Energy Users Rule Change Committee
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16 April 2012

Mr Richard Khoe
Australian Energy Market Commission
PO Box A2449
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Dear Richard,

Submission on AEMC Directions Paper (ERC 0134)

The Energy Users Rule Change Committee representing Australian Paper, Amcor, Rio Tinto, Simplot, Wesfarmers/Coles, Westfield and Woolworths is very pleased to have the opportunity to make a submission to the AEMC's Directions Paper on the changes to Chapter 6 and 6A proposed by the Australian Energy Regulator and the Energy Users Rule Change Committee. Please find attached document.

Yours sincerely,

Brian Green
Chairman of the Energy Users Rule Change Committee

Submission on AEMC 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

Submission by Amcor, Australian Paper, Rio Tinto, Simplot, Wesfarmers, Westfield and Woolworths (the Energy Users Rule Change Committee)

16 April 2012

Executive Summary

This document is a submission from the Energy Users Rule Change Committee (EURCC) on the AEMC's Directions paper. The EURCC's membership includes Amcor, Australian Paper, Wesfarmers, Westfield, Woolworths, Rio Tinto and Simplot. This submission focuses principally on the AEMC's response to the EURCC's rule change proposals.

The submission suggests that the regulation of the return on debt should be specified in the Rules, contrary to the AEMC's apparent direction. It also calls for the consideration of the return on debt to be elevated to a discussion of regulatory economics rather than narrow financial analysis. The AEMC is asked to extend the terms of reference of its main advisors – Professors Littlechild and Yarrow – to also include consideration of the cost of capital in general and the return on debt in particular.

The submission then explains why the Committee rejects the AEMC's dismissal of the EURCC's proposals on the return on debt to government-owned NSPs. The Committee:

1. Considers that the AEMC's claims of resource allocation distortions can not be sustained.
2. Recognizes the jurisdictional governments' right to charge the network service providers that it owns whatever fees it chooses to. However this does not confer an obligation on users to pay those fees. The charges to users should reflect the National Electricity Objective and the AEMC has failed to take account of that.
3. Suggests that the AEMC's claims of geographical distortions that would arise with different allowances for the return on debt are without foundation.
4. Concludes that the AEMC's claim that its proposal would dissuade jurisdictions from divestiture of their NSPs is not correct. Furthermore the Committee notes that the design and implementation of the regulatory framework should not be influenced by policy considerations either for or against divestiture.
5. Suggests that the taxes on the profits of the NSPs owned by jurisdictional governments are effectively a return on the governments' investment in their NSPs and should be counted as such in consideration of the appropriate return on debt.

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1 Introduction

This document is a submission from the Energy Users Rule Change Committee (EURCC) on the AEMC's Directions paper. This submission focuses principally on the AEMC's response to the EURCC's rule change proposals. It makes limited comment on the submissions of other stakeholders on the EURCC's proposals and it does not explore the AER's rule change proposals or the response of the AEMC and other stakeholders to those proposals.

This submission focuses in order on the following three issues:

- **Should the arrangements for the determination of the return on debt be specified in the Rules?** The AEMC's Directions Paper suggests that the determination of the return on debt, as with other elements of the regulated return on capital, should not be specified in the Rules. We disagree with this and in this submission we substantiate this view.
- **If the return on debt is to be specified in the Rules, how should this issue be resolved by the AEMC?** We are concerned that the AEMC's approach to this issue is too narrow and we explain our view that it should be resolved through a wider consideration of regulatory economics, not financial economics.
- **Why we reject the AEMC's dismissal of the EURCC's proposals on the return on debt to government-owned NSPs.**

2 Should the return on debt be specified in the Rules?

In our proposal, we argued that the return on debt should be specified in the Rules. The AEMC's Directions Paper suggest that the return on debt should be determined by the AER, but as with the rest of the WACC calculation, subject to merits review.

Whether or not the return on debt is specified in the Rules is a threshold question: if the return on debt is to be determined by the AER, much of the debate and consideration of the determination of the return on debt in the current rules, and the estimation of the actual and allowed return on debt, becomes largely irrelevant to this review.

We continue to believe that the return on debt should be specified in the Rules, not in reviews undertaken by the AER, for the following reasons:

- The return on debt, unlike many other WACC parameters is observable within a reasonable range. Investment certainty, and price certainty may be enhanced through this.
- Through the rule change process, consumers are able to engage in the debate on the specification of the return on debt, by proposing solutions. The scope for users to engage in this way is not possible in AER reviews.
- The specification of the mechanism for the return on debt is an issue of regulatory design, which should be accountable to the National Electricity Objective. This is within the AEMC's not the AER's mandate. As such, we suggest than referring the determination of the design of the mechanisms for the calculation of the return on debt to the AER, would be an abrogation of the AEMC's regulatory design role.

We commend this to the AEMC's consideration.

3 A process for the resolution of the return on debt

The EURCC's proposals elicited submissions from all NSPs and several jurisdictional governments. The issues relating to the allowed return on debt for government-owned NSPs is dealt with in the next section. Other relevant issues included:

- Whether or not the actual cost of debt was below the allowed return on debt;
- The actual financing practices of privately owned NSPs and hence the appropriateness of the EURCC's proposals.

On the first of these, some NSPs (and the Queensland Treasury Corporation) suggested that the actual cost of debt was not in fact lower than the allowed return on debt, or that the EURCC had over-estimate the gap. Other NSPs conceded the actual cost of debt was lower than the allowed return on debt but suggest that this was fully (or at least mainly) explained by the shorter tenure of debt raised since the Global Financial Crisis ("GFC"), which they contended meant that lower debt costs were offset by higher refinancing risks borne by shareholders.

We recognize that part of the difference between the allowed return on debt and the actual cost of debt may be explained by a 10 year benchmark for the former and typically five year or shorter for the latter (at least since the GFC). However the materiality of this is in question. For example, in February, SPI Assets Australia raised 5 year bonds with a coupon at issue of 6.25%, while ETSA followed that in March with 4 year bonds with a coupon at issue of 6.25%. This is around 2.7% cheaper than the circa

9% return on debt that is reflected in the price that users are being charged. It is implausible to attribute all of this 2.7% difference in 10 year and 5 year debt. Furthermore even pointing to this difference (whatever it may be) does not justify its existence. If NSPs are typically raising 5 year bonds, even if they would prefer to raise 10 year or longer bonds, why should consumers be paying a premium to reflect this preference?

Some NSPs have argued that the benefit that NSPs are deriving from the difference between their allowed return on debt and their actual debt costs is off-set partially or fully by higher refinancing risks borne by their shareholders. While it may be plausible to argue that equity holders bear higher refinancing risk with shorter tenure loans, it is not clear that the allowed return on equity does not already reflect appropriate compensation for refinancing risks. Specifically, there is no evidence that in the contemplation of the Market Risk Premium or Equity Beta there is an underlying assumption of refinancing risk associated with 10 year debt, rather than 5 year debt. Indeed the higher refinancing risk would be factored into the return demanded by debt investors resulting in actual debt costs increasing. This would have the undesirable consequence of also leading to an increase in the return on debt given the methodology of its determination.

Some NSPs – on the advice of their consultants - pointed to theory by Miller and Modigliani (Nobel prize winning finance academics) that the overall weighted cost of capital is constant, whatever the mix of equity and debt. From this they suggest that even if actual debt costs are below the allowed return on debt, there is no gain overall since equity holders are exposed to higher risks. This argument attributes – by assertion – all of the difference between actual debt cost and the allowed return on debt to differences in debt tenure and in addition asserts that all of this difference is offset directly by higher refinancing risk. Neither of these propositions are supported by evidence.

Furthermore, invoking such theoretical constructs is, we suggest, at best argumentative: Miller-Modigliani's theory assumes liquid, fully function and deep financial markets. It is well recognized that Australian debt markets are immature and, since the GFC, longer tenure corporate debt has been all but impossible to finance. Clearly the least cost combination of debt and equity and indeed the relative cost of long and short term debt will be affected by the liquidity and efficiency of these capital markets.

On the second issue (the actual financing practices of privately owned NSPs and hence the appropriateness of the EURCC's proposals) ETSA's submission helpfully provided detail on their actual financing practices, as the basis for their partial agreement (and partial disagreement) with the EURCC's proposals. Their underlying proposition is that the design of a mechanism for the determination of the regulated return on debt should reflect their borrowing and risk management practices. Such practices will vary amongst NSPs and will change over time with changes in capital markets. Furthermore the proposition that regulatory incentives should be designed around the risk management practices of the NSPs (and by implication should be targeted at minimizing the risks borne by those NSPs) is, we suggest, not necessarily consistent with the long-term interest of consumers.

These issues may be argued in different ways. The clear point of agreement that we would have with many of the NSPs' responses is that the resolution of the regulatory design for the return on debt needs to have regard not just to the broader WACC calculation but indeed to the whole regulatory design.

We strongly believe that the AEMC's consideration of rules relating to the return on debt, should not be driven by financial analysis but rather should be based on a broader consideration of regulatory economics. We also think that it is essential that the AEMC takes account of the practices adopted by other regulators in Australia and internationally in its consideration of this issue. For this reason, we proposed that the AEMC should extend the terms of reference of the involvement of Professors Littlechild and Yarrow to also include consideration of the cost of capital in general, and the return on debt in particular.

4 The AEMC's dismissal of the EURCC's proposals on the return on debt to government-owned NSPs

In its Directions Paper, the AEMC has said that it rejects the Committee's proposal that the return on debt for jurisdictional government-owned NSPs should be based on the cost of debt. It provided several reasons for this rejection. We disagree with the AEMC's rejections and this section explains our reasoning.

4.1 Reason 1: Resource allocation distortions

The AEMC has concluded that the Committee failed to recognise that competitive neutrality principles also apply to correct resource allocation distortions that can result in input as well as output markets of government-owned monopoly businesses.

The Committee disagrees with this. The purpose of the Competition Principles Agreement (CPA) is to ensure "competitive neutrality between government and private business activities". The agreement states the objective of the competitive neutrality policy is:

"the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net <u>competitive advantage</u> simply as a result of their public sector ownership."

As indicated in the name of the agreement (competition principles) and the main purpose of the agreement (ensuring government businesses do not gain an unfair competitive advantage), this policy is intended to ensure that government owned businesses do not have an unfair competitive advantage. As the Committee pointed out in its proposal, in the application of this policy the Commonwealth Government requires that:

"*there must be an actual or potential competitor (either in the private or public sector) i.e. users are not restricted by law or policy from choosing alternative sources of supply*" (Competitive Neutrality Statement (1996), page 7).

In its Directions Paper the AEMC has implied that it disagrees with the Australian Government's application of this policy. The AEMC has said that the absence of competition in output markets (i.e. in the services that NSPs provide) does not matter in the application of the Competition Principles Agreement because resource allocation distortions also occur in input markets (i.e. the markets for the products and services that NSPs require to deliver their outputs).

It seems sensible that in considering the legitimacy of competitive neutrality fees, it is important to be aware of allocation distortions in both input and output markets. The relevant issue, therefore, is to whether such distortions will arise as a result of the role that jurisdictional governments play in providing debt to government-owned NSPs. If such distortions do arise then competitive neutrality fees may be a legitimate response. If they don't arise then we suggest that competitive neutrality fees can not be justified under the Competition Principles Agreement.

It appears that the AEMC agrees with us that there is no competition in network service providers' output markets. Indeed there could surely be no dispute here since the absence of competition for their services is precisely why monopoly network service providers are regulated.

However there seems to be a difference in respect of input markets: the AEMC's suggestion that the Committee has ignored input markets suggests that the AEMC thinks that the Committee has failed to consider the misallocation of resources that would occur if governments were not able to charge fees for the debt capital they provide to their NSPs

Dealing first with possible resource allocation distortions that might occur between privately-owned and publicly-owned NSPs: whether or not jurisdictional governments charge fees on the debt that it provides to its NSPs has no impact on the ability of governments and privately owned network service providers to raise debt. Neither does it have any impact on the cost that each might pay for that debt. To put it another way, charging a fee to NSPs (or not charging a fee) will not make any difference to the cost of debt raised by governments or raised by private network service providers, or on their respective ability to raise such debt. In other words there is no distortion between privately owned or government owned NSPs that needs to be rectified through fees on the debt provided to government-owned NSPs.

Resource allocation distortions can however arise if the governments charge fees to some government departments (or corporatised businesses that it owns) but not to others. For example the Queensland and New South Wales Governments charge competitive neutrality / government guarantee fees for the debt that it provides to its NSPs, but it does not charge the same fee for the debt that it provides to its health, education or housing departments. This distortion would lead the governments to prefer lending to its NSPs rather than to its health department (it gets a fee from the loans it makes to the former but not the latter). The competitive neutrality / government guarantee fees may therefore encourage misallocation of resources – more lending for networks at the expense of hospitals, schools, roads and so on. This is a reason not to charge NSPs competitive neutrality / government guarantee fees - exactly in contradiction to the AEMC's conclusion.

It could also be that by "resource allocation distortions" in "input markets", the AEMC might be suggesting that government-owned NSPs might use more inputs than they need to, because the inputs are artificially under-priced. If this is what the AEMC means then it has linked the allowed rate of return on debt (which affects the prices that consumers pay for network services) to the NSPs' cost of debt.

But such a link does not exist. In the same way that the AER's views of what a transformer costs (and allows an NSP to charges its customers for that transformer), does not affect what an NSP actually pays its suppliers for its transformers, so there is no link between the allowed return on debt and the actual cost of debt. The government treasuries that own NSPs can charge their NSPs whatever they like for debt or equity irrespective of whatever the AER considers to be the return on equity and debt in the calculation of regulated charges. Similarly irrespective of whatever the government's treasuries charge for equity and debt, the Boards of Directors can set whatever investment hurdle rate they like, as a means to discipline investment decisions. Indeed it should be expected that they would do this. It follows from this, that the AEMC's claim that the EURCC failed to account for "input market" distortions rests on an incorrect understanding of the relationship between the return on debt (that sets the charges that users pay) and the NSPs calculation of their actual cost of debt. For this reason, in addition to the previous discussion, we reject the AEMC's claims on resource allocation distortions.

4.2 Reason 2: Jurisdictions' right to levy debt guarantee fees

The AEMC has said that the Committee does not recognise the autonomy of state and territory governments to make policy decisions in compliance with the Competition Principles Agreement to corporatise their NSPs and apply commercial disciplines.

In the text above we concluded that such fees are not in compliance with the CPA. In addition, for the avoidance of doubt, in its proposals the Committee made no comment on jurisdictional governments' right to corporatise their NSPs and apply commercial disciplines, and neither could such comment be implied from the Committee's proposals. The Committee can confirm that it supports the application of commercial disciplines in the management of NSPs, although the Committee recognises that its views on this are not material and neither are they relevant to the Committee's rule change proposal.

It might be that what the AEMC is alluding to here is that the AEMC considers that the Committee has erred in not recognising that the jurisdictions have a right to charge competitive neutrality fees (or any other fees for that matter) and recover these fees from users.

The AEMC's concluded that charging competitive neutrality / government guarantee fees is a policy decision for the jurisdictions, and not "in the scope of the National Electricity Rules". This is in agreement with views put to the AEMC by the New South Wales and Queensland Treasuries in their submissions on the Issues Paper. The implication of the AEMC's conclusion is that the jurisdictions can make "policy decisions" to charge their NSPs whatever fees they choose (or presumably also impose on them whatever costs or obligations they choose) and the AEMC will conclude that such decisions are jurisdictional policy decisions and hence outside the scope of the NER.

In general the Committee can't contest that the jurisdictional governments have a right to charge their NSPs debt guarantee fees, but the Committee disagrees that this automatically confers a legitimate obligation on users to pay for them.

The issue here can be likened to the regulatory response to decisions made by the owners of privately-owned NSPs. For example, some privately-owned NSPs have established related-party contracts between the regulated entity and other entities owned or controlled by parent or sister entities. As the owners of the regulated entity it is their right to establish such related-party contracts. But the regulator recognizes that related party contracts could unfairly extract profits and impose costs to be recovered in regulated charges. The AER, quite rightly, scrutinises such contracts and only allows reasonable costs - irrespective of the terms of the related party contracts – to be charged to electricity users.

The Committee suggests that competitive neutrality / debt guarantee fees should be considered in the same vein. Jurisdictional governments are able to impose such fees but the AEMC is not bound to require that users pay for them. To the contrary, the AEMC has a clear obligation to determine rules and regulations that are in the long-term interest of consumers. This means deciding which costs and obligations should be passed through to users in regulated charges, regardless of the "policy" decisions of the jurisdictional governments. The Committee contends that the AEMC can not and should not abrogate its responsibilities in the design of the Rules simply because jurisdictional governments have chosen to impose particular costs or obligations on its NSPs.

Finally, as an aside, whether or not the jurisdictions and Commonwealth have discretion in its application of the CPA is a matter for the parties to that agreement. However, it seems remarkable that parties to an agreement can have such widely differing views on what they have agreed to: the Commonwealth is clear that the CPA does not apply to monopolies while New South Wales and Queensland insist that it does.

Furthermore the position in New South Wales is not clear to us. On the one hand, in its response to the AEMC's issues paper, the Treasury of New South Wales insisted that its levying of Government Guarantee fees are legitimised by the CPA. But its own guideline for the application of this agreement (Competitive Neutrality Policy and Principles) says that the government will impose debt guarantee fees "<u>directed towards off-setting the competitive advantages provided by government guarantees</u>". Since the Government's NSPs derive no competitive advantage as a result of the government guarantee (they don't' have any competitors to gain advantage over), there is no competitive advantage to be offset. If there is no competitive advantage to be offset, there can be no basis for the levying of debt guarantee fees according to the NSW Government's own guidelines.

In addition, the "General Pricing Guidelines" (part of the New South Wales Government's Competitive Neutrality Statement) **does** require a business to be competitive for the General Pricing Guidelines to apply. In its submission, the NSW Treasury then said that this is not relevant since the general pricing guidelines only apply if there are complaints from the private sector in which case IPART would use these pricing guidelines to assess the merits of the complaint. In other words, the Competition Principles Agreement applies to monopolies in New South Wales unless there is a complaint from the private sector in which case it does not apply. This seems to be an untenable inconsistency. We conclude that it is not clear that the claim by NSW Treasury that levying government guarantee fees is consistent with their stated Competitive Neutrality Statement, can be sustained.

4.3 Reason 3: Geographical distortions

The AEMC suggest that basing the return on debt on the cost of debt for government-owned NSPs will potentially create "artificial geographical market distortions in generation and network capacities across the NEM because of the differing pricing signals that would be created due to network ownership".

We understand that the AEMC is suggesting that if government-owned NSPs have a lower return on debt then existing generators and end users will be inclined to relocate (and new generators and users to locate) to those jurisdictions served by government-owned NSPs since electricity will be cheaper there. The suggestion, as we understand it, is that this will lead to inefficient development and operation of the transmission and distribution network, and wasteful relocation. We noted that in their submission on the Issues Paper a number of network service providers and the New South Wales and Queensland Government also said this and the AEMC has evidently agreed with them.

We suggest that this conclusion can not be sustained:

- Firstly with regard to generators, since they do not pay for the use of the transmission (or distribution) systems they will not be impacted by any difference between the charges levied by private or government NSPs.
- Secondly, with regard to end users AEMC (2011) shows that privately owned NSPs already have lower network charges than government-owned networks, in many cases significantly so. If there is indeed a prospect of inefficient end-user re-location due to prices differences between networks then, if anything, reducing the charges of government-owned NSPs will help to address this problem, not exacerbate it, as the AEMC has concluded.

However, we suggest that there is no evidence to conclude that customer relocation (or future new customer location) decisions will be impacted to any meaningful extent by network charges. Network service provision is a natural monopoly. If the AEMC is suggesting that customers are price sensitive and will relocate if prices rise, then there would be no need to regulate the prices charged by network service providers. It is internally inconsistent for the AMEC to conclude that differences in debt costs will lead to geographical relocation and at the same time maintain that network service provision should be a regulated monopoly. The AEMC is not suggesting that NSPs should be unregulated, and so a conclusion that end users will relocate in response to differences in the allowed return on debt can not be sustained on this logic.

4.4 Reason 4: Sale or divestiture of government-owned NSPs

The AEMC has concluded that setting the return on debt equal to the cost of debt for government-owned NSPs will remove the option of any future sale or other divestiture of government-owned NSPs. We suggest that this conclusion can not be sustained for the following reasons:

1. Private NSPs already charge considerably less than government owned NSPs. The evidence in Australia supports a conclusion that if government owned network service providers are privatised, their private owners will deliver higher levels of investment and operating efficiency than has occurred under government ownership. This will drive prices down and this can be expected to more than completely offset any increase in charges attributable to higher allowed returns on debt.
2. Contrary to the AEMC's conclusion that a lower return on debt for government-owned NSPs will discourage the jurisdictions from privatising them, the Committee suggests exactly the opposite will occur. Specifically if the jurisdictional government were not able to derive such high profits and fees from their NSPs, they are more likely to want to sell them.

More generally, the Committee considers that it is inappropriate for the AEMC to be mindful of the impact of rule change proposals in terms of the propensity for jurisdictional governments to privatise NSPs. Such consideration is not contemplated in the National Electricity Objective which the AEMC is required to apply in its consideration of rule change applications.

4.5 Reason 5. Taxes versus equity ownership

The AEMC has said that the Committee has confused the roles of jurisdictional governments that own NSPs, as shareholders of those NSPs, and as the taxing authority of that NSP. By implication the AEMC has concluded that the fact that jurisdictional governments also receive the tax on NSP profits does not affect the decisions that jurisdictional governments would make as owners of NSPs. In effect the AEMC considers that the Committee has erred in describing the taxes that the jurisdictions get from the profits of the NSPs, as a return on the government's investment in its NSPs.

The Committee disagrees with the AEMC and suggests that consideration of the substance rather than form suggests that the AEMC's conclusion cannot be sustained. The Committee does not dispute that the mechanism by which the NSP-owning jurisdictions obtain their tax equivalent payments is quite different to the mechanism for the receipt of dividends or the governments' title to attributable profits that are retained in the NSPs. But this is simply an administrative issue, and has no meaning for the economic substance. The fact is that the NSP-owing jurisdictions obtain their tax equivalent payments purely as a result of their ownership of their NSPs. If they did not own their NSPs they would not obtain the income tax on their profits. This is no different to NSP-owning jurisdictions' rights to the profits of their NSPs – their rights to these exist as a result of their ownership. In substance therefore the NSP-owning governments' rights to the profits that NSPs produce are no different to their rights to the income tax on those profits. If the profits are counted as a return on equity, tax equivalent payments should be counted in the same way.

In addition, we suggest it is not sustainable to argue that NSP investment decisions are not affected by the fact that they also retain the taxes on the profits from their NSP. The propensity for a shareholder to invest $1000 with the prospect of a profit of $100 after tax will be different to the propensity to invest if that same investment returned an effective profit of $130 after tax ($100 profit plus $30 income tax equivalent payment). It seems reasonable to suggest that NSP directors would be failing in their fiduciary duties if they were not mindful of the effective after-tax profitability of their NSPs' investments.

The AEMC's conclusion that taxation of an NSP's profits is not, in substance, a return on equity seems to rely on the notion that NSPs' directors (whom the governments appoint) will abrogate their fiduciary duties to the companies they direct. The Committee suggests it is inappropriate for the AEMC to rely on this notion.

Finally we should stress that we are not suggesting that jurisdictional governments should not receive the income tax on the profits of their NSPs. Rather we are suggesting that in considering the effective returns that jurisdictional governments are receiving from their NSPs, that it be counted as an effective return on the government's equity.

4.6 Summary and next steps

Summary

The AEMC's directions paper has rejected the Committee's proposal that the return on debt for government-owned NSPs should be based on their cost of debt. The justification for this appears to range from arguments of principle (the jurisdictions have a right to fees on the debt provided to their NSPs) to economic arguments (there will be resource and geographical distortions if such fees are not charged) to policy arguments (jurisdictions will be less inclined to privatise their NSPs unless such fees are charged). We have questioned the validity of some of these reasons (taking account of the National Electricity Objective) and have also concluded that none of these reasons can be sustained.

The Committee is concerned that the AEMC has failed to address the Committee's essential proposition: that the treatment of the return on debt should be evaluated against the National Electricity Objective having regard to the extraordinary profitability of the NSPs to their jurisdictional government owners.

The Committee noted that the AEMC's consultant, SFG, dismissed the Committee's analysis of the profitability of NSPs in New South Wales. This dismissal was based on the New South Wales Government's submission to the Issues Paper, not on SFG's own analysis. The Committee's evaluation of this aspect of the New South Wales submission concluded that their dismissal of the Committee's analysis could not be sustained. The Committee's reasoning to support this conclusion was submitted to the AEMC on the 17th of February 2012. The AEMC's advisor needs to justify its rationale for accepting the NSW Treasuries' position over ours.

Next Steps

On the basis of the analysis in this submission, the Committee calls on the AEMC to reconsider its position in relation to the treatment of the return on debt for government-owned NSPs. Whether or not any premium to the underlying cost of debt should be reflected in the allowed return on debt for government NSPs merits further objective assessment.

The approach adopted by the Australian Government in relation to the Guarantee Scheme for Large Deposits and Wholesale funding may provide a suitable way forward and the Committee commends it to the AEMC for its consideration. In this scheme the Australian Government has guaranteed Long-term Wholesale Funding of numerous Australian Deposit-taking Institutions (ADIs). This is, in substance, akin to the guarantees that the jurisdictional governments provide for the debt issued to its NSPs. Through this scheme the Australian Government charges fees that range between 70 basis points and 150 basis points depending on the long term credit rating of the ADI (70 basis points for AA- and above and 150 for BBB+ and above). This can be compared to the circa 400 basis point margins that NSPs are charging electricity users (being circa 9% allowed return on debt less circa 5% cost of debt).

The approach adopted by the Australian Government establishes a benchmark that the Committee suggests could be a suitable basis for the calculation of the return on debt for government owned NSPs, that electricity user should reasonably be required to pay.