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Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
Australia Square NSW 1215

By email to: submissions@aemc.gov.au

20 October 2006

Dear Dr Tamblyn,

Economic Regulation of Transmission Services - AGS Advice

The Commission has invited submissions on issues raised in the advice from AGS dated 10 October. AGL offers the following brief comments.

The Commission undertook extensive consultations in developing its draft rule and again in preparation for its final decision. AGL is confident that the Commission has given due consideration to the many submissions received from interested parties, and believes that the process for regulatory decision-making set out in the draft rule is consistent with the objectives of efficiency and fairness.

AGL does not believe that the AGS advice provides any basis on which to depart from the decision-making process in the draft decision.

In relation to the questions addressed in the AGS advice and in the Commission's request for further submissions, AGL wishes to make the following points:

- The AGS was asked to provide advice on the extent of discretion for the regulator when considering whether to accept or reject operating and capital expenditure proposals by a service provider. The AGS was asked particularly to compare the reasonableness test proposed by the Commission with an alternative test nominated by the Commonwealth Department of Industry, Tourism and Resources.
- The question that needs to be addressed is not the factual question as to what discretion the regulation has under the different tests, but rather a judgement as to which test (with their respective levels of discretion) is more consistent with the policy direction and objectives for the access regime that have been agreed by Governments.
- While the AGS has offered opinions about this latter matter of judgement, it is not a legal question – it is a question of regulatory economics. In this area a legal opinion, no matter how eminent the author, should carry no greater weight than other opinions.
- It is AGL's view that, on the contrary, an opinion based upon technical legal considerations is less relevant than practical considerations about the efficiency and effectiveness of the regulatory decision-making process.
- The Commission's request for further submissions addresses the correct question as identified above – namely "whether the rules should provide (for the reasonableness test or the alternative)" (emphasis added). AGL believes that the three questions "raised by interested parties in relation to the draft wording of the revenue rules" can be answered very simply:

- a. They impose an "onus of proof" on both the TNSP (ie that its proposal is indeed reasonable) and the AER (ie that it has reached its decision reasonably on the basis of relevant information);
 - b. Yes, it would be necessary for the AER to form a view that the TNSP's proposal was unreasonable (although perhaps it would be more appropriate to use the term 'not reasonable') before it could reject it; and
 - c. The notion of a 'presumption in favour of acceptance' is both incorrect and misleading – the AER must approach each decision without any preconceptions; it must form a view based upon the stated criteria and its decision whether to accept the proposal or not flows automatically according to that view.
- Importantly, the Commission's proposed model allows broad scope for the regulator to consider a wide range of factors in assessing the reasonableness of the service provider's cost estimates.
 - AGL firmly believes that the reasonableness test in the draft decision is appropriate because it places the onus for preparing a reasonable set of forecasts squarely on the service provider. The alternative test would mean that the service provider prepares its forecasts in the knowledge that the regulator will in any case have to undertake its own forecasts to identify what it considers to be the 'best estimate'. That is, the service provider is more likely to build an 'ambit claim' into its forecasts in anticipation of a 'negotiation' with the regulator. Further, the obligation for the regulator to develop its own 'best estimate' (rather than merely assessing the reasonableness of the service provider's proposal) will significantly increase the time required by the regulator to reach its decision.
 - AGL is of the view that the alternative model is misconceived because it is based on the false notion that it is possible to achieve a perfectly and uniquely correct outcome. The notion that there exists a definitive 'best' forecast of costs is a theoretical construct that has little basis in practice. AGL believes that in this respect there is a danger of repeating the mistake of the WA regulator in the Epic case, where the Supreme Court ruled against the regulator's reference to the notion of a perfectly competitive market, in favour of the more practical concept of a workably competitive market.

AGL therefore responds very firmly in favour of the first of the two positions on which the Commission is seeking comment, namely whether the rules should provide that:

- a. A TNSP's proposal must be accepted if the AER is satisfied that the proposal for forecast expenditure satisfies the criteria in the Rules – YES; or
- b. The AER should have a residual discretion to substitute its own reasonable estimate of forecast expenditure in those circumstances – NO.

As a final comment I draw to your attention the recent agreement between AGL and Alinta to swap certain assets. This arrangement has now been approved by AGL's and Alinta's shareholders and the Federal Court and will take effect from 25 October 2006. A significant element of this arrangement is the transfer of AGL's infrastructure assets to Alinta. Consequently AGL's interest in the present issues as an owner of infrastructure will cease from that date. However, as Alinta is acquiring these assets it will be appropriate for any ongoing dialogue to be held with the personnel moving to Alinta. Details of these personnel will be forwarded to you shortly.

Yours Sincerely,

Robert Wiles
General Manager, Regulation and Policy