

**IN THE MATTER OF THE  
AUSTRALIAN ENERGY  
REGULATOR'S RULE  
CHANGE REQUESTS TO THE  
AUSTRALIAN ENERGY  
MARKET COMMISSION  
CONCERNING CHAPTERS 6,  
6A, 10 AND 11 OF THE  
NATIONAL ELECTRICITY  
RULES AND PART 9 OF THE  
NATIONAL GAS RULES 2008**

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**MEMORANDUM OF ADVICE**

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Stephen Lloyd SC

Instructed by:  
ACCC  
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Melbourne VIC 3000

Attention:  
Anthony Goh

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Professional Standards Legislation*

## MEMORANDUM OF ADVICE

### Questions

1. I have been asked to advise on:
  - a) whether the existing *National Electricity Rules* (NER) are drafted in a manner that gives rise to a susceptibility to systemic bias in making distribution determinations and transmission determinations;
  - b) whether the rule changes proposed by the Australian Energy Regulatory (AER) would, if made, operate to reduce or remove any existing systemic bias;
  - c) whether the rule changes proposed by the AER allow it to make distribution determinations and transmission determinations that are consistent with the national electricity objective and the revenue and pricing principles set out in the *National Electricity Law* (NEL);
  - d) whether the draft rules allow for the AER to make cost of capital decisions in access arrangement decisions that are consistent with the national gas objective and the revenue and pricing principles set out in the *National Gas Law* (NGL).
2. I am asked to provide this advice not in the context of any fact situation but by reference to the materials noted below. I note that factual circumstances may arise in the future that present issues that I have not been able to anticipate in my review of the draft rules. My advice is necessarily qualified to this extent.

### Materials

3. I have been briefed with:
  - a) the AER's rule change request concerning the *National Electricity Rules* (NER) and the its rule change request concerning the *National Gas Rules* (NGR) both current as at 13 September 2011;

- b) copies of the current chapters of the NER and NGR that are proposed to be changed and also copies of the form in which it is proposed that those chapters should take;
- c) copies of the relevant enabling legislation for the rules just mentioned; and
- d) copies of certain publications of the Australian Energy Markets Commission (**AEMC**), including guidelines to proponents for new rules.

### **Critical legislative provisions**

4. For convenience, I set out the core provisions relating to the objectives and revenue and pricing principles contained within the relevant legislation.

5. The national electricity objective (**NEO**) is set out in s 7 of the NEL, which is itself a schedule to the *National Electricity (South Australia) Act 1996* (SA). The NEO states:

*The objective of this Law 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; and*
- (b) *the reliability, safety and security of the national electricity system.*

6. The national gas objective (**NGO**) is set out in s 23 of the NGL, which is itself a schedule to the *National Gas (South Australia) Act 2008* (SA). The NGO states:

*The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

7. I note that there is a certain tension inherent in the objectives. While all of the matters specified in the objectives are ultimately in the interests of consumers; there is a tension between price and most of the other

desirable characteristics (quality, safety, reliability and security) in that improvements in the latter generally come at a higher price.

8. The revenue and pricing principles, in relation to electricity services, are set out in s 7A of the NEL, which provides:

***7A—Revenue and pricing principles***

*(1) The revenue and pricing principles are the principles set out in subsections (2) to (7).*

*(2) A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in—*

- (a) providing direct control network services; and*
- (b) complying with a regulatory obligation or requirement or making a regulatory payment.*

*(3) A regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to direct control network services the operator provides. The economic efficiency that should be promoted includes—*

- (a) efficient investment in a distribution system or transmission system with which the operator provides direct control network services; and*
- (b) the efficient provision of electricity network services; and*
- (c) the efficient use of the distribution system or transmission system with which the operator provides direct control network services.*

*(4) Regard should be had to the regulatory asset base with respect to a distribution system or transmission system adopted—*

- (a) in any previous—*
  - (i) as the case requires, distribution determination or transmission determination; or*
  - (ii) determination or decision under the National Electricity Code or jurisdictional electricity legislation regulating the revenue earned, or prices charged, by a person providing services by means of that distribution system or transmission system; or*
- (b) in the Rules.*

*(5) A price or charge for the provision of a direct control network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the direct control network service to which that price or charge relates.*

*(6) Regard should be had to the economic costs and risks of the potential for under and over investment by a regulated network service provider in, as the case requires, a distribution system or transmission system with which the operator provides direct control network services.*

*(7) Regard should be had to the economic costs and risks of the potential for under and over utilisation of a distribution system or transmission system with which a regulated network service provider provides direct control network services.*

9. Materially the same principles, but applicable to gas “reference services”, are contained in s 24 of the NGL.
10. Under s 16(1) of the NEL, the AER must, in performing or exercising an AER economic regulatory function or power (which includes making distribution and transmission determinations) perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the NEO. Further, by operation of s 16(2), in making such determinations the AER must take into account the revenue and pricing principles. Materially similar requirements are contained in s 28 of the NGL, in relation to access arrangements relating to a reference tariff and access determinations relating to a rate or charge for a pipeline service.
11. The AEMC is also bound to have regard to the NEO or NGO when performing or exercising any of its functions or powers (s 32 of NEL; s 72 of the NGL). Moreover, the AEMC has power to make a rule only if it is satisfied that the proposed rule will or is likely to contribute to the achievement of the NEO or NGO (s 88 of the NEL; s 291 of the NGL). In many instances, it must also take into account the revenue and pricing principles in making a proposed rule (s 88B of the NEL; s 295 of the NGL).
12. The only time that the NEO or NGO have been discussed by a court was in *ActewAGL Distribution v The Australian Energy Regulator* [2011] FCA 639. The discussion did not really canvass its meaning. Justice Katzmann did, however, set out the following passage from *Application by EnergyAustralia* [2009] ACompT 8 with apparent approval:

*[14] The national electricity objective provides the overarching economic objective for regulation under the NEL: the promotion of efficient investment and efficient operation and use of, electricity services for the long term interests of consumers. Consumers will benefit in the long run if resources are used efficiently, that is if resources are allocated to the delivery of goods and services in accordance with consumer preferences at least cost. As reflected in the revenue and pricing principles, this in turn requires prices to reflect the long run cost of supply and to support efficient investment, providing investors with a return which covers the opportunity cost of capital required to deliver the services.*

13. It may be observed that the NEO and NGO and the revenue and pricing principles all involve notions derived from economic concepts. In this way, not only is the work of the AER to be assessed against those concepts, the power of the AEMC to make rules is constrained by reference to those concepts. This is not however to say that the concepts contained within the objectives and principles are certain or unambiguous in their application. The AEMC's rule-making power turns upon its own satisfaction that the proposed rules meet the relevant economic criteria.
14. It is with these principles in mind that I turn to the rule change requests.

### **Assessment of proposed changes to the NER**

15. The NER rule change request (the **Request**) refers to concerns expressed as early as 2006 that the framework for regulating transmission (and distribution) networks was overly prescriptive in a way that would "tilt the regulatory balance in favour of the NSPs and would limit the AER's capacity to respond to the individual circumstances of each NSP".<sup>1</sup>
16. Section 2.2 provides data concerning recent increases in electricity prices, including higher regulated network charges, occurring under the current rules. Section 2.3 provides detail on the step change increases in forecasts by networks for capital and operating expenditure.
17. Section 3 provides a statement of issues arising from the current rules. The AER states that there are a number of limitations in the current rules that do not permit the effective regulation of natural monopoly network businesses. The AER states that the detailed codification in the NER has

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<sup>1</sup> NER Rule Change Request, section 2.1

- restricted the AER's ability to balance the interests of consumers and regulated networks. The AER has identified a risk that the current rules may be requiring consumers to pay more than the efficient cost required to maintain the services. The AER has identified three key areas for reform.
18. **First**, the AER has stated that the current framework concerning the setting of capital expenditure (**capex**) and operating expenditure (**opex**) is not promoting efficient outcomes in the long term interests of consumers. The framework provides incentives for inflated forecasts of such expenditure and, in essence, inadequate tools to address this issue.
  19. The AER identifies in particular the existence of aspects that create a systemic upwards bias. One is that it is required to accept a forecast that "reasonably reflects" efficient costs and, if not satisfied, can reduce the forecast only to the extent necessary to ensure that the forecast does reasonably reflect such costs. There tends to be a margin of appreciation in the notion of "reasonably reflects". The result is that the network service providers are encouraged to provide inflated forecasts knowing that they can be reduced only to the top of the range of forecasts that *reasonably* reflects efficient costs. This is an example of how the framework creates an upwards bias in charges.
  20. Another example included in the same section concerns the automatic rollover of actual investments and their inclusion in the regulatory asset base (**RAB**) of service providers. A result of the automatic rollover of actual investments whether or not the investment was in excess of the capex forecast and whether or not it was efficient or prudent is that service providers will be provided with a return on it until it is fully depreciated. The rollover then results in increased returns in the future irrespective of the investment's productivity. This tends to encourage inefficient investment.
  21. **Secondly**, the AER identifies two issues concerned with determining the weighted average cost of capital (**WACC**), namely the process, method and timing for determining the WACC and the particular method for determining the debt risk premium (**DRP**).

22. **Thirdly**, the AER identifies a number of concerns with the efficiency of the regulatory process. One such concern is the ability of network service providers (**NSPs**) to lodge important material late in the process, giving interested parties little or no opportunity to address it and giving the AER little opportunity to assess and determine its correctness. The capacity of NSPs to do this creates a capacity for them to game the system in a manner that can lead to or encourage results favourable to them above the broader public interest.
23. Section 4 describes the proposed rule changes in general terms. The capex and opex framework is sought to be reformed to remove or reduce the susceptibility to systemic bias in the current framework. Further proposals seek to reduce incentives to overspend on capital expenditure. Yet further reforms are directed at addressing more effectively how the regime deals with uncertainty.
24. The Request also proposes reforms to the determination of the WACC so that there will be a single regime for determining the WACC for gas and electricity determinations. The Request also proposes a number of reforms to the regulatory processes to ensure better transparency and fairness for the benefit of all stakeholders.
25. The Request also proposes reforms to ensure that all stakeholders have the opportunity to analyse material from NSPs thoroughly.
26. Section 5.2 provides a high level overview as to how the proposed rule changes would, if enacted, contribute to the achievement of the NEO, principally by promoting efficient investment in, and efficient operation of, electricity networks in the long term interests of consumers. The proposed rule changes are also directed to minimising administrative costs, which would play a part in this.

### **Susceptibility to systemic bias**

27. The AER's discussion of the detailed rule change proposals commences at section 6. It is not appropriate that I set out in my advice all of the detail in the Request or even seek to summarise it. Rather, I focus upon the questions that have been set out above.

28. This requires me to consider whether the existing rules have a susceptibility to a systemic bias. I agree with the AER that the aspects that it has identified as involving a systemic bias do contain such a susceptibility to bias. The key aspects of this are the framework for forecasting capex and opex and the need for the AER to accept a forecast that “reasonably reflects” the likely capex and opex required for efficient operations.
29. I also consider that the current mechanism for the automatic rollover of investment creates a susceptibility for NSPs to over invest, even in poor and unproductive investments, because a return on that investment is largely assured by the mechanism that determines pricing in a way that allows a return on capital in the RAB irrespective of the merit or efficiency of the investments undertaken.
30. This susceptibility to inefficient investment is exacerbated if the calculation of the WACC results in a figure that provides a return on capital that is higher than the actual cost of capital to the NSPs. That is, if the WACC allowance is inflated, there is an incentive on NSPs to over invest because they are able to raise capital more cheaply than the AER’s calculations would suggest. It is, therefore, critical to have a system for determining WACC that is as robust and reliable as possible. A substantial overstatement of WACC is likely to encourage inefficient investment for which consumers will have to pay for many years.
31. I will turn now to consider the main proposals for change that are addressed to these susceptibilities to bias.

## **Proposals for reform**

### *Capex and opex framework*

32. The first aspect of the rule proposal concerning the capex and opex framework is the proposed replacement of the ‘propose-respond’ model with a ‘consider-determine’ model. The main reason for this is that the existing framework, especially in light of the information asymmetry, has a bias in favour of ever increasing capex and opex forecasts. The changes

- proposed in Table 6.2 give effect to the change discussed in the section. The removal of this bias would clearly be consistent with the NEO and the revenue and pricing principles.
33. The principal change is to remove the process according to which the NSP is to provide a forecast of opex and capex and the AER is required to accept the forecasts if they *reasonably reflect* efficient costs. In its place, the AER is (after receiving the NSPs forecasts) to determine what it considers to be forecasts of capex and opex of efficient costs for a prudent operator. This removes the innate upwards bias in the language of the previous system, especially where it was coupled with a limitation on the AER to reduce the NSP's forecast only to the extent necessary to make the forecast reasonably reflective of efficient costs (hence the top of the range of reasonable forecasts).
  34. In my view, this proposed change would reduce or remove the current bias arising on the language of the relevant provisions concerning forecasts of opex and capex. The AER would be bound to attempt to identify forecasts that meet the NEO and the revenue and pricing principles. There is, thus, no reason why these objects would not be achieved by the proposed reforms.
  35. The second aspect of this rule change proposal concerns refinement of the expenditure criteria and clarification and extension of a number of expenditure factors. The first expenditure criterion is retained and the third is moved to a different rule. The second, which concerns the need to have regard to the circumstances of the relevant NSP has been removed in order to make it clear that benchmarking processes are not precluded (but consideration of these circumstances is not itself excluded under the proposed regime). Some of the existing expenditure factors are moved to a different rule, to which they more appropriately belong (because they concern forms of material and not content). The remaining factors are either left untouched or clarified or supplemented. In my view, each of the reforms proposed in Table 6.3 gives effect to the changes proposed in the Request. More importantly, the changes are all directed to ensuring that the AER determines forecasts that are directed more clearly to the achievement of the NEO and the revenue and pricing principles.

36. The third aspect of the rule change proposal is to address the incentive to overspend on capex (this has been mentioned above). Actual capex above forecast was responsible for a significant proportion in the increase in network charges in Queensland and New South Wales. The rule change proposal seeks to provide a full rollover for capex up to the forecast in the determination but to rollover only 60% of the capex above the forecast, leaving shareholders to bear the cost of the remaining investment. This will tend to remove the current incentive (detailed in the Request) to overspend on capex. In my view, the drafting proposed will give effect to the intention of the discussion in the Request. The AER considered but rejected other options to reduce the incentive for over expenditure.
37. In my view, the reduction of an incentive for over expenditure on capex would contribute towards the achievement of the NEO. Obviously, care needs to be taken to ensure that *efficient* investment is not the subject of disincentive. I note that the proposed rules do not encourage under expenditure, they simply reduce any incentive to invest beyond the forecast amount. Where exceptional circumstances arise justifying capex above the forecast amount, the proposed rules will provide mechanisms to allow these amounts to be included into forecasts (and thereupon in the RAB), such as through capex re-openers and contingent projects. These mechanisms are discussed below.
38. The fourth aspect of the rule change proposal concerning capex is to give the AER the same flexibility that it has with DNSPs (in Chapter 6) in respect of TNSPs (in Chapter 6A) when determining whether depreciation is to be calculated on the basis of actual or forecast depreciation. The difference in approach affects the degree of incentives relating to capex. This is a relatively minor reform but there appears to be no reason why the ASER should not have the same flexibility as between the two classes of NSPs. The conferral of flexibility in a context where the AER is subject to the NEO and must have regard to the revenue and pricing principles should contribute towards their achievement.
39. The fifth aspect of the rule change proposal is concerned with mechanisms in the rules concerning how uncertainty is managed. At present, for TNSPs there are mechanisms for a capex re-opener, for contingent

- projects and for pass through events. For DNSPs the only mechanism is for pass through events.
40. The AER has recognised that the adoption of the earlier proposals would make it appropriate to create greater scope, especially for DNSPs, to make adjustments for opex and capex forecasts arising in unforeseen circumstances. It is proposed that provision be made for contingent projects and a capex re-opener for DNSPs. These are however to be subject to thresholds to ensure that they are only activated in circumstances where there has been a material change in expected expenditures.
  41. The draft rules give effect to the proposals set out in the Request. The creation of these extra mechanisms for DNSPs provides flexibility and reduces incentives to inflate forecasts to deal with certainty. They are better and more flexible tools for managing uncertainty and should allow for more precise forecasts, while also allowing for corrections when material unforeseen circumstances arise. In this way, these proposals are clearly designed to advance the NEO.
  42. The sixth aspect of the rule change proposal concerning capex is a lack of symmetry in the existing rules concerning related third party margins. At present, there is capacity to adjust capex forecasts to exclude unjustified third party margins but no equivalent power in respect of actual capex and its (automatic) inclusion in the rollover of the RAB. The proposed rule changes empower adjustments to be made for this when determining the RAB, and also a related problem of the capitalisation of overheads (where opex is reclassified as capex).
  43. The implementation of these rules would clearly contribute to the achievement of the NEO because they would remove from the RAB costs that are not efficient costs.
  44. The seventh aspect of the rule change proposal concerns the current differences in incentive schemes as between TNSPs and DNSPs and the limited ability to create new incentive schemes. The proposed rule changes would allow the AER to develop new incentive scheme that met specified criteria with a view to meeting best practice in setting incentive

- mechanisms. This proposal would allow for adjustments in schemes and the creation of new schemes in a manner more efficient than the current position (requiring rule changes on each occasion). This flexibility would reduce the administrative costs incurred in introducing such arrangements. The mandatory considerations set out in the new provisions and the fact that the AER remains subject to the need to pursue the NEO should ensure that all new schemes are designed to contribute to the achievement of those ends.
45. The eighth aspect of the rule change proposal concerns the current absence of an ability of the AER to make any adjustment in respect of standard control assets that are also used in the provision of other services including unregulated services. The result is that the whole cost of those assets are recovered from consumers of standard control services without any compensation for the use of the asset in the provision of other services. The proposed amendment would allow such an adjustment. This amendment would tend to attribute costs more fairly so that consumers of standard control services are exposed to pricing premised on efficient costs of those services and do not need effectively to subsidise other services.
  46. Section 6.10 of the Request sets out how the proposed changes would contribute to the NEO and the revenue and pricing principles. The material in this section appears to be balanced. Insofar as I am asked to advise whether the changes would contribute to these matters, I would respectfully adopt the reasons advanced in this section.
  47. More importantly, I have not identified any manner in which the rule changes would detract from the achievement of the NEO or the revenue and pricing principles. Most of them are focused principally upon remedying current rules that do detract from the achievement of these matters. Those that are not so focused provide the AER with additional flexibility that is at least capable of being employed to this end and which, given the AER's obligations in this regard, should be so exercised.

### *Determination of the rate of return*

48. Section 7 contains proposals for rule changes concerning the determination of the rate of return for capital. I note that analogous changes are proposed for the NGR. I do not address them separately.
49. There are currently different regimes for determining the WACC as between TNSPs, DNSPs and gas networks. Where the parameters for the WACC are not fixed periodically (as is the position for DNSPs), the AER has noted that DNSPs seek to re-agitate the parameters in every determination process, focusing upon (cherry picking) the parameter(s) most likely to be adjusted in their favour (not disputing any parameter that may be liable to an adjustment adverse to them). This process continues from the AER to the Australian Competition Tribunal. This process has diminished the capacity for the AER adequately to consider the resulting *overall* rate of return. Given the resources of the NSPs, the tendency is always to press for the highest possible WACC. I understand that there is little or no organisation within consumer groups to agitate for the lowering of WACC parameters. This tends to create a systemic bias to in favour of the WACC parameters that are determined tending to be higher than they might otherwise be.
50. The current rules have also led to difficulties in setting the debt risk premium (**DRP**), a matter regularly the subject of dispute and appeal. The NER currently requires reference to be made to certain benchmark bond rates, a process which leads to a cost of debt that bears little resemblance to the actual cost of debt faced by NSPs.
51. The AER notes that an overstatement of the DRP by just 1% would result in consumers paying around \$400M in additional charges per year. This shows the incentives in NSPs vigorously to pursue the most favourable WACC parameters.
52. The essential elements of the AER proposals are to:
  - a) align the determination of WACC across all electricity and gas networks;

- b) hold periodic review of WACC, the outcomes of which cannot be departed from in subsequent determinations (as is the current position for TNSPs);
  - c) not have a “persuasive evidence” test when undertaking WACC reviews (which is the current test for departing from a statement of regulatory intent, which is relevant to DNSPs);
  - d) increase the ambit of the WACC review to include determining a methodology for setting the DRP;
  - e) empower the AER to initiate a WACC review ahead of the scheduled periodic review across the industries.
53. Section 7.2 addresses the status of WACC review across determinations. The essential mechanism is to have a periodic WACC review, which produces a statement on the cost of capital (see proposed rule 6.5.4). When determinations are made, they need to be made “in accordance with the statement on the cost of capital” (proposed rule 6.5.2(b)(2)). For TNSPs, see proposed rule 6A.6.2.
54. The proposed rules do not require any special level of evidence to justify a change in parameters. This means that, at each periodic review, the WACC parameters will be open for consideration without prior reviews being given undue weight.
55. This substantially aligns the regulatory scheme for TNSPs with the other network schemes.
56. There are probably advantages and disadvantages to this approach. In its favour, it will avoid much administrative costs in the repeated re-agitation of arguments concerning WACC parameters over periods of time generally too short to make a difference to the parameters involved. There is also a mechanism for making an early adjustment to the parameters in the statement on the cost of capital by undertaking a WACC review earlier than five years if circumstances do change materially within the five year limit for new reviews. Conversely, it may be argued that, as this mechanism (like the existing regime for TNSPs) will not allow WACC parameters to be re-assessed in every individual determination, it provides

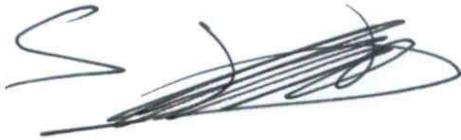
- less capacity to identify the “true” WACC parameters at the time of each determination thereby diminishing the capacity to achieve the NEO.
57. The flexibility provided by the proposed mechanism should ensure that the WACC parameters can remain appropriate and provide a route to determining a cost of capital that will contribute to the achievement of the NEO (and NGO). At the same time, costs involved in constant challenges to WACC parameters can be reduced. There is a contestable matter of judgment in relation to this issue but I consider that it is reasonably arguable that the proposed mechanism with its package of features will be likely to advance the achievement of the NEO, especially when the difficulties with the existing DNSP and gas regimes are considered. In my view, it certainly cannot be said that the proposed amendments would necessarily detract from the achievement of the NEO.
  58. Section 7.3 expands upon the reasons for removing the “persuasive evidence” test. This includes that the test is legally uncertain. The AER’s contention is that it is inappropriate to have the test in its periodic reviews. Past reviews will be given weight without such a test. There should not be any undue inertia in a periodic review in changing the parameters if the data and circumstances justify doing so. This reform should be considered in conjunction with that discussed in section 7.2 as providing a balanced and appropriate package allowing regular but not incessant reviews of WACC parameters.
  59. In this way, the statement on the cost of capital will provide short to midterm stability and certainty in which investment can take place, while there is still a mechanism for appropriate adjustments to be made periodically. The alternative mechanism of a mini-WACC review in every determination tends to reduce investment stability.
  60. In my view, there is no necessary inconsistency between this approach and the achievement of the NEO.
  61. Section 7.4 discusses provisions that effect a WACC review every five years at a given date. Given other provisions for modifying the WACC parameters if circumstances change, I see no reason that this reform would detract from the achievement of the NEO.

62. Section 7.5 principally addresses the provisions that remove from the rules the methodology for estimating the DRP, allowing a methodology to be determined in the periodic WACC review. The AER identifies a number of significant deficiencies with the existing rules, not least that the current methodology involves estimating the DRP by reference to certain kinds of bond yields, many of which are not reflective of the cost of debt actually incurred by NSPs and other market participants.
63. The AER's proposal is, in substance, to remove the current deficient rules and replace them with the means to determine a methodology, at least able to respond to market conditions every WACC review. The methodology selected could be based upon the current methodology (bond yields of certain bonds) but could involve any best practice system for determining DRP.
64. In some instances the replacement of a certain system with a flexible one would lead to a reduction in stability, which could deter investment. However, the current rules do not provide a "certain system". The determination of DRP is almost always highly contested under the current rules. Moreover, it is not proposed that the methodology can change from determination to determination but only from WACC review to WACC review (every five years). Thus, once the WACC review has been carried out, there is a reasonable amount of certainty into the mid term.
65. In my view, this proposal does not detract from the achievement of the NEO. Indeed, insofar as it is likely to lead to a determination of the DRP that is more accurate and thereby provide a cost of debt component of WACC that is closer to the actual cost of debt incurred, it is likely to contribute to the achievement of the NEO.

#### *Regulatory decision-making processes*

66. Section 8 addresses a number of proposals to change the processes for the making of regulatory determinations under the NER.
67. The changes in this section are not directed to remedying provisions that directly contribute to systemic biases in the making of determinations. Rather, they are directed to provisions in the current rules that need

- clarification or which operate inefficiently. The rule proposals are mostly directed to having the regulatory decision-making process work more fairly and more efficiently.
68. I do not understand that these proposals fall within the ambit of the request for advice.
69. I should indicate that I have reviewed the proposal and the rules drafted to give effect to the proposal in section 8. In my opinion, those rule changes do not detract from or preclude the achievement of the NEO. To the extent that they make the regulatory determination process more efficient, they should reduce the costs of that process and contribute to the NEO.
70. I advise accordingly,

A handwritten signature in black ink, appearing to be 'S Lloyd', with a large, dense scribble underneath.

**Stephen Lloyd SC**

Ph: (02) 9235 3753

21 September 2011