

20 June 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear John,

EUAA Rule Change Proposal – Prescribed Values of equity beta and gamma

On 21 April 2008, the Energy Users Association of Australia (EUAA) submitted a proposal to change the values of equity beta and gamma that are presently prescribed in clauses 6A.6.2(b) and 6A.6.4(a), and clauses 6.5.2(b) and 6.5.3 of Appendix 1 of the Rules.

The Rules that the EUAA seeks to change were put in place following careful consideration, and extensive consultation and analysis by policy makers and the Commission itself. In particular, it is noteworthy that in its Chapter 6A Rule Determination, the Commission stated:

“The Commission’s Review has been guided by the NEM objective of promoting an efficient, reliable and safe electricity system. Its goal has been to design a regulatory regime that will facilitate efficient investment in and operation of transmission services, thereby promoting competition and efficiency in the electricity wholesale and retail markets and the long-term interests of consumers of electricity. It has also sought to improve the environment for investment by increasing regulatory clarity and certainty through the Rules.”¹

More specifically, in relation to the prescribed values for equity beta and gamma, the Chapter 6A Rule Determination concluded as follows:

“In the interests of certainty and predictability the Commission has codified elements of the SRP where there is general acceptance. Consequently, the Revenue Rule specifies an equity beta of 1.0. Should compelling evidence arise to warrant a change in the assumed equity beta, this can be dealt with, as appropriate, at the time of the AER’s five year review of the WACC parameters.”²

¹ AEMC 2006, *Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006, Rule Determination*, 16 November 2006, page iv.

² *Ibid*, page 87.

“From its analysis and the evidence of the reports, the ESC determined that there was inadequate evidence to support changing the value of gamma from 0.5. On this basis the Commission maintains the view that it is not appropriate to change the value of gamma at this stage. However, the Commission notes that the value of gamma is also subject to review by the AER every five years, allowing additional analysis and developments in financial theory to be taken into account at that time.”³

The EUAA Rule change proposal presents no evidence to support a contention that the Commission’s reasoning in relation to the provisions governing the determination of beta and gamma values in its Chapter 6A Rule Determination do not accord with the NEM objective and that the Rules should be changed. Indeed, as noted above, whilst the Commission recognised the need for reasonable certainty and predictability to be provided in the Rules regarding these two WACC parameter values, the Rules also provide for the prescribed values to be reviewed periodically by the AER, to take account of any additional analysis or developments in finance theory.

The EUAA Rule change proposal simply seeks to advocate a particular position on the values of beta and gamma, based on additional analysis commissioned by the EUAA since the relevant Rules were promulgated. In effect therefore, the EUAA is seeking to advance the timing of the forthcoming WACC review (which is scheduled to be undertaken by the AER in accordance with clauses 6.5.4(a) and (b), and clause 6A.6.2(g)).

It is noteworthy however that the EUAA has not sought a change in the provisions of the Rules that govern the timing of the AER’s WACC review. Rather, the rationale for the Rule change proposal appears to be the EUAA’s concern that the principle set out in clauses 6A.6.2(j)(4)(ii) and 6.5.4(e)(4)(ii)⁴ could result in the continued application of the parameter values now prescribed in the Rules. Indeed, paragraph 86 of the EUAA’s Rule change proposal states:

“As such, although the AER is required to conduct the Parameter Reviews, if the Current Parameter Values were to remain in place at the time of the reviews, the principle set out [in clauses 6A.6.2(j)(4)(ii) and 6.5.4(e)(4)(ii)] could establish a stronger presumption that the pre-existing parameter values be adopted by the AER absent ‘persuasive evidence’ to the contrary. As a result, if the Rule change requested in this Proposal is not made, the AER may be more inclined to adopt the Current Parameter Values in the Parameter Reviews in 2009.”

As already noted, the present Rules were put in place following careful consideration, consultation and analysis by policy makers and the Commission. The EUAA has presented no evidence (persuasive or otherwise) that warrants the present Rules being changed. The standard prescribed in clauses 6A.6.2(j)(4)(ii) and 6.5.4(e)(4)(ii) - namely the requirement for a change to the prescribed WACC parameters to be based on persuasive evidence - is an appropriate standard, and one which, the EUAA has

³ *Ibid*, page 88.

⁴ This principle requires that: “where the values attributable to the [relevant parameters] cannot be determined with certainty ... [there is a] need for persuasive evidence before adopting a value for that parameter that differs from the value that has previously been adopted for it.”

not sought to challenge in its Rule change proposal. Moreover, the concern expressed in paragraph 86 of the EUAA's Rule change proposal strongly implies that the EUAA doubts whether the information submitted by it would satisfy this test.

The Rules provide clearly for the information and views presented by the EUAA to be considered fully by the AER during its forthcoming reviews of WACC parameters. In particular, the Rules provide for the economic regulator (the AER) and not the Rule maker (the Commission) to conduct these reviews, subject to the guidance provided by the Rules, and in accordance with the energy policy development and governance framework established by the Ministerial Council on Energy.

The Commission's consideration of the EUAA's Rule change proposal would pre-empt (and duplicate) the AER's forthcoming WACC parameter reviews and it would substantially blur the roles of the AER and the AEMC. In this context, it is noteworthy that that AER issued a stakeholder communication (number 117) on 12 June 2008, advising that it has submitted a Rule change proposal to the AEMC seeking the alignment of both the transmission and distribution WACC reviews so that they will be completed by 31 March 2009. The AER advised that it is proceeding on the basis that these reviews will be aligned subject to the outcome of its Rule change proposal presently before the AEMC. As noted above, the AER's (now imminent) review of WACC parameters is the appropriate forum for consideration of the EUAA's views on the values of equity beta and gamma. On this basis, the Commission should reject the Rule change proposal.

Moreover, as noted above, the Commission's Chapter 6A Rule Determination sets out clearly the sound reasoning underpinning the present Rules, and also demonstrates clearly that these Rules are consistent with NEM objective. The EUAA's Rule change proposal fails to demonstrate any case for changing the present Rules. This is further reason for the EUAA's Rule change proposal to be rejected. In light of the substantial shortcomings in the EUAA's Rule change proposal, SP AusNet does not believe that it is necessary or productive to address the detailed information submitted by the EUAA in relation to the WACC parameters.

We would be pleased to provide further information to the Commission in relation to this matter at any time. If you require any further information from SP AusNet, please do not hesitate to contact us.

Yours sincerely,



Kelvin Gebert
MANAGER REGULATORY STRATEGY AND COMPLIANCE