatory reviews. The required involvement of staff with specialised skills and experience, detailed business history and knowledge would severely disadvantage ActewAGL Distribution if the reviews were undertaken concurrently.

We also note in assessing these resourcing implications, the possibility that the ACT Government may require the continuation of retail electricity price regulation in the ACT from 1 July 2014 and impose a significant retail regulatory inquiry in the ACT during 2013-14 .

Secondly, we are well underway on the review process and about to conclude consultation with the AER on the framework and approach for a 2014 determination. The AEMC has now stated that the proposed transitional arrangements provide for a new framework and approach process in 2013 and may involve a repeat of some of the work already being done.[3] This has been an involved process and while some of the work already completed may be recycled in a subsequent review, there would be significant and unnecessary additional effort involved in preparing further submissions and participating in a new review process on the same matter in 2013.

Finally, as the smallest network in the National Electricity Market (NEM), ActewAGL Distribution has the smallest customer base and the lowest regulatory asset base (RAB). Critically, we rely on economies of scope across the multi utility operation to keep costs down for customers. ACT electricity prices are the lowest in Australia, according to the most recent AEMC report on current and likely future electricity prices, while our service standard studies confirm that our network customers value existing levels of network reliability, with no suggestion of 'gold-plating'.

In view of these considerations, ActewAGL Distribution proposes that the AER's upcoming ACT distribution determination for the 2014-19 regulatory control period would most efficiently proceed on the current timetable, applying the current rules to ActewAGL Distribution for the first time.

Consistent with the AEMC's suggestion that alternative approaches be discussed with the AER prior to any submission being put to the AEMC, ActewAGL Distribution staff met with the AER to advise and discuss its circumstances on 4 October 2012. ActewAGL Distribution staff discussed its position with AEMC staff on 22 October 2012.

ActewAGL Distribution does not support the transitional arrangements proposed by the AEMC in its consultation paper. In particular, the proposal to have a transitional determination (for 2014-15) in advance of a subsequent determination for the regulatory control period commencing 1 July 2015, is particularly onerous and would result in the unnecessary duplication of costs associated with two determinations. It would also mean submitting a revenue proposal without the benefit of a longer review process, and in the absence of important AER guidelines.

ActewAGL Distribution notes the AEMC's stated principle in the consultation paper that "the final rules...should apply to all service providers as soon as possible." In ActewAGL Distribution's case this would be at the following review, as it is not possible to delay the upcoming review of our electricity distribution network by one year to allow the new rules to apply sooner, without unfairly impacting the gas access arrangement process.

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[3] AEMC, 2012, 14 September, p. 8

Should the AEMC not accept that its proposed transitional arrangement is unfair and unreasonable given ActewAGL Distribution's circumstances, then we would consider as an inferior but second best solution, that there is most merit in TransGrid's *Alternative Transitional Model* because it requires only one determination for the upcoming regulatory period instead of two. This model would also give the AER adequate time to develop required guidelines, allowing NSPs to more effectively participate in this process than they otherwise could if they were required to submit two regulatory proposals in two years.

Although ActewAGL Distribution supports the TransGrid alternative model in principle, we would suggest that there may be a simpler approach to setting the 'appropriate revenue' for the first year (2014/15). Whilst the TransGrid model proposes a simplified process based on information provided by the NSP, we would argue that the preparation of this information (including the opening asset base, current forecasts and historical trends for opex, capex, forecast tax expenses and depreciation and the cost of capital), would still require significant effort. It is proposed that this process would commence in early 2014. ActewAGL Distribution would at the same time be in the process of preparing its substantive electricity networks submission (for the period commencing 1 July 2015) to the AER in May 2014, as well as its gas networks access arrangement for submission to the AER in June 2014. As previously noted, this would present significant and binding resourcing issues for us.

ActewAGL Distribution is of the view that a one year roll-forward of the current 2009-14 determination, where practicable, would be a preferred transitional arrangement to apply to the first year (2014-15). Consistent with the TransGrid model, this would also be subject to a 'true-up' at the end of the first year, thus also meeting the objective of matching reasonably expected smoothed Maximum Allowed Revenues to minimise price volatility throughout the regulatory period.

It is our strongly held position that a crucial feature of the TransGrid model, and one that ***must*** be upheld by the AEMC, is that there be no retrospective application of the new rules. In particular, the proposed ex-post prudency test would first occur as part of the revenue determinations subsequent to the upcoming determinations and only apply to investment made after the start of each NSP's upcoming regulatory period.

To apply an ex-post prudency test to investment undertaken before this date would be unfair and could create outcomes that are not consistent with the NEO. Put simply, network businesses would suddenly have an incentive to manage network expenditure in a way that best meets the pressures of a looming, previously unforseen ex-post review of its expenditure, rather than in a way that best meets the current and future needs of its customers. The AEMC noted the AER's view on this matter in its March 2012 Directions Paper:

> *"....the AER does not support ex-post reviews on the grounds that they may add to regulatory risk by creating potential for investment write downs and that the evidentiary burden that the regulator must satisfy before it could disallow an investment is so high that ex-post reviews may offer limited protection against inefficient expenditure."*[4]

There is much evidence to suggest that ex-ante incentives are often better able to deliver the desired objectives without the corresponding intrusiveness and risk of an ex-post prudence test.

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[4] AEMC, 2012, *Directions Paper: National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012*, March, p. 44

International experience and previous application in the NEM indicate that it has been difficult to design and implement an ex-post prudence regime that achieves the desired objectives without causing economic harm due to an inappropriate increase in risk.[5] As the AEMC recognised in its Directions Paper[6]:

> *"In 2006 the AEMC determined not to allow for ex-post reviews of the efficiency and prudency of capex as it considered it would undermine incentives to efficiently incur capital costs that were not foreseen at the time of the applicable regulatory determination. That is, it would undermine incentives of the ex-ante cap. It also considered it would contribute to investment uncertainty."*

However, should the AEMC decide to implement an ex-post prudency review of capex, then the ex-post review guidelines to be developed by the AER should be light handed and principle based. ActewAGL Distribution proposes that the set of principles that were developed by NERA Consulting and PriceWaterhouseCoopers, and originally proposed by the Energy Networks Association (ENA) in its response to the AEMC's Draft Rule Determination[7], would be appropriate.

ActewAGL Distribution looks forward to further engagement with the AEMC on how best to deal with the problems arising from the specific issues that we face in transitioning to the new rules. It is my view that this must be done without unfairly impacting ActewAGL Distribution or our electricity and gas network customers. Matters arising from this submission should be directed in the first instance to Mr Chris Bell, Manager Regulatory Affairs on (02) 6248 3180.

Yours sincerely,

Michael Costello
Chief Executive Officer

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[5] NERA, PwC, 2012, *Capital and Operating Expenditure – Response to the AEMC Directions Paper: A joint report for the Energy Networks Association*, April, p.40

[6] AEMC, 2012, p. 44

[7] NERA, PwC, 2012, pp 40-47.