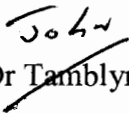


23 February 2006

Dr J Tamblyn  
Chair  
Australian Energy Market Commission  
PO Box H166  
Australia Square NSW 1215

  
Dear Dr Tamblyn

**RE: Reform of the Regulatory Test Principles**

Thank you for the opportunity to comment on the Ministerial Council on Energy's (MCE) Rule change application to amend the regulatory test principles.

The AER recognises that the Rule change package follows through with the MCE's commitment, as stated in its May 2005 Statement on NEM Electricity Transmission, to develop regulatory test principles that provide minimum coverage guidelines for the AER to apply in promulgating the regulatory test.

The AER supports the overall direction of the draft Rule changes which largely reflect the key principles underpinning the existing regulatory test and provide an appropriate balance between the high level principles in the Rules and guideline coverage. We would, however, like to comment on certain references regarding maintaining consistency between the regulatory test and the basis of asset valuation used in revenue resets.

The MCE proposal amends certain references to making the regulatory test consistent with the basis of asset valuation used in revenue cap decisions (proposed clause 5.6.5(a)(7)). While the current Rules state that the AER must 'have regard to the need to ensure' the regulatory test is consistent with the basis of asset valuation used in setting revenue caps, the draft Rules say the AER 'must ensure.' This further emphasises the need to make the regulatory test consistent with the asset valuation methodology used in setting revenue caps.

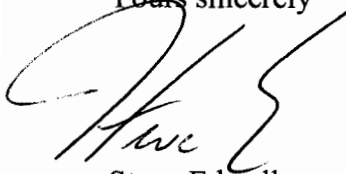
It is noted that the relationship between the regulatory test and asset valuation methodology may need to be revised depending on the outcomes of the Chapter 6 review, in particular the approaches to asset valuation (optimised replacement cost or roll forward).

The recently released draft Rules for Chapter 6 advocate a lock-in and roll forward approach to asset valuation, rather than a revaluation approach. Should such an approach be adopted in the Chapter 6 Rules, the AER questions the relevance of proposed clause 5.6.5A(a)(7).

More broadly, the AER believes that the draft regulatory test principles need to be considered in conjunction with the framework established by the Chapter 6 review.

We look forward to discussing this response with you and participating in the subsequent stages of the review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Edwell', written over a light blue background.

Steve Edwell  
Chairman