

13 October 2008

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

Dear Dr Tamblyn

Draft Determination – EUAA Cost of Capital Parameter Rule Change

The Energy Networks Association (ENA) welcomes this opportunity to respond to the AEMC regarding their Draft Determination - EUAA Cost of Capital Parameter Proposed Rule Change

ENA is the peak national body for Australia's energy networks which provide the vital link between gas and electricity producers and consumers. ENA represents gas distribution and electricity network businesses on economic, technical and safety regulation and national energy policy issues.

Energy network businesses deliver electricity and gas to over 13 million customer connections across Australia through approximately 800,000 kilometres of electricity distribution lines. There are also 76,000 kilometres of gas distribution pipelines. These distribution networks are valued at more than \$40 billion and each year energy network businesses undertake investment of more than \$5 billion in distribution network operation, reinforcement, expansions and greenfields extensions. Electricity transmission network owners operate over 42,000 km of high voltage transmission lines, with a value of \$10 billion and undertake \$1.2 billion in investment each year.

Please contact Vicki Brown of ENA on (02) 6272 555 or vbrown@ena.asn.au should you require clarification on any points in this submission.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'ABlyth', is positioned above the typed name.

Andrew Blyth
Chief Executive



Draft Determination – EUAA Cost of Capital Parameter Rule Change

13 October 2008

The Energy Networks Association (ENA) welcomes the Draft Rule Determination National Electricity Amendment (Parameter Values, equity beta and gamma) Rule 2008 (Draft Determination) released by the Australian Energy Market Commission on 28 August 2008.

ENA member businesses strongly support the Draft Determination to not make either the rule change originally proposed by the Energy Users Association of Australia (EUAA), or the alternative rule change subsequently proposed. It remains energy network businesses' view that the rule change has no material prospect of contributing to the achievement of the National Electricity Objective.

Implications for market governance and certainty

Network businesses remain fundamentally concerned over the misuse of the rule change process represented by the application and its implications for ongoing regulatory certainty. The application seeks to alter transitional rules applying to New South Wales and ACT electricity distribution businesses which were formally agreed by Ministers and incorporated into statutory rules only four months prior to the rule change application. Acceptance of the rule change would undermine the Ministerial Council on Energy's stated purpose for establishing transition rules, and also interfere with the market governance arrangements under which transitional rules were developed as part of an intensive consultative policy process.

The rule change proposal also has the potential to substantially increase regulatory uncertainty. The proposal would, if implemented, encourage the proliferation of ad hoc rule changes which preempt the operation of existing rules. It would also establish a precedent for a range of recently settled rule matters being re-opened in circumstances where the facts and considerations underlying the original rule-making decisions remain unchanged.

Interference with AER review and consultation processes

ENA agrees with the conclusion in the Draft Determination that the proposed rule change would conflict with the smooth operation of the current Australian Energy Regulator (AER) cost of capital review process, and foster wasteful duplication. These concerns are reinforced by the fact that the review process has progressed to an intensive public consultation phase following release of a detailed AER issues paper in August. The AER is now actively considering submissions and expert

evidence from energy businesses, governments, consumer and industry bodies covering the full range of issues related to estimating an appropriate cost of capital under the relevant provisions of the National Electricity Rules. Substantial financial and other resources are being expended by representatives of consumers, the AER and the energy industry in participating in the review. At the date of writing, ENA notes that EUAA does not appear to have provided the reports relied upon in its application to support an alteration in current equity beta and gamma values in the transition rules to this wider process for reviewing and testing by the AER and other parties.

Deficiencies in the rule change proposal design and supporting evidence

The above fact highlights a critical deficiency of the rule change proposal. The deficiency is that the proposal provides unbalanced and incomplete information representing two parties' views on appropriate parameters, but which is insufficient to demonstrate that the change would contribute to the National Electricity Objective.

The Draft Determination also correctly observes that the rule change proposal fails to account for linkages between the two parameters EUAA is proposing to adjust, and five others which are currently subject to review by the current AER process. The proposal, for example, selectively adjusts the cost of capital parameter representing the assumed value of franking credits – or 'gamma' – without making adjustments which would be required for the logically consistent operation of the Capital Asset Pricing Model set out in the Rules across the parameters. Further, the effect of implementation of the EUAA rule change would be to prevent such cross-linkages being properly accounted for in future AER decisions.

Retrospective application of rule change

A factor taken into account in the Commission's Draft Determination is the need to comply with Clause 33 of Schedule 2 of the National Electricity Law. This clause sets out a series of savings arrangements typical of many Acts. The Commission has interpreted these provisions as meaning that a rule change cannot apply to any existing process. ENA queries this interpretation and seeks clarification and expansion from the Commission on the practical implications of this element of the Draft Determination for future rule-making.

On its face, this interpretation would appear to prevent any rule change which (unlike the present case) proposed minor or uncontroversial improvements to, for example, a regulatory process already formally commenced. Were this interpretation to be correct, this could serve to discourage rule change applications designed to improve the efficient operation of regulatory determination processes. It is acknowledged that many sound policy reasons exist for avoiding the retrospective alterations of substantive rights, obligations or privileges of parties under a formal review.

Further clarification from the Commission in its final rule determination on the issues above would assist energy network businesses and other stakeholders in considering whether these are issues which may be the appropriate subject of future legislative amendments.