

17 September 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Dear Dr Tamblyn

Proposed Rule Change: Pass through of Easement Land Tax in Victoria

Overview of Proposal

SP AusNet proposes a Rule change to allow SP AusNet to recover the costs of easement land tax in Victoria. The proposed Rule change would have the effect of reinstating regulatory practice immediately prior to the introduction of the Chapter 6A Rules for the economic regulation of transmission services.

SP AusNet believes that the proposed Rule change would contribute to the achievement of the National Electricity Objective¹ because it would:

- ensure that the amount paid by SP AusNet's customers in respect of easement land tax is no higher or lower than the actual cost incurred;
- reinstate the understanding reached between SP AusNet and the Victorian Government on the introduction of the easement land tax in 2004 and reinstate the regulatory treatment previously applied by the ACCC; and
- correct shortcomings in the existing Rules that have unintentionally resulted in SP AusNet and its customers being exposed to the prospect of windfall gains or losses where the actual easement land tax paid by SP AusNet is higher or lower than the forecast made by the Australian Energy Regulator (AER) in its revenue determination for SP AusNet.

¹ The National Electricity Objective (NEO) is stated in section 7 of the National Electricity Law (NEL) where the object of the NEL is:

“to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –

- (a) price, quality, safety, reliability and security of supply of electricity;
- (b) the reliability, safety and security of the national electricity system.”



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It is self-evident that the above outcomes would be consistent with good regulatory practice and economic efficiency, thereby promoting the achievement of the National Electricity Objective. In particular, efficient investment in the long term interests of customers depends on regulatory arrangements delivering appropriate allocations of risk and honouring commitments made by Government. Unintentional changes to regulatory arrangements, as have occurred in relation to the treatment of easement land tax under the present Rules, are contrary to the National Electricity Objective.

The Rule change proposal is non-controversial for the following reasons:

- it will ensure that only the actual amount of easement land tax paid by SP AusNet is recovered from customers and therefore it follows that no person or group is adversely affected by the proposed Rule change;
- it will reinstate previous regulatory practice regarding the treatment of easement land tax;
- it is consistent with the National Electricity Objective; and
- it is unlikely to have a significant effect on the national electricity market.

For these reasons, SP AusNet therefore requests that the Rule change proposal is expedited in accordance with section 96 of the National Electricity Law.

Explanation of the matter to be addressed by the Rule change

The AER's revenue determination for SP AusNet explained the easement land tax issue in the following terms²:

"In 2004, the Victorian Parliament introduced the *Land Tax (Amendment) Act 2004*. The effect of this was to extend Victoria's land tax regime to easements held by electricity transmission companies. As the tax was not included in SP AusNet's current revenue determination, for the years 2004-05, 2005-06, 2006-07 and 2007-08, SP AusNet applied for, and was granted by the ACCC/AER, full pass through of the easement tax, under the pass through rules in its current revenue determination. However, for the forthcoming regulatory control period SP AusNet is required to forecast its easement land tax liability as part of the forecast opex component of its revenue proposal. Where the forecast accepted in this final decision differs from the actual tax paid, SP AusNet will be entitled to apply for a pass through. Under the new pass through rules, which are now prescribed in the NER, a materiality threshold (1% of the MAR) must be met before a pass through is granted.

The AER further commented that the new Chapter 6A Rules do not provide it with any discretion to pass-through the full amount of the tax³.

² AER, *SP AusNet Transmission Determination 2008-09 to 2013-14, Final Decision*, January 2008, page 158.

“Before the commencement of chapter 6A, the AER/ACCC was able to determine the pass through provisions for each TNSP at the time of the reset, with the discretion to tailor the pass through provision to incorporate the specific circumstances of individual TNSPs. Under the current version of the NER, the AER’s discretion is limited. The AER does not have the discretion to continue the current approach of treating the full amount of the tax as a pass through.”

It is also important to note that SP AusNet was very concerned at the unexpected imposition of the easement land tax in 2004, which is now in excess of \$80 million per annum. As a result, SP AusNet sought and received assurances from the Victorian Government at the time that the introduction of this new tax would result in no negative impact on the business. This commitment by the Victorian Government is relevant to this Rule change proposal in two respects:

1. Firstly, it implies that the application of the new Chapter 6A Rules in respect of easement land tax has unintentionally disallowed the full pass-through of easement land tax; and
2. Secondly, dynamic efficiency is promoted if Government commitments are given full effect. Dynamic efficiency is an important element in furthering the National Electricity Objective.

In relation to point 1 above, it is instructive to examine the savings and transitional provisions in Chapter 11 of the Rules, where clause 11.6.21 relates to the pass through arrangement for SP AusNet’s (referred to below as “SPI PowerNet”) easement tax:

“**easements tax change event** means a change in the amount of land tax that is payable by SPI PowerNet in respect of the easements which are used for the purposes of SPI PowerNet’s *transmission network* where that change results in SPI PowerNet incurring higher or lower costs in providing *prescribed transmission services* than it would have incurred but for that event. For these purposes the change in the amount of land tax that is payable by SPI PowerNet must be calculated by applying the relevant land tax rate to the difference between:

- (1) the value of the easements which is used for the purposes of assessing the land tax that is payable; and
- (2) the value of the easements which is assumed for the purposes of the *revenue determination* for the *regulatory control period*, and

an easements tax change event does not include an event described in paragraphs (a), (b) or (c) of the definition of *tax change event*.”

In SP AusNet’s view, the first sentence of this definition indicates clearly that an “easements tax change event” is focused on the amount of land tax payable by SP AusNet. It is evident that the intention of the drafting is to allow SP AusNet to recover easement land tax in accordance with the commitments made by the Victorian

³ AER, SP AusNet transmission determination 2008-09 to 2013-14, Final Decision, January 2008, page 161.

Government. However, we note that the drafting is not straightforward because the escalation in land values (which affects the amount of land tax payable) is not “an event” as such.

A further complexity in the definition of an easements tax change event arises in relation to that part of the definition which states: “*and an easements tax change event does not include an event described in paragraphs (a), (b) or (c) of the definition of tax change event.*” SP AusNet interprets this provision as either intending to clarify that:

- any cost recovery should not be ‘double counted’ as a result of being caught simultaneously by the definitions of a *tax change event* and an *easements tax change event*, or
- any costs associated with an *easements tax change event* are to be quarantined from a *tax change event*, thereby ensuring that the easement tax is passed through.

In making these observations, SP AusNet is conscious of the commitments made by the Victorian Government regarding easement land tax; the ACCC’s prior regulatory treatment of these costs; and the strong economic rationale for allowing these costs to be passed through to customers in full, whether or not the actual costs are higher or lower than initially forecast.

In contrast to SP AusNet’s interpretation of clause 11.6.21, the AER concluded that the reference to *tax change event* requires that the materiality threshold applies to the easement tax rate (which would be addressed in the definition of “*tax change event*”) and the value of land (which is addressed in the definition of “*easement tax change event*”). It is evident from these varying interpretations of clause 11.6.21 that the drafting is imprecise and that the AER’s interpretation of this provision is contrary to the commitments made by the Victorian Government.

SP AusNet further notes that the Energy Users Coalition of Victoria (EUCV) recently supported the full pass through of the actual easement land tax incurred by SP AusNet, whether the actual tax paid is higher or lower than initially forecast. This important customer group recognised that there is no benefit in exposing customers and SP AusNet to the risks that arise from estimating the costs of easement land tax. Whilst the AER appeared to be sympathetic to the views expressed by the EUCV, the AER concluded as follows⁴:

“Whilst the AER has considered the EUCV’s submission and SP AusNet’s arguments for a full pass through of the easement land tax (as opposed to treatment as a component of forecast opex), the AER do not permit the AER the discretion to implement these recommendations.”

In summary, SP AusNet’s view is that it is appropriate to amend the Rules to:

⁴ AER, *SP AusNet Transmission Determination 2008-09 to 2013-14, Final Decision*, January 2008, page 161.

- ensure that the amount paid by SP AusNet’s customers in respect of easement land tax is no higher or lower than the actual cost incurred;
- reinstate the understanding reached between SP AusNet and the Victorian Government on the introduction of the easement land tax in 2004 and reinstate the regulatory treatment previously applied by the ACCC; and
- correct shortcomings in the existing Rules that have unintentionally resulted in SP AusNet and its customers being exposed to the prospect of windfall gains or losses where the actual easement land tax paid by SP AusNet is higher or lower than the forecast made by the Australian Energy Regulator (AER) in its revenue determination for SP AusNet.

Potential impacts of the change on those likely to be affected

As noted earlier, the Rule change would ensure that only the actual amount of easement land tax paid by SP AusNet is recovered from customers. Therefore, it follows that no person or group is adversely affected by the proposed Rule change.

Rule change proposal

To give effect to the Victorian Government’s commitment to allow SP AusNet to pass through the easement land tax costs in full, SP AusNet proposes that clause 11.6.21 should include the following clarifying amendments:

“**easements tax change event** means a change in the amount of land tax that is payable by SPI PowerNet in respect of the easements which are used for the purposes of SPI PowerNet’s *transmission network* where that change results in SPI PowerNet incurring higher or lower costs in providing *prescribed transmission services* than the amount included by the AER in its Revenue Determination—it would have incurred but for that event. The easements tax change event is not subject to any materiality threshold that would otherwise apply [in accordance with the definitions of positive change event and negative change event] but for this clause 11.6.21. For the avoidance of doubt the purpose of this provision is to ensure that SPI PowerNet is neither financially advantaged nor disadvantaged in present value terms by the payment of easement land tax. For these purposes the change in the amount of land tax that is payable by SPI PowerNet must be calculated by applying the relevant land tax rate to the difference between:

(3) ~~the value of the easements which is used for the purposes of assessing the land tax that is payable; and~~

(4) ~~the value of the easements which is assumed for the purposes of the revenue determination for the regulatory control period, and~~

~~an easements tax change event does not include an event described in paragraphs (a), (b) or (c) of the definition of tax change event.”~~

It is noted that the proposed amendments are also intended to ensure that there is no possibility of SP AusNet recovering the costs of increased land tax through both the “easement tax change event” and the “tax change event” provisions of the Rules.

Explanation of how the proposed Rule addresses the issues raised

The proposed Rule change simplifies the drafting of 11.6.21 and in doing so clarifies that the purpose of this provision is to ensure that SP AusNet is neither financially advantaged nor disadvantaged in present value terms by the payment of easement land tax. An important element of the proposed clause is to clarify that no materiality threshold applies to the pass-through arrangements for easement land tax. The effect of this provision is therefore to ensure that SP AusNet only recovers from customers the amount of land tax actually paid by SP AusNet.

Expected benefits and costs of the proposed change

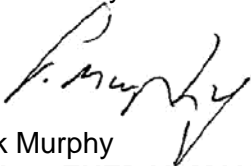
The sole effect of the proposed Rule change is to ensure that SP AusNet only recovers from customers the exact amount of easement land tax that it incurs, in present value terms. As such, SP AusNet and its customers are not exposed to windfall gains or losses as a result of changes in the amount of easement land tax payable by SP AusNet. This outcome benefits all parties and, as noted above, is consistent with the national electricity objective.

There would be no material increases in costs arising from the implementation of the proposed Rule. In particular, the effect of the change is purely to clarify that no materiality threshold should apply in relation to the pass-through of easement land tax, whether the actual tax paid is higher or lower than initially forecast. Whilst this proposed Rule change may in practice lead to the pass-through of amounts that would otherwise be caught by the threshold, SP AusNet does not believe that the administrative costs involved would be material.

For the reasons set out in this proposal, SP AusNet strongly commends the proposed Rule change to the AEMC and to stakeholders.

We look forward to further opportunities to engage with the AEMC and stakeholders in the finalisation of this Rule change proposal. If you require any further information from SP AusNet, please do not hesitate to contact Kelvin Gebert on (03) 9695 6603.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'P. Murphy', is written over a vertical red line.

Patrick Murphy

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