ELECTRICITY TRANSMISSION NETWORK owners

Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006

Response to AEMC Draft Rule Determination

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TransGrid ElectraNet electricity transmission Powerlink QUEENSLAND TRANSEND SP AusNet A member of Singapore Power Group

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1. Introduction and overview

This submission is made by the Electricity Transmission Network Owners Forum, which comprises ElectraNet Pty Limited, Powerlink Queensland, SP AusNet, Transend Networks Pty Ltd and TransGrid ("**ETNOF**"). Collectively, this group own and operate over 40,000 km of high voltage transmission lines and have assets in service with a current regulatory value in excess of $9.1 billion. ETNOF welcomes the opportunity to respond to the Australian Energy Market Commission's (the "**AEMC**") Draft Rule and accompanying Draft Rule Determination.[1]

As noted in its previous submission, ETNOF supported many of the features of the Rule Proposal.[2] ETNOF considers that the further improvements made in the Draft Rule, will materially advance regulatory certainty for investors and increase confidence about the future treatment of their investments. ETNOF acknowledges the improvements the AEMC has made in the Draft Rule, including:

- *A recognition of the role of incentive regulation* – and consequent conclusion that, as a consequence of the incentives created by the regime, it is unnecessary to sanction an intrusive, risk-creating administrative *ex post* test of prudence/efficiency;

- *Improvements to the method for deriving the cost of capital* – by requiring an assumption about the credit rating for firms that is more consistent with empirical evidence, and encouraging greater stability in the costs of capital over time;

- *Improvement in the drafting of the Rules* – and resulting greater clarity of the regime's intent; and

- *Recognition of transitional issues* – and the need for effective management of issues associated with transitioning to the new regime.[3]

However, there are a number of important matters where ETNOF considers that changes are required to enhance the achievement of the Market Objective. Particular areas of concern to ETNOF include:

- *Forecasts of capital and operating expenditure* – amendments are required to preclude the AER from making arbitrary decisions, and to require expenditure forecasts to be judged against the standard of a 'prudent operator';

- *Contingent project regime* – the threshold is too high to permit the contingent project regime to perform its proper incentive role and should be amended;

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1 AEMC, 2006, Draft Rule Determination: Draft National Electricity Amendment Rule 2006, 26 July and AEMC, Draft National Electricity Amendment Rule 2006 (Draft Rule Accompanying Draft Determination), 26 July 2006.

2 ETNOF, 2006, Submission to the AEMC Review of the Electricity Transmission Revenue and Pricing Rules: Rule Proposal and Rule Proposal Report, March.

3 As before, however, ETNOF members will respond on the specifics of the transitional arrangements relevant to them.

- *Definition of prescribed and negotiable services* – ETNOF has a number of concerns about the definition of prescribed and negotiable services, including the potential for services to 'fall between the cracks', which we propose to work with the AEMC to resolve;

- *Service performance incentive arrangements* – the drafting of the Rule should clarify the scheme's objective to ensure it is implemented as intended;

- *Re-use of optimised assets* – the Rules should clarify that the existing practice whereby assets that were written down or ascribed no value in the initial 'optimised depreciated replacement cost' may be re-included in the regulatory asset base when their use has changed to justify that re-inclusion;

- *Efficiency carry-over for operating expenditure* – the Rules should preclude a negative carry-over (in line with the requirements of the NEL) and require further aspects of the scheme to be clarified up-front;

- *Pass through arrangements (excluding grid support)* – a lower threshold and one that is flexible enough to take account of multiple events is justified. There should also be flexibility for further pass through events to be defined during a revenue cap review;

- *Guidelines* – more robust procedural requirements are required for the guideline approval and amendment process, these decisions should be open to merit review and the treatment of non-compliance with guidelines should be addressed; and

- *Averaging period for the risk free rate* – scope should be provided for the averaging period to be agreed between the AER and TNSP in advance but kept confidential to reduce the risk of causing adverse movements in debt markets (and raising the TNSPs' financing costs).

These matters are discussed in Chapter 2, with proposed re-drafting of the Draft Rule included where appropriate.

In addition, ETNOF has identified a number of concerns in relation to the detailed drafting of the Rules. While all of the matters identified raise substantial issues, ETNOF considers that these concerns reflect problems with the translation of the positions adopted in the AEMC's Draft Determination into Rules or other oversights, rather than differences of view about matters of principle. These matters are considered in Chapter 3.

1.1 Savings and Transitional Arrangements

ETNOF considers that appropriate savings and transitional arrangements are an essential component of any change to the Rules, and without which the AEMC's objectives to increase the certainty of regulatory outcomes for investors may not be achieved.

ETNOF noted in its previous submissions that savings and transitional arrangements should meet certain principles, including that existing revenue caps should not be reopened, previous commitments that have been relied upon by TNSPs (for example,

about incentive arrangements) are upheld and that there is clarity about the Rules well in advance of a revenue cap review. However, the precise nature of required savings and transitional arrangements depend upon the circumstances of the individual businesses. Accordingly, individual businesses will respond to the detail of savings and transitional arrangements proposed. This matter is not addressed further in this joint submission.

2. Elements of the Draft Rule where Changes are Required

2.1 Forecasts of capital and operating expenditure

The legal due diligence commissioned by ETNOF concluded that the Draft Rule may inadvertently permit an arbitrary decision to reject a provider's capital and operating expenditure estimates. Amongst other things, this may occur through the AER simply not making a decision that it is satisfied the proposal is reasonable, or through some level of technical non-compliance resulting in an expenditure estimate not being considered. The advice received by ETNOF and the relatively minor but important drafting changes proposed to remedy this concern, are attached to this submission.

In addition ETNOF remains of the view that the Rules should contain a transparent standard against which the TNSPs behaviours (and hence their expenditure forecasts) should be judged, which should refer to expenditure that would be undertaken by a prudent TNSP.

A standard of 'the prudent operator' would direct the AER to assess the behaviour of a TNSP against decisions and procedures that are accepted within the industry as prudent, and encourage reliance on the wealth of evidence available from experts on the practical operations of transmission businesses both within Australia and internationally. In contrast, the alternative standard implied in the Rules – namely estimates of 'benchmark' expenditure – tends to focus on aggregate comparisons that need to be informed by analysis of the inherent differences between the TNSPs. While theoretically attractive, benchmarking cannot be considered to be sufficiently reliable, on its own, to inform regulatory decision making in Australia.

Lastly, the requirement for the AER to take account of arrangements that *might not* be on arm's length terms should be changed to arrangements that *are not* on arm's length terms. The AER should be required to act on the basis of evidence and not supposition.

2.1.1. Amendments are required to preclude arbitrary decisions

The legal due diligence of the Draft Rule that ETNOF commissioned identified a shortcoming in the translation of the AEMC's policy intent into the Rules that was considered would have the effect of permitting the arbitrary rejection of a provider's operating and capital expenditure estimates. Clearly, such an outcome would be inconsistent with the AEMC's expressed policy intention of a fit for purpose model of regulation in which expenditure estimates are proposed by the provider and are to be assessed by the AER against transparent and specified criteria.

The aspects of the Rule drafting considered to leave open excessive scope to reject a proposal (i.e. scope to reject where this is not supported by evidence) include that:

- the criteria the AER is required to consider when assessing expenditure forecasts do not include the criteria the TNSP is required to apply;

- the test is couched in terms of the AER requiring to be satisfied that the forecasts are reasonable, which leaves open the scope for the AER simply to conclude that it is not satisfied and therefore will not make that determination;

- the Rules would permit a proposal to be rejected for a technical breach (and in situations where some of the requirements a proposal needs to satisfy are at the discretion of the AER); and

- the AER is not required to have regard to any particular material in reaching its own decision as to a reasonable estimate of expenditure, not even the provider's own estimates or the information the AER can have regard to in rejecting the provider's estimates.

The advice provided by Gilbert+Tobin on these matters is at Attachment B to this submission, including proposed drafting changes. ETNOF notes that the proposed drafting changes are relatively minor but important to restore the AEMC's intended effect.

2.1.2. A standard for assessing expenditure forecasts is required

An important element of the framework under which expenditure is to be assessed is the standard against which the behaviour of the TNSPs – and hence the forecasts of expenditure – are to be judged as reasonable. An important inquiry for the AER will be whether it should accept that the expenditure is required. By providing a clear statement of the standard against which this question should be addressed, the Rules would inform the AER about the sources of evidence that are most relevant to its inquiry, hence enhancing the degree of certainty provided.

ETNOF considers that the most appropriate standard against which the need for expenditure should be assessed – and hence, the most appropriate source of evidence for this inquiry – is the expenditure that would be undertaken by a 'prudent operator'. We note that this standard would ensure that a TNSP's behaviour is judged against that of its peers, and that the most appropriate source of evidence for the inquiry is evidence from experts in the practical operation of transmission businesses, both within Australia and internationally. We also note that the application of a 'prudent operator' standard of behaviour for electricity transmission would also be consistent with the standard that the regulator is required to apply when assessing forecasts of expenditure under the Gas Code.[4]

The alternative standard for assessing the need for expenditure – which is currently set out in the Draft Rule – is estimates of 'benchmark' expenditure, which we consider is likely to be interpreted as requiring the use of one of the available econometric techniques.[5] As we have noted in our previous submissions, the idiosyncratic nature of each transmission business, combined with a paucity of data

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[4] National Third Party Access Code for Natural Gas Pipeline Systems, sections 8.16(a)(i) and 8.37.

[5] Draft Rule, clauses 6A.6.6(b)(2)(vii) and 6A.6.7(b)(3)(vii).

available in Australia, means that benchmarking methods cannot deliver predictions of expenditure needs that are sufficiently reliable to be considered as 'evidence' in revenue cap setting (and directing the AER to take account of 'benchmarks' may have the effect of requiring benchmarks to be taken as evidence notwithstanding their reliability). Thus, ETNOF considers it preferable for the AER to take account of the TNSPs' operational decisions and internal procedures when reviewing the TNSPs' expenditure forecasts to it relying on a method (benchmarking) that has the appearance of being 'light-handed', but in reality is ill-informed and hence imposes unnecessary regulatory uncertainty and risk.

On a related matter, one of the factors to which the AER is required to have regard is whether the expenditure may be referable to arrangements that *might not* be on arm's length terms. This provision would permit the AER to discount information provided by the TNSPs based upon supposition, rather than evidence. ETNOF considers that it would be more appropriate for the provision to refer to arrangements that *are not* on arms length terms, with the associated requirement for the AER to demonstrate the existence of those arrangements.

PROPOSED DRAFTING CHANGE

Please refer to the memorandum from Gilbert+Tobin at Attachment B for a proposed re-drafting of the relevant clauses to address the matters set out above.

2.2 Contingent project scheme

An extremely high threshold has been set for the 'contingent project' regime (the same threshold as is proposed to apply to the 'shipwreck' clause, S6A.7.1) which will remove most or all of the benefits of the scheme. The concerns that justify a contingent project scheme remain material for projects that fall short of the scheme, that is:

- projects under the proposed threshold can create material risk for TNSPs; and
- projects may fail to reach the threshold, and yet deliver substantial market benefits – a regime that ensures these projects are not inefficiently deferred (as may otherwise occur under a revenue cap) remains important.

Moreover, the scheme proposed by the AEMC – particularly the fact that these projects will be identified during a revenue cap review – should avoid much of the possible cost (administrative and otherwise) associated with implementing a contingent project scheme.

Given the requirements that a contingent project needs to meet, an additional materiality threshold is unnecessary. However, if a threshold is to remain, then it should align with the 'new large transmission network asset' threshold for detailed public consultation of regulatory test assessments. At this threshold, the annual financing cost of a project is material, hence giving rise to material risk and efficiency concerns as noted above. Moreover, the fact that a public regulatory test assessment is undertaken implies that there is transparency about the need for, and cost of, the project. Importantly, this threshold will ensure that typical 'market benefit' projects could be accommodated within the scheme.

The scheme should also be modified to ensure that the threshold is only applied once (and at the revenue cap review) in order to remove the prospect of projects not being in the revenue cap but also precluded as contingent projects. Lastly, the apparent omission of projects whose timing is known but cost is uncertain should be remedied.

ETNOF welcomes the introduction of a 'contingent project' regime in the Draft Rule. As argued in previous submissions, ETNOF considers it essential that the Rules be able to address capital projects that emerge during a regulatory period, but whose timing (or need at all) is uncertain and contingent upon factors outside the control of the relevant TNSP. By permitting these projects to be included in the revenue cap if and when they arrive:

- the risk borne by both customers and TNSPs with respect to whether these projects arise is removed; and

- the financial disincentive to commencing such projects during a regulatory period is removed. This ensures that developments which provide benefits to market participants are undertaken in a timely manner, and are not deferred until after the next review.

ETNOF notes that there are a number of types of projects that may fit into this category, which include:

- reliability augmentations contemplated at the time of a revenue reset but whose trigger is dependent upon a new customer (or major increase to the load of an existing customer) that has not been included in the demand forecast; and

- potential economic ('market benefit') projects contemplated at the time of a revenue reset but whose precise scope and timing cannot be confirmed until after the conduct of the 'regulatory test'.

Notwithstanding the AEMC's acceptance of a contingent project scheme, ETNOF is concerned that an extremely high threshold has been set – 5 per cent of a TNSP's regulatory asset base – the same threshold proposed to apply to the 'shipwreck' clause. As previously pointed out, for the TNSP with the largest regulatory asset base (TransGrid), the project would need to have a cost of around $200 million (based on the forecast opening regulatory asset base for TransGrid's next regulatory control period), and even for the smallest (Transend) will set a threshold of about $30 million per project. These examples clearly demonstrate that the scheme will have very little practical operation and will remove most or all of the benefits of the scheme.

ETNOF notes that, regardless of the threshold adopted, the scheme proposed by the AEMC should avoid much of the possible costs associated with its implementation. In particular, the requirement to identify contingent projects during a revenue review provides transparency to all market participants as to which projects are included in the revenue cap and which are excluded (thus preventing potential concerns about 'double dipping'). The requirement for objective 'triggers' also minimises associated administrative costs. Moreover, the incentive arrangements for contingent projects are not dissimilar to those proposed for other capex, and hence should reduce concerns about these projects being gold-plated. It is also noted that as much of the work required of the AER to give effect to a contingent project scheme would be

undertaken during a revenue cap review and as part of regulatory test evaluation and associated consultation processes, and so additional administrative costs are expected to be low.[6]

Given the other requirements that contingent projects have to meet in order to be accepted – including a qualitative requirement for the project to be sufficiently uncertain to be included in the forecast of capex – we do not consider that the Market Objective requires a further materiality threshold. However, if a threshold is to remain, we consider that the threshold should refer to 'new large transmission network assets' as the term is used in Chapter 5 of the Rules (which we note are currently defined as projects whose cost is $10 million or above). This would align the threshold for contingent projects with the threshold above which detailed public consultation is required for regulatory test assessments.

ETNOF notes that the financing cost associated with a 'new large transmission network asset' is material – approximately $1 million per annum for projects at the threshold – and hence material risk and incentive concerns would arise even for the smallest contingent projects. We also note that the consultation the TNSPs are required to undertake in relation to proposed 'new large transmission network assets' means that there will be transparency about the reasons for the project (and, where relevant, the expected benefits), the likely costs of the project and the intended timing of its construction, as well as the potential for the AER to be called to resolve disputes about these matters. The tasks the TNSPs are required to undertake already for the regulatory test means that the TNSP's administrative cost of complying with the subsequent 'approval' of a contingent project is low. Moreover, the transparency created by the regulatory test process will mean that the administrative cost to the AER of monitoring whether (and when) contingent projects are likely to occur also should be low. Importantly, such a threshold will ensure that key 'market benefit' projects of the type that have occurred in recent years, and that may occur in the future, can be accommodated within the scheme.

Table 1 sets out a number of case studies for projects that we consider should be treated as contingent projects.

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[6] That is, teams would be established and already be aware of the TNSP's capex and other plans, and meetings of the Commission would already be scheduled.

TABLE 1
EXAMPLES OF POSSIBLE CONTINGENT PROJECTS – POWERLINK AND TRANSGRID

Project	Approximate Value	Trigger for Project
Powerlink (5% of RAB ≈ $190 million)		
Desalination Plant in SEQ	$35 million (at time of last revenue reset)[7]	Commitment for a large desalination plant in SEQ
Upgrade to Bowen Basin coal mining area	$17 – 115 million	Additional 50 MW mining demand above the 2005 forecast
TransGrid (5% of RAB ≈ $200 million)		
Snowy to Victoria Upgrade	$44 million	Successful passage of regulatory test[8]
QNI Upgrade (relief of northern line limits)	$10-15 million	Successful passage of regulatory test
QNI Upgrade with series capacitors	$100-120 million	Successful passage of regulatory test
Snowy to Victoria Upgrade by 180MW	$95 million	Successful passage of regulatory test
Victoria to Snowy Upgrade	$60 million	Successful passage of regulatory test
Snowy to NSW Upgrade	$20-100 million	Successful passage of regulatory test

These projects are described more fully in Attachment A to this submission. It is noted that these projects all have a common feature in that:

- if the relevant trigger occurs, the benefit to the market from the project is likely to be very large (and, for the case of the Powerlink projects, essential to the security of supply of water in SEQ and for the timely and efficient provision of infrastructure to the booming, export-oriented coal industry);

- whether the project would have been required or the scale of the project was very uncertain at the time of the relevant revenue cap review; but

- none of the projects would have passed the AEMC's proposed threshold for contingent projects, but all would have passed ETNOF's proposed threshold.

A further concern with the contingent project scheme is that the threshold is applied to any project twice – once during the revenue cap review, and then a second time if the contingent project eventuates. The 'double threshold' opens the prospect of projects not being in the revenue cap but also precluded as contingent projects. This

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[7] The trigger has arguably just recently occurred, which will imply an additional 70MVA demand in the Gold Coast area. The augmentation required to serve this load is currently being investigated.

[8] This project has passed the test and has recently been completed.

'black hole' problem can only practicably be remedied by applying the threshold once only during the revenue cap review.

Lastly, we note that the Draft Determination states that '[c]ontingent projects are relatively large (i.e. costly) projects that address foreseen events but where the TNSP is uncertain as to whether the project will proceed, its costs and/or its timing.' However, the Draft Rule 6A.8.1(c)(5) has neglected to include the situation where the *costs* of a contingent project are uncertain. This would appear to have been an oversight in the drafting, which should also be remedied in the drafting of the final rule.

PROPOSED DRAFTING CHANGE

ETNOF proposes the following drafting changes:

- Rule 6A.8.1(b)(2)(iii) should be amended as follows:

the *Transmission Network Service Provider* considers is likely to meet or exceed the minimum amount of total capitalised expenditure required for an augmentation to be a *new large transmission network* asset ~~exceeds 5% of the value of the *regulated asset base* for the relevant *transmission system* as at the beginning of the first year of the relevant *regulatory control period*~~;

- Rule 6A.8.1(c)(5) should be amended as follows:

a *trigger event* to be an event or condition, the occurrence of which is probable during the *regulatory control period*, but the inclusion of capital expenditure in relation to it under clause 6A.6.7(a) is not appropriate because it is not sufficiently certain:

(i) that the event or condition will occur during the *regulatory control period*; ~~or~~

(ii) ~~if it~~that the event or condition may occur after that *regulatory control period*; or

(iii) the amount of expenditure required on the *contingent project* if the circumstance or event occurs; or

(iv) whether or not the event or condition will occur at all

- Rule 6A.8.2(b) should be amended as follows:

An application referred to in paragraph (a):

(1) must not be made within 90 *business days* prior to the end of a *regulatory control year*;

(2) subject to subparagraph (1), must be made as soon as practicable after the

occurrence of the *trigger event*; and

(3) must contain the following information:

(i) an explanation of that substantiates the occurrence of the trigger event;

(ii) a forecast of the total capital expenditure for the contingent project;

(iii) a forecast of the capital and incremental operating expenditure for each remaining regula*tory year* which the *Transmission Network Service Provider* considers is reasonably required for the purposes of undertaking the *contingent project*;

~~(iv) how the forecast of the total capital expenditure for the *contingent project* meets the threshold of 5% of the value of the *regulatory asset base* as referred to in clause 6A.8.1(b)(2)(iii);~~

(iv) the intended date for commencing the *contingent project* (which must be during the *regulatory control period*);

…

2.3 Definition of prescribed and negotiable services

A number of aspects of the definitions of the various services require revision, including the potential for some services 'falling between the cracks', an unclear and uncertain boundary between regulated and unregulated services, a lack of certainty with how to treat connections to another network service provider which relate to a contestable connection and uncertainty with the treatment of fees for applications for negotiable services.

ETNOF proposes to work with the AEMC further on ways to address the above concerns with the definitions of prescribed, negotiated and unregulated transmission services.

ETNOF also considers the proposed definition of 'transmission service' has a defect that needs to be remedied.

ETNOF endorses the classification of services in Table 3.1 of the Draft Determination except with respect to the following four matters:

First, it is important to note that TNSPs are predominantly regulated businesses with a wide variety of regulatory obligations as well as providing services that pass the market benefits limb of the regulatory test.

The *only* means by which TNSPs can recover these costs under the Draft Rule is via the total revenue cap which includes *only* the costs of prescribed transmission services. It is therefore important that the definition of prescribed transmission services is a broad one which enables the TNSP to recover the costs of this wide range of services.

The following items have been omitted from the definition of prescribed transmission services in the Draft Rule:

- services resulting from an application of the market benefits limb of the regulatory test;

- services required by the Rules but not by NEMMCO (for example, the provision of information to the market, such as outage information and augmentation plans);

- services required by NEMMCO to be provided under the Rules in addition to those necessary to ensure the integrity of the transmission network (for example, communications services to support market operations); and

- where, as a result of efficient pre-building of capacity, services may currently exceed the requirements of jurisdictional electricity legislation or exceed the requirements of schedule 5.1a or 5.1.

ETNOF is concerned that the Draft Rule defines prescribed and negotiated transmission services in such a way that creates the potential for services to 'fall between the cracks'.

Secondly, the definition of prescribed transmission services should exclude the processing of connection inquiries and connection applications where the TNSP charges the connection applicant for those services.

Thirdly, the definition of prescribed transmission services should exclude, and the definition of negotiated transmission services should include, services that are provided by one network service provider to another when the two network service providers are competing with each other to provide a service to a new or existing customer. This may arise where a customer seeks substantially increased connection services and a TNSP and DNSP are both offering to undertake the work.

Fourthly, it concerns ETNOF that, while the Draft Determination explicitly recognises that prescribed and negotiated transmission services do not include non-regulated services, non-regulated services are not explicitly excluded from the definitions of prescribed and negotiated transmission services. ETNOF understands that a market participant could, perhaps, infer from the definition of non-regulated services and the absence of an explicit obligation of a TNSP to supply non-regulated services that these services are non-regulated and not included in the definitions of prescribed and negotiated services. However, ETNOF considers that such an indirect means of identifying the boundaries between prescribed and negotiated services on the one hand, and non-regulated services on the other hand, invites confusion and conflict. ETNOF would prefer that a transparent and direct means of identifying non-regulated services be identified and that non-regulated services be listed as an explicit exclusion from the definitions of prescribed and negotiated services.

ETNOF proposes to work with the AEMC further on ways to address the above concerns with the definitions of prescribed, negotiated and unregulated transmission services.

Finally, the Draft Rule would amend the definition of transmission service apparently to align it with paragraph (b) of the definition of electricity services in the National Electricity Law. However:

- the change fails to pick up the following words in the introduction to paragraph (b) 'services that are necessary or incremental to the supply of electricity to consumers of electricity'; and

- in doing so the Draft Rule loses the concept that the services must relate to the conveyance of electricity and potentially brings within the definition other services – e.g. telecommunications services.

PROPOSED DRAFTING CHANGE

In relation to the last matter only, ETNOF proposes that the definition of transmission service should be redrafted as follows:

The services that are necessary or incidental to the supply of electricity to consumers of electricity provided by means of, or in connection with, a *transmission system*.

ETNOF proposes to work with the AEMC further on ways to address its remaining (and more material) concerns with the definitions of prescribed, negotiated and unregulated transmission services.

2.4 Service performance incentive arrangements

Refinement to the drafting is required to make the intent clear that the scheme should be directed towards influencing the TNSPs' *operational behaviours*, which refers to how maintenance and investment is scheduled and delivered, rather than seeking to influence whether major *new investments* should be undertaken. The AEMC has responded to a submission that assumed that the purpose of the scheme should be to influence investment decisions, which has created some confusion as to the intent of the scheme.

We also remain of the view that different TNSPs should have some control over the size of the incentive that applies, and that TNSPs should propose the size of the financial incentive as part of its revenue cap application, and require the AER to accept the proposal if it is reasonable, having regard to the prescribed criteria. The key criteria in this regard should be the objective of the scheme (which is to influence operating behaviour, as discussed above) and the risk created to the relevant TNSP.

Lastly, we consider that there should be clear criteria for setting the important elements of the scheme, most notably the determination of the performance targets that will underpin the rewards and penalties.

While ETNOF generally supports the service performance incentive arrangements set out in the Draft Rule, we remain of the view that refinement to the drafting is required to make the intent clear that the scheme should be directed towards influencing the TNSPs' *operational behaviours*, which refers to how maintenance and investment is scheduled and delivered, rather than seeking to influence whether major *new*

investments should be undertaken. As discussed in our previous submissions, the reasons why it is appropriate for the service incentive arrangements to focus on operating decisions only are a function of the following constraints:

- reliability and other non-discretionary projects account for nearly all of TNSP capital expenditures; and

- a capex incentive framework and other incentives already exist to encourage the TNSPs to undertake efficient discretionary investments (and which will be furthered if the ETNOF proposals with respect to contingent projects are accepted).

While we do not consider this objective for the scheme to be inconsistent with the AEMC's views of the appropriate role of the scheme,[9] we note that the AEMC has responded to a submission that assumed that the purpose of the scheme should be to influence *investment decisions*.[10] This position of the AEMC has created some confusion as to the scheme's intent, which we would urge the AEMC to clarify.

Turning to the size of the financial incentive that is provided, ETNOF remains of the view that different TNSPs should have some control over the size of the incentive that should apply to it, reflecting each TNSP's different appetite and capability of absorbing risk, as well as the uncertainty inherent in the performance benchmarks for the regulatory period ahead. Regarding this latter point, while reliable performance benchmarks can be set when the activities are largely unchanged from one period to the next, step changes in maintenance or capital expenditure can imply large forecast errors is performance benchmarks, and hence large risk to the TNSP (which risk is magnified as the incentive rate is raised). We consider this would best be accommodated by permitting the relevant TNSP to propose the size of the financial incentive as part of its revenue cap application, and to require the AER to accept the proposal unless it is unreasonable, having regard to criteria that are set out in the Rules. The key criteria in this regard should be a clear statement of the objective of the scheme (which, as discussed above, should be to influence *operational behaviour* rather than *investment decisions*), and the risk that the scheme is likely to create for the relevant TNSP.

We note in this regard that if the role of the scheme is constrained to influencing operational behaviour, that the size of the incentive that is required will depend upon the likely costs that would be incurred as a result of changing the delivery of maintenance or new projects in a manner that increases the availability of assets at times when they are most valued by the market. These changes in operational behaviour include:

- increased use of live working arrangements;

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[9] By way of example, clauses 6A.6.6(b)(2)(xi) and 6A.6.7(b)(3)(xi) recognise that the intent of the service incentive scheme may be to undertake maintenance or construction/commissioning of new projects out of hours, which may in turn increase the labour cost.

[10] AEMC, Draft Rule Determination, p.86.

- change of work practices to schedule outages in off peak times, including increased use of overtime and introduction of 3day/4day roster;

- outage coordination to maximise the opportunities for work when outages actually occur;

- increased use of helicopter services to reduce restoration times; and

- passing on incentives to optimise outages to construction and maintenance service providers.

An examination of the likely costs incurred to change operational behaviour in the manner desired would demonstrate that the level of incentives required to induce the behavioural change is well below the rate suggested in some submissions.

We consider that there should be clear criteria for setting the important elements of the scheme, most notably the determination of the performance targets that will underpin the rewards and penalties. We note that historical performance will provide a guide to future service performance if an entity is in a 'steady-state' position, but that large changes to the capital expenditure from one regulatory period to the next will lead to a change in the extent to which assets need to be taken out of service, which must be taken into account when setting performance benchmarks. The AER should be required to have regard to such factors when considering a TNSP's service incentive proposal.

Lastly, we consider that the scheme should apply in relation to *prescribed transmission services* rather than the *transmission system*. The latter includes services that are negotiable or contestable, for which the relevant service performance requirements are set out in contracts between the parties.

PROPOSED DRAFTING CHANGE

ETNOF proposes the following drafting changes:

- Rule 6A.7.4(b)-(c) should be amended as follows:

(b) The principles are that the service target performance incentive scheme should:

(1) provide incentives with respect to operational performance for each Transmission Network Service Provider to:

(i) provide greater *reliability* of the *prescribed transmission services* ~~*system*~~ that it provides ~~is owned, controlled or operated by it~~ at all times when *Transmission Network Users* place greatest value on the *reliability* ~~of the *transmission system*~~; and

(ii) improve and maintain the *reliability* of those aspects ~~elements~~ of the *prescribed transmission services* ~~*system*~~ that are most important to determining *spot prices*;

For the avoidance of doubt, providing incentives with respect to

network investment is not part of this principle.

(2) result in a potential adjustment to the revenue that the Transmission Network Service Provider may earn, from the provision of prescribed transmission services, in each regulatory year in respect of which the service target performance incentive scheme applies;

(3) ensure that the maximum revenue increment or decrement as a result of the operation of the *service target performance incentive scheme* will be no more than 5% of the *maximum allowed revenue* for the relevant *regulatory year*;

(4) take into account the regulatory obligations with which Transmission Network Service Providers must comply;

(5) take into account any other incentives provided for in the *Rules* that *Transmission Network Service Providers* have to minimise capital or operating expenditure; ~~and~~

(6) take into account the age ~~and~~ , ratings, nature and configuration of the assets used to provide prescribed transmission services~~comprising the relevant *transmission system*~~;

(7) take into account past performance and reasonably expected trends in the relevant *Transmission Network Service Provider*'s service performance given the forecasts of capital and operating expenditure over the upcoming *regulatory control period*;

(8) that any volatility in the *maximum allowed revenue* that would result from the scheme should be limited to a level that is appropriate, having regard to the *market objective*; and

(9) take into account the possible impact of forecast capital expenditure on plant availability.

(c) At the same time as it *publishes* a *service target performance incentive scheme*, the *AER* must also *publish* a menu of parameters (the *performance incentive scheme parameters*) for the scheme from which a *Transmission Network Service Provider* must, as part of its *Revenue Proposal*, propose parameters that satisfy the requirements of the scheme and the principles set out in paragraph (b). For the avoidance of doubt, the parameters may differ as between *Transmission Network Service Provider*s and over time.

(d) The *AER* must set out in each *service target performance incentive scheme* any requirements with which the values attributed to the *performance incentive scheme parameters* must comply, and those requirements must be consistent with the principles set out in paragraph (b). For the avoidance of doubt, the values may differ as between *Transmission Network Service Provider*s and over time.

…

- Rule S6A.1.3 should be amended as follows:

A *Revenue Proposal* must contain at least the following additional information and matters:

(1) an identification and explanation of any significant interactions between the forecast capital expenditure and forecast operating expenditure programs;

(2) for the *service target performance incentive scheme*, the *Transmission Network Service Provider* must provide:

(i) the selected *performance incentive scheme parameters* that the *Transmission Network Service Provider* proposes in accordance with 6A.7.4(c);

(ii) the values that the *Transmission Network Service Provider* proposes are to be attributed to the selected *performance incentive scheme parameters* in accordance with 6A.7.4(d);

(iii) the revenue at risk that the *Transmission Network Service Provider* proposes in relation to *service target performance incentive scheme* in accordance with 6A.7.4(e); and

(iv) ~~for the purposes of the application to the provider of the *service target performance incentive scheme* that applies in respect of the relevant *regulatory control period*, and~~ an explanation of how the proposed selected *performance incentive scheme parameters;* the proposed values proposed to be attributed to those parameters; and the proposed revenue at risk comply with any requirements relating to them set out in that scheme~~;~~.

…

2.5 Re-use of 'optimised' assets

The Rules should continue existing practice whereby assets that were previously excess to requirements and therefore written down or ascribed no value in the initial 'optimised depreciated replacement cost' may be re-included in the regulatory asset base when their changed use justifies that re-inclusion. Optimised assets may return to service at any future revenue review. As the issue is common to all TNSPs, it is not amenable to being addressed in transitional arrangements.

While ETNOF supports the roll-forward approach for updating the regulatory asset base associated with investments from time to time, all TNSPs have assets that were excess to requirements when the initial 'optimised depreciated replacement cost' valuations were determined. These assets were written down or ascribed no value.

Under existing practice, if these optimised assets subsequently become used (or used to a greater extent), they would be ascribed a value (or greater value) in the regulatory asset base, effectively reversing the 'optimisation' previously applied. The continuation of existing practice is essential to preserving the expectations of all parties when those optimisations were performed, and is also important to avoid perverse incentives for TNSPs to dispose of (or scrap) otherwise productive assets.

ETNOF notes that there is the potential for optimised assets to return to service at any future revenue review, and that the issue is common to all TNSPs. Accordingly ETNOF considers that this issue would best be dealt with in the main provisions of the Rules rather than in individual transitional arrangements.

PROPOSED DRAFTING CHANGE

ETNOF proposes the following drafting changes:

- Insert at the end of S6A.2.1(f):

(9) The previous value of the *regulatory asset base* must be increased by the value approved by the *AER* pursuant to rule S6A.2.X for return of *removed or excluded asset value* to the *regulatory asset base*.

- Insert between S6A.2.3 and S6A.2.4:

S6A.2.X Return of Optimised Assets to the Regulatory Asset Base

(a) As part of a *Revenue Proposal*, a *Transmission Network Service Provider* may propose that *removed or excluded asset value* be returned to its *regulatory asset base*.

(b) The *AER* must approve a *Transmission Network Service Provider's* proposal to return a *removed or excluded asset value* to the *regulatory asset base* if:

(1) the *removed or excluded asset value* has not previously been returned to the *regulatory asset base* (or any previous concept that was substantially similar to the *regulatory asset base*); and

(2) the excess assets or excess functionality that lead to the removal or exclusion of the asset values is now being usefully employed in the provision of *prescribed transmission services*.

- Insert in the definitions:

removed or excluded asset values

A value that was removed or excluded pursuant to a regulatory decision under the Rules or any previous economic regulatory regime applying to a *Transmission Network Service Provider* from that *Transmission Network Service Provider's regulatory asset base* (or any previous concept that was substantially similar to the *regulatory asset base*) on the basis that the asset or its functionality was wholly or partly in excess of that required, or prudently

incurred for, the relevant *transmission system*.

2.6 Efficiency carry-over for operating expenditure

The option for the AER to apply a negative carry-over is at risk of being inconsistent with the requirements placed on the AEMC under the NEL (and which requirements also apply directly to the AER). ETNOF considers that the AER should be required to consider whether a negative carry-over would meet the NEL requirements where the situation arises.

In addition, the Rules should prescribe further the matters that the AER needs to address in the guideline, most notably to set out the categories of operating expenditure that are (and are not) to be included in the carry-over.

While ETNOF supports many of the design features proposed for the calculation of the efficiency carry-over in relation to operating expenditure, ETNOF notes that the proposed principles advocate strongly the symmetric treatment of gains and losses in such a scheme.

Section 35(3)(a) and (c) of the National Electricity Law requires that Rules in relation to economic regulation of transmission systems that are made by the AEMC must:

> (a) provide a reasonable opportunity for a regulated transmission system operator to recover the efficient costs of complying with a regulatory obligation
>
> …
>
> (c) require the AER, in making a transmission determination, to make allowance for the value of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator, and the value of proposed new assets to form part of that transmission system, that are, or are to be, used to provide services that are the subject of a transmission determination

A negative carry-over means that the revenue requirement will be set at a level below the cost of service that is forecast (using the building block approach), which in turn means that the new revenue cap will:

- fail to permit a TNSP to recover the efficient cost of meeting its obligations over the regulatory period, thus creating a risk that the scheme would breach of section 35(a) of the NEL; or

- imply that the returns a TNSP expects to receive on the regulatory value of its past investments will be lower than the cost of capital, which could be interpreted as a reduction in the value of the those assets, hence also creating a risk that the scheme would breach section 35(c).

The same provisions apply directly to the AER. Hence a requirement for the AER to develop and apply a scheme that had the effect of applying a negative carry-over would carry a risk that the AER would also be required to breach the NEL directly.[11]

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[11] National Electricity Law, section 16(a), (c).

To ensure that the paramount obligations of the NEL are always met, ETNOF considers that the AER should be directed to consider whether the possibility (when designing the scheme) or occurrence (when implementing the scheme) of a negative carry-over would be consistent with the NEL. ETNOF is not proposing specific drafting changes to address this issue at this stage, but proposes to discuss the matter further with the AEMC before the Rule is finalised.

In addition, the certainty of the carry-over scheme would be enhanced substantially by requiring the AER to provide in its guideline full details of how the carry-over would be calculated in advance, including the categories of operating expenditure that would be included in the carry-over. By way of example, ETNOF expects that allowances for taxation, capital raising charges and allowances for self insurance would be excluded, but this should be clarified. In addition, an agreed treatment of network support payments and pass through items and the effect of new obligations that may not meet the requirements for a pass through also need an agreed position.

PROPOSED DRAFTING CHANGE

In relation to the last matter only, ETNOF proposes the following drafting changes:

- Insert between paragraphs (b) and (c) of rule 6A.6.5:

([x]) The AER must set out in each efficiency benefit sharing scheme:

(1) the categories of operating expenditure that would be included in, and the categories of expenditure that would be excluded from, the quantification of the efficiency gains or efficiency losses; and

(2) any events or circumstances which, if they occur may affect the quantum of a Transmission Network Service Provider's operational expenditure but which effects upon the quantum of operational expenditure are to be excluded from the quantification of the efficiency gains or efficiency losses.

2.7 Pass through arrangements (excluding grid support)

The proposed materiality threshold of 1 per cent of revenue unnecessarily limits the operation of the scheme. If the AEMC decides that a threshold for pass through applications is necessary, it would be more appropriate for the threshold to require an assessment of 'materiality' in the context of an individual pass through application. ETNOF also considers it appropriate for the Rules to permit additional pass through events to be defined during a revenue cap review.

ETNOF welcomes the inclusion of 'pass through' arrangements for a set of defined events (namely, for defined changes to insurance, service standards, taxes, a terrorism event and a defined change to grid support payments). However, ETNOF considers that two changes to the arrangements are appropriate.

Firstly, the proposed materiality threshold of 1 per cent of revenue amounts to more than $4 million per annum for the largest of the TNSPs.[12] As the rationale for having a threshold for pass through applications is to dissuade such applications where administrative costs exceed the benefits; ETNOF considers this threshold to be excessive. If the AEMC considers that a threshold for pass through applications is warranted, we consider that the Rules should simply require the pass through to be a 'material' amount, and to permit this to be determined having regard to the circumstances of an individual pass through application. Amongst other things, this would provide the flexibility to deal with multiple separate (but connected) events, events that may span two or more regulatory years, and other like matters that a prescriptive threshold may not adequately address.

Secondly, additional pass through events may also be appropriate for the unique circumstances of individual TNSPs. Therefore, ETNOF considers that flexibility should be allowed for additional pass through events to be defined during a revenue cap review.

PROPOSED DRAFTING CHANGE

ETNOF proposes that:

- the definition of *materiality* be re-drafted as follows:

For the purposes of the application of clause 6A.7.3, an event (other than a *network (grid) support event*) results in a *Transmission Network Service Provider* incurring materially higher or materially lower costs if:

(a) the change in costs (as opposed to the revenue impact) that the *Transmission Network Service Provider* has incurred and is likely to incur in any *regulatory year* of the *regulatory control period*, as a result of that event, exceeds 1% of the *maximum allowed revenue* for the *Transmission Network Service Provider* for that *regulatory year*; or

(b) either the *Transmission Network Service Provider* or the *AER* nominates a change in costs as a change and the other agrees.

- the definition of *pass through event* be re-drafted as follows:

Any one of the following events:

(a) an insurance event;

(b) a service standard event;

(c) a tax change event;

(d) a terrorism event; or

[12] ETNOF notes that any materiality threshold would not apply to grid support.

(e) any other event that is identified as a pass through event in the TNSP's Revenue Proposal, and approved by the AER as part of the revenue cap determination, for the regulatory period.

2.8 Guidelines and industry-wide reviews

A more robust process is required for the development and amendment of guidelines given the significance of the decisions that will be made therein. At a minimum, the AER should be required first to publish an issues paper and invite submissions and then be required to publish a draft guideline and invite a further round of comments. The time permitted for submissions should also be extended to a reasonable period, not less than 45 business days on the issues paper and a further 30 business days for submissions on the draft guideline.

It is also essential for merit review (as foreshadowed by governments) to apply to AER decisions to issue or change guidelines. ETNOF urges the AEMC to ensure that government officials are appropriately informed of the significance of the decisions that will be made in guidelines, and modify the legislation accordingly.

Furthermore, the Rules at present do not state how non-compliance with guidelines is to be treated, even in situations where compliance is not possible. Provisions to deal with such situations – and to avoid a case where arbitrariness in decision making is possible – need to be included in the Rules.

2.8.1. General observations

ETNOF supports the requirement for the AER to issue (binding) guidelines on a number of matters, noting that this was a central component of its Model Rules. However, the effect of the Draft Rules is that many important decisions will be made in the setting of those guidelines rather than in revenue cap reviews. We note, in particular, that the full suite of guidelines and industry-wide reviews will determine such matters as:

- the parameters to be used to derive the weighted average cost of capital for the companies, which is of fundamental commercial importance;

- the design of the incentive arrangements for operating expenditure and service performance, which will determine the extent to which the TNSPs are appropriately rewarded for efficiency gains and also have substantial implications for the risk that is borne; and

- the method that is used to translate regulatory asset values, forecasts of expenditure and the weighted average cost of capital into a stream of revenue – while this is a matter of some detail, different methods can mean material differences in allowed revenue.

Therefore, it is important that procedural and other requirements in the Rules that apply to the development of, and amendment to, guidelines are as robust as the procedural and other requirements that apply to revenue cap reviews.

ETNOF notes in particular that the AER and other regulators have commonly been tasked with the preparation of guidelines, statements of regulatory principle and the like. Generally these equivalent instruments in the energy industry have been subject to a more detailed consultation process comprising (in addition to the steps provided for in the Draft Rule) an issues paper and a second round of submissions. Each stage of the consultation process when applied to other such documents have typically resulted in significant improvements.

In particular, ETNOF considers that a more robust process should be mandated for the creation and subsequent amendment of guidelines required under the Rules. ETNOF notes that the current process envisages only one round of consultation (which need not necessarily be informed by a draft guideline) and provides little time for submissions to be produced (30 businesses days). At a minimum, ETNOF considers that the AER should be required to publish an issues paper that identifies the main issues to be considered and that invites views (and, where relevant, proposals) from stakeholders, and then be required to publish a draft guideline and invite a further round of comments. In addition, ETNOF considers that the minimum time that should be made available for submissions should be 45 business days on the initial issues paper and a further 30 business days for submissions on the draft guideline, with the overall timelines for the review extended to accommodate this.

Moreover, given the significance of the decisions that will be made outside of revenue cap decisions, ETNOF considers it essential for merit review (as foreshadowed by governments) to apply equally to AER decisions to issue and change guidelines. ETNOF urges the AEMC to ensure that government officials are appropriately informed of the significance of the decisions that will be made in guidelines, and aware of subsequent implications for the scope of merit review.

Lastly, ETNOF notes that the proposed date for issuing the first guidelines – the end of December this year – is not achievable under the current process for developing and changing guidelines. However, ETNOF considers it important for robust procedural arrangements to be applied for the development of all guidelines, and so considers that the time provided for the AER to issue initial guidelines should be extended to accommodate such a robust process. ETNOF considers that the most appropriate means for addressing timing issues for the forthcoming revenue cap reviews is through transitional arrangements that apply to the effected TNSPs.

2.8.2. Non-compliance with the submission guidelines

There may be circumstances in which it is not reasonably practicable (or even not possible) to comply with the submission guidelines. However, there is no provision made for this situation, but rather the rules proceed on the basis that a TNSP will ultimately provide a compliant submission.

The implications of non-compliance in circumstances where a TNSP cannot comply, or cannot reasonably practicably comply, are quite unclear. If the lack of any merits review of a decision to publish the submission guidelines is maintained, then the prospect for a particular provider that it may not be able to fully and technically comply with the submissions guidelines becomes greater and correspondingly the implications of non-compliance (rejection of expenditure estimates) become more acute.

Given the importance of the submission guidelines and the risks to a provider of non-compliance under the current drafting, it would be appropriate to provide that:

- a TNSP can make a submission that it is unable to comply with the submission guidelines and in such circumstances the AER may consider revisions to the requirements of the submissions guidelines in the case of that particular TNSP;

- in the event of non-compliance, the AER must still have regard to the information that is submitted, but in making its decision can have regard to the fact that the TNSP has not complied with the submission guidelines.

In a parallel issue, it is noted that the MCE proposes that leave to appeal may be refused unless the Australian Competition Tribunal is satisfied that the applicant, **without reasonable excuse**, failed to comply with any requests for information (or other requests or directions) made by the regulator in the primary regulatory proceedings. It is notable that even in this case the concept of reasonable excuse is included, recognising that there may be a reasonable basis for non-compliance with an information request.

PROPOSED DRAFTING CHANGE

ETNOF proposes the following drafting changes:

- Rules 6A.20(b) to (e) be amended as follows:

(b) If the *AER* is required to comply with the *transmission consultation procedures* in making, developing or amending any guidelines, models or schemes, or in reviewing any values or methodologies, it must:

(1) publish:

(i) an issues paper setting out all the issues the AER considers relevant to the guideline, model, scheme, amendment or revised value or methodology which is to be proposed;

(ii) an invitation for written submissions on the issues paper.

(2) following the expiration of the period for submissions on the issues paper, publish:

(i) the proposed guideline, model, scheme, amendment or revised value or methodology;

(ii) an explanatory statement that sets out the provision of the *Rules* under or for the purposes of which the guideline, model, scheme or amendment is proposed to be made or developed or the value or methodology is required to be reviewed, and the reasons for the proposed guideline, model, scheme, amendment or revised value or methodology; and

(iii) an invitation for written submissions on the proposed guideline,

model, scheme, amendment or revised value or methodology.

(c) The invitations for submissions must allow no less than:

(1) 45 business *days* for the making of submissions on the issues paper, and

(2) 30 *business days* for the making of submissions on the proposed guideline, model, scheme, amendment or revised value or methodology,

and the *AER* is not required to consider any submission made pursuant to ~~that~~ an invitation after ~~this~~ the relevant time period has expired.

(d) The *AER* may publish such ~~issues,~~ additional consultation and discussion papers, and hold such conferences and information sessions, in relation to the proposed guideline, model, scheme, amendment or revised value or methodology as it considers appropriate.

(e) Within 80 *business days* of *publishing* the document referred to in paragraph (b)(ii), the *AER* must *publish*:

(1) its final decision on the guideline, model, scheme, amendment, value or methodology that sets out:

(i) the guideline, model, scheme, amendment or revised value or methodology (if any);

(ii) the provision of the *Rules* under which or for the purposes of which the guideline, model, scheme or amendment is being made or developed or the value or methodology is being reviewed; and

(iii) the reasons for the guideline, model, scheme, amendment value or methodology; and

(2) notice of the making of the final decision on the guideline, model, scheme, amendment, value or methodology.

- A new provision to be inserted into 6A.10.2 to the following effect:

(ca) For the purposes of this Part E and Part C:

(1) where a provider considers that it can not reasonably comply with the submission guidelines it may make an application to the AER for a derogation from the application of the submission guidelines and the AER may consider such application and may determine a derogation from the submission guidelines in relation to that provider on such terms and conditions as the AER considers reasonably appropriate;

(2) in the event of non-compliance with the submission guidelines, the AER must still have regard to:

(i) information that is submitted in a revenue proposal but in making a decision under this Part E or Part C can have regard to the fact that the provider has not complied with the submission guidelines;

(ii) such information that is submitted in compliance with the submission guideline.

2.9 Averaging period for the risk free rates

The scope should be provided for the averaging period to be agreed between the AER and TNSP at the commencement of the revenue review, but kept confidential to reduce the risk of causing adverse movements in debt markets (and raising the TNSP's financing costs).

While ETNOF supports many features of the AEMC's proposed Rules in relation to the weighted average cost of capital, ETNOF notes that the proposal to prescribe the averaging period for the risk free rate in the Rules has the potential to increase the financing costs of TNSPs with no corresponding benefit.

In particular, a number of TNSPs raise their finance (or enter into derivative instruments) over the same period that the risk free rate is averaged as part of their risk management strategy. If the period over which the risk free rate is averaged – and this new debt finance is to be raised – is made public beforehand, there is the likelihood that financial market traders will seek to take advantage of the forthcoming debt issuance, a consequence of which is a higher cost of debt finance for the TNSP.

ETNOF proposes instead that the TNSP and AER reach agreement over the averaging period for the risk free rate at the start of the review, and that the TNSP have the option of keeping that date confidential until it has passed (i.e. the date would be published as part of the final decision). Such an approach would not erode the integrity of the method used to determine the risk free rate and would provide full transparency to stakeholders, while not adversely affecting the interests of TNSPs who seek to raise or hedge their debt in line with regulatory resets.

PROPOSED DRAFTING CHANGE

ETNOF proposes that:

- Rule 6A.6.2(c) be amended as follows:

(c) The nominal risk free rate for a *regulatory control period* is the rate determined for that *regulatory control period* by the *AER* on a moving average basis from the annualised yield on Commonwealth Government bonds with a maturity of 10 years using:

(1) the indicative mid rates published by the Reserve Bank of Australia;

and

(2) a period ~~of between 5 and 40 days~~:

~~(iv) which expires seven days before the publication of the *AER*'s final decision on the *Transmission Network Service Provider's Revenue Proposal* under clause 6A.13.3; and~~

(i) the ~~length of~~commencement and conclusion of which is ~~nominated~~ proposed by the relevant *Transmission Network Service Provider* in a confidential annexure to its *Revenue Proposal* and agreed to by the AER within 20 days from the lodgement of the *Revenue Proposal* (such agreement to be declined only if the proposed period is unreasonable); and

(ii) if the period proposed by *Transmission Network Service Provider* is not agreed to by the AER, such period as the AER specifies and notifies to the *Transmission Network Service Provider* prior to the commencement of that period.

- Amend clause Rule 6A.18.1(a) as follows:

"protected information" means the confidential annexure to a Revenue Proposal referred to in rule 6A.6.2(c), information in certified annual accounts…

3. Drafting issues with the Draft Rule

As noted above, ETNOF has also identified a number of concerns in relation to the detailed drafting of the Rules. While all of the matters identified raise substantial issues, ETNOF considers that these concerns reflect problems with the translation of the positions adopted in the AEMC's Draft Determination into Rules or other oversights, rather than differences of view about matters of principle.

3.1 Convention for recording the timing of capital expenditure – 'as incurred' vs. 'as commissioned'

As the AEMC would be aware, different standards are available for the time at which capital expenditure is taken as incurred, being:

- *as incurred* – which reflects the time at which the TNSP pays for the project are made, which generally occurs over its construction; and

- *as commissioned* – which reflects the time at which the asset enters into service (if this convention is used, then the cost of the project will need to include the cost of finance during construction).

The Draft Rule makes inconsistent statements about which of these conventions are to be adopted. By way of example:

- the definition of the regulatory asset base states that assets are only to be included 'to the extent they are used',[13] which appears to prescribe an 'as commissioned' convention; but

- the treatment of contingent projects envisages that part completed projects will be included in the regulatory asset base,[14] which assumes an 'as incurred' convention.

To the extent that the AEMC seeks to mandate either one of these conventions, the Rules should do so in a consistent manner.

PROPOSED DRAFTING CHANGE

ETNOF proposes that new provision be added to Part C to the following effect:

6A.[X] Timing of Capital Expenditure

Unless the context requires otherwise, in this Part C actual and forecast capital expenditure are taken to occur at the time the costs of that expenditure are incurred rather than any other time such as the time when assets are commissioned for service.

3.2 Avoiding ambiguity in the description of the regulatory asset base

The words 'but only to the extent that [the assets in the regulatory asset base] are used to provide [prescribed transmission services]' in clause 6A.6.1 are ambiguous and have at least three possible meanings:

- that if a TNSP invested in particular assets in previous periods but the assets were no longer 'used' that they should be excluded from the regulatory asset base (ie a process similar to the optimisation process that the ACCC undertook in the past);

- that assets should only be included in the regulatory asset base once they start being "used" and not earlier such as during construction or commissioning (ie that the regulatory asset base should be established on an "as incurred" basis rather than an "as commissioned" basis) – that would be inconsistent with the timing convention ETNOF proposes in the preceding section of this submission; or

- reflecting that the cost allocation process will allocate certain assets to other revenue streams (eg to negotiated services) rather than proscribed services.

Only meaning (iii) properly aligns with the Draft Determination and the other parts of the Rules, and the Rules should be amended to clarify this intention.

PROPOSED DRAFTING

ETNOF proposes that Rule 6A.6.1(a) be amended as follows:

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[13] Clause 6A.6.1(a).

[14] Clause 6A.6.7(d)-(h).

(a) The *regulatory asset base* for a *transmission system* owned, controlled and operated by a *Transmission Network Service Provider* is the value ascribed to those assets pursuant to these *Rules*, but only to the extent that the value ascribed to those assets is allocated to the provision of *prescribed transmission services* pursuant to these *Rules*~~*they* are used to provide such services~~.

3.3 Treatment of depreciation – roll-forward v.s. revenue cap

One of the policy changes the AEMC has made in the Draft Rule has been to include depreciation in the capex incentive mechanism (so that depreciation savings are treated as part of the benefit from underspending).

ETNOF notes, however, that the implementation of this policy change also requires changes to the principles dealing with depreciation to avoid ambiguity, most notable clause 6A.6.3(b)(2) – the clause that defines the total of depreciation charges over time. In particular, where depreciation is included in the incentive scheme:

- the depreciation allowances used to roll-forward the regulatory asset base over a historical period (i.e. using actual expenditure) will sum to the original cost of the asset, and so clause 6A.6.3(b)(2) will be met; but
- the depreciation included in the revenue cap will exceed or fall short of the original cost of the asset whenever actual capital expenditure differs to the forecast, and so clause 6A.6.3(b)(2) is unlikely to be met.

PROPOSED DRAFTING CHANGE

ETNOF proposes that Rule 6A.6.3(b)(2) be amended as follows:

(b) The depreciation schedules referred to in paragraph (a) must conform to the following requirements:

(1) except as provided in paragraph (c), they must depreciate the value of each asset or category of assets over the economic life of that asset or category of assets; and

(2) the sum of the real value of the depreciation that is attributable to any asset or category of assets over the economic life of that asset or category of assets (such real value being calculated as at the time the value of that asset or category of assets was first included in the regulatory asset base for the relevant *transmission system*) must be equivalent to the value at which that asset or category of assets was first included in the regulatory asset base for the relevant *transmission system* except to the extent that there is a difference between:

A. the depreciation allowance provided for in a *transmission determination* within the *regulatory control period* in which an asset is procured; and

B. the depreciation that would have applied in the *regulatory*

control period by applying the depreciation schedules approved in the *transmission determination* to the actual expenditure instead of the expenditure allowed for in the *transmission determination*.

3.4 Establishment of first year revenues

The Draft Rule requires the revenue cap for the first year of the new regulatory period to be established as a 'dollar amount'.[15] Actual inflation over the year to the quarter prior to commencement of the new revenue cap is unlikely to be available at the time of the final decision, which means that a forecast of inflation will be required to set the first year revenues. An inconsistency will also be created between how revenues are updated and the regulatory asset base is rolled-forward.

A more standard approach is to establish the revenue cap for the first year of the new regulatory period as a function of the previous year's cap, being raised for actual inflation once the relevant year of inflation is available and then with any one-off change implemented. This approach has the benefit of not requiring a forecast of inflation and allows consistency with the roll-forward of the regulatory asset base, and should be permitted (or required) by the Rules.

PROPOSED DRAFTING CHANGE

ETNOF proposes that rule 6A.5.3(c) be amended as follows:

(c) The *post-tax revenue model* must be such that:

…

~~(2) The maximum allowed revenue for the provider for the first regulatory year is expressed as a dollar amount;~~

(2~~3~~) the *maximum allowed* revenue for the provider for each *regulatory year* (~~other than~~including the *first regulatory year*) is calculated by escalating the *maximum allowed revenue* for the provider for the previous *regulatory year* using a CPI-X methodology;

…

3.5 Network support pass-through provisions

ETNOF has two concerns regarding the detailed drafting of the network support pass through provisions.

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[15] Clause 6A.5.3(c)(2).

First, the definition of a network support payment restricts the class of persons to whom such payments may be made to Generators or Customers,[16] whereas such services could be provided by other participants (such as an aggregator of demand side response, who may not also be a retailer and hence a Customer). ETNOF cannot see a need to restrict the definition of network support payment according to the identity of the participant (or non-participant) providing network support, and note that economic sources of network support may be excluded if the restriction remains.

Secondly, ETNOF notes that the procedures for passing through network support payments require the adjustment to be made after a year has ended, with the pass through then reflected in the revenue cap for the further subsequent year (i.e. two years after the occurrence of the network support pass through event). In contrast, the practice of some TNSPs has been to pass through an estimate of the network support pass through amount in the following year (i.e. which requires a pass through process to take place prior to the end of the relevant year), and then to allow any estimation error to be addressed in the subsequent year's revenue cap. ETNOF considers that the flexibility for network support amounts to be passed through as soon as possible – including for estimates to be used – should remain. It is arguable that the Draft Rule does not preclude this approach. However, it would be useful for the AEMC to clarify this point in its Final Determination.

PROPOSED DRAFTING CHANGE

ETNOF proposes the following drafting changes:

- The definition of network support payment should be re-drafted as follows:

A payment by a Transmission Network Service Provider ~~to:~~

~~(a) any *Generator* providing *network* support services in accordance with clause 5.6.2; or~~

~~(b) Customers;~~

for network support services to enable the safe and reliable operation of the *transmission system* owned, controlled or operated by that *Transmission Network Service Provider*."

3.6 Treatment of company taxation

While the AEMC clearly intends for the taxation calculation to be a benchmark calculation (rather than one that attempts to capture the actual taxation circumstances of an entity), the current definition of the 'estimated cost of corporate income tax' refers to an estimate of the 'Transmission Network Service Provider's taxable income'. ETNOF is concerned that this statement of the target for the estimate may inadvertently sanction (or require) an examination of an entity's actual taxation affairs. ETNOF considers that the relevant definition should be clarified to ensure that

[16] Schedule 3, p.7.

the target for the estimation is a benchmark (i.e. that what should be estimated is the tax that would be paid by a firm in the same position as the relevant TNSP).

PROPOSED DRAFTING CHANGE

ETNOF recommends that the definition of ETI_t in Rule 6A.6.4 should be amended as follows:

ETI_t is an estimate of the ~~Transmission Network Service Provider's~~ taxable income for that *regulatory year* that would be earned by a benchmark efficient entity as a result of the provision of *prescribed transmission services* as determined in accordance with the *post-tax revenue model*.

3.7 Threshold for the 're-opener' provision

ETNOF notes that one of the criteria required to permit a re-opening of the revenue cap in accordance with rule 6A.7.1 is that the event 'could not reasonably have been foreseen'. While the AEMC clearly intends that the hurdle for obtaining this form of re-opener is high, the requirement for something to not have been 'foreseen' is likely to prevent the clause from ever having application, as even highly remote possibilities could be reasonably foreseeable. ETNOF also notes that the quantitative threshold for such a reopening would limit the application of the clause to extremely unlikely events already.

An amendment to the clause that changes the reference to the event not being 'reasonably foreseeable' to one that was not 'reasonably anticipated' would remedy this concern.

PROPOSED DRAFTING CHANGE

ETNOF proposes that the reference to 'foreseen' in rule 6A.7.1 be amended to 'anticipated'.

3.8 Confidential information provided under the submission guidelines

The submission guidelines can require the production of information that is confidential and which can be released by the AER without any specific consideration of whether the information should be kept confidential (nor any criteria for guiding this decision). The Draft Determination discusses the issue of the non-voluntary release of confidential information in the context of the AER's information powers.[17] In this regard, it notes certain safeguards, stating as follows:

> Specifically, under the Draft Rule the AER has the power to publish confidential information provided by TNSPs (or another party), even in the absence of written consent, provided that the following conditions are all met:
>
> - the AER must be of the opinion either that the disclosure of the information would not cause detriment to the party that provided it or, if it would cause detriment, that this detriment is outweighed by the public benefit from disclosing that information;

[17] Draft Determination, Op. Cit., at 8.4.3.2, p 119.

- information can only be published where it relates to the AER's regulatory functions set out in clause 6A.17.1(d));
- the information is published in an aggregated form so that particular participant information cannot be identified; and
- the AER must inform the TNSP via a notice at least 28 days prior to publication of the information and form and timing of that information to be published.

Under the Draft Rule, the AER will have the power to publish information provided by TNSPs (or another party) in aggregate form only. Restricting the AER's publication power to publish aggregated information only, addresses concerns regarding the release of confidential information.

The Commission believes that these restrictions will allow adequate information to be available to the regulator and stakeholders, while ensuring appropriate limitations on confidential information.

These principles are given effect in rule 6A.18.3.

ETNOF considers that it would be appropriate for the AER to have regard to the same principles set out in rule 6A.18.3 when formulating its submission guidelines and also to provide a process for making and assessing confidentiality claims.

PROPOSED DRAFTING CHANGE

ETNOF proposes that a new provision to be inserted into 6A.10.2 to the following effect:

(ba) The AER must determine whether information required to be provided in compliance with the submission guidelines is to be treated as confidential or non-confidential. In determining that information is to be treated as non-confidential:

(1) the AER must be satisfied that the disclosure is reasonably necessary for a purpose of this Part E;

(2) the AER is to consider whether that information may be published in an aggregated or otherwise reprocessed form; and

(3) the AER must be satisfied that:

(i) in relation to the provider:

(A) the disclosure of the protected information would not cause detriment to the provider; or

(B) although the disclosure of the protected information would cause detriment to the provider that provided it, the public benefit in disclosing it outweighs that detriment; and

(ii) in relation to any other person who has provided the provider with information or documents that form part of the protected information, that:

(A) the disclosure of the protected information would not cause detriment to that person; or

(B) although the disclosure of the protected information

would cause detriment to that other person, the public benefit in disclosing it outweighs the detriment, and the procedures set out in paragraphs (b) and (c) have been followed.

3.9 PTRM guidance

There are two second order issues that we have identified with the guidance to the AER regarding the contents of the PTRM set out in rule 6A.5.3(b), which are:

- Subclause (1) includes the following words that should be redundant and therefore be deleted: 'a methodology that the AER determines is likely to result in…'. All the items in clause 6A.5.3(b) are to be determined by the AER and there is a risk by including these words that the AER will have an additional level of discretion in the determination of expected inflation.

- Subclause (2) includes the words 'the associated discount rates'. There is a risk that this could be interpreted as the AER being required to provide fixed discount rates in the PTRM rather than that the PTRM identifies the method for working those out as part of each TNSP's revenue cap proposal and decision.

PROPOSED DRAFTING CHANGE

ETNOF proposes that Rule 6A.5.3(b) be amended as follows:

The post-tax revenue model must specify:

(1) a methodology ~~that the AER determines is likely to result~~ for establishing ~~in~~ the best estimates of expected inflation;

(2) the timing assumptions and the way in which the associated discount rates are to be obtained that are to apply in relation to the calculation of the building blocks referred to in clause 6A.5.4;

…

3.10 Treatment of the transfer of responsibilities from the ACCC to AER

It is noted that the Draft Rule does provide a form of saving in relation to arrangements between TNSPs and the AER in relation to roll forward of the regulatory asset base and other adjustment mechanisms (see Rules 11.5.9, 11.5.10 and 11.5.12 (under heading 'Roll forward of regulatory asset base'). However, this provision refers explicitly to the AER, and may not capture existing arrangements that were made with the Australian Competition and Consumer Commission (the predecessor to the AER). The savings provision should be amended to clarify that it does also apply to existing arrangements entered into with the ACCC.

PROPOSED DRAFTING CHANGE

The references to 'the *AER*' in Rules 11.5.9, 11.5.10 and 11.5.12 should be amended 'the *AER* or *ACCC*'.

3.11 Application of inflation to the regulatory asset base

While the Draft Rule clearly envisages that the regulatory asset base would be adjusted for inflation over time, and this is provided for where the regulatory asset base is to be *projected* during a regulatory period, the criteria for adjusting the regulatory asset base over an *historical* period (Rule S6A.2(f)) do not mention an adjustment for inflation.

ETNOF considers that this is an oversight that needs to be remedied.

PROPOSED RE-DRAFTING

ETNOF considers that a clause that is equivalent to Rule S6A.2.4(4) should be included in Rule S6A.2.2, as follows:

(9) The previous value of the regulatory asset base must be increased by an amount necessary to maintain the real value of the regulatory asset base as at the beginning of the later year by adjusting its value for inflation.

ATTACHMENT A

FURTHER INFORMATION ON POTENTIAL CONTINGENT PROJECTS

Powerlink

If the new revenue rules were applicable to Powerlink during its current revenue determination, then 5 per cent of RAB (proposed at $3,796 million at 1 July 2007) would be a project with an expected value of $190 million.

Of note is that none of the projects Powerlink has included in its proposed list of contingent projects have forecast expenditure which would exceed this threshold. Below are two examples of projects which were included in Powerlink's Revenue Proposal for 2007–12 which are well below the AEMC proposed threshold. Both these projects present inappropriate risks to Powerlink. The trigger for one of the projects has arguably just occurred. Neither of these projects would meet the AEMC proposed threshold, yet one has already been triggered and the other has a high level of uncertainty and could have an inappropriate impact on Powerlink's financial position if the upper end of the estimated range was required after assessment in accordance with the regulatory test.

Desalination plant in SEQ

Brisbane and the south east Queensland area is short of water from dams. The Gold Coast City Council (GCCC) requested ENERGEX to provide information on electricity supply availability for various sites (15) being considered in the feasibility study for the Desalination Plant. ENERGEX identified the specific requirement for supply for each site and the earliest timing to deliver the associated assets.

For the Coombabah option, it is expected that a third Powerlink 110/33kV transformer would be required at Molendinar Bulk Supply Substation to maintain N-1 conditions for the loss of one of the other two units. Another location discussed for a desalination plant is in the Sunshine Coast area which would require a new 275/110kV injection at Caboolture. At the time of Powerlink's Revenue Proposal a contingent project was estimated to cost $35 million.

The trigger for this project was commitment of a large desalination plant in the south east Queensland area requiring transmission augmentation. This trigger has arguably just recently occurred already. The Queensland government has recently announced that a large water desalination plant will be constructed at Tugun on the Gold Coast by late 2008. The demand to be supplied is up to 70MVA, which is substantial relative to the Gold Coast load. This large additional load on the Gold Coast was not included in the 2005 load forecast on which Powerlink's Revenue Proposal capex was determined. The network augmentation required to supply this additional load is currently being determined.

Nebo to Moranbah 275kV DCST & Lilyvale to Dysart 132kV SCST

Ergon has provided information on anticipated loads and growth from all Major Mining Customers in the Bowen Basin area, including Anglo Coal, BMA and Rio Tinto. All are reasonably confident that expansions will continue for at least the next

5 years in the coal industry (there are more than $6 billion of coal mining and minerals expansions underway in the region). This expansion will require reinforcement of the network into the Moranbah and Dysart areas.

The trigger for this contingent project pair is an additional 50 MW mining demand (above the 2005 demand forecast levels) to be supplied in the Bowen Basin area. That additional demand will overload the 132 kV supply network and trigger an investigation and consultation for augmentation of the transmission system. The preferred network solution could be Nebo – Kemmis or Nebo – Moranbah depending on the magnitude and location of the new mining demand. Costs can therefore range from approximately $17-115 million.

TransGrid

The AEMC draft Rules propose a contingent project threshold of 5 per cent of RAB. For TransGrid, the AEMC's proposed contingent project threshold means that a project can only become eligible if it is expected to cost between about $190 million and $200 million (expected opening RAB value at the next reset decision is between $3.8 billion and $4 billion).

TransGrid has recently completed, or is actively investigating, a number of projects to increase the transfer capability along national flow paths, including:

- Snowy to Victoria Upgrade ($44 million, completed);
- QNI Upgrade – relief of northern 132kV line limits ($10-15 million, investigating);
- QNI Upgrade with series capacitors ($100-120 million, investigating);
- Snowy to Victoria Upgrade by 180MW ($95 million, investigating);
- Victoria to Snowy Upgrade ($60 million, investigating); and
- Snowy to NSW Upgrade ($20-100 million, investigating).

If a revenue cap application was lodged by TransGrid at the present time, none of the prospective projects on the attached list would have completed a regulatory test assessment. However, all are being actively considered via the Inter-regional Planning Committee (IRPC) as part of the annual process for reviewing and reporting on national transmission flow paths via the Annual National Transmission Statement (ANTS). The QNI upgrade has also been examined in detail by TransGrid and Powerlink and may subjected to a formal regulatory test process shortly.

In most cases detailed costing of options, and the likelihood of these projects proceeding (except, perhaps the QNI upgrade) is impossible to assess with confidence. The implications of this are that it would be unlikely that TransGrid could persuade the AER, or its advisers, at the present time, to recognise a specific provision for these projects as reasonable.

While an ex ante regime provides incentives for TNSPs to deliver projects in an efficient manner, it also provides tangible incentives to defer discretionary projects, such as new interconnector developments. To take a relevant example, while the exact cost of the Snowy to NSW upgrade project is currently uncertain, and the prospects of this project proceeding cannot yet be determined, this situation is expected to change within about 12 months. Aerial laser surveys are being progressively carried out to determine the scope and cost of line up-ratings. The survey results will inform the regulatory test assessment of upgrade options and it is quite feasible that an upgrade option would pass the market benefits limb of the regulatory test. The nature of the work is that expenditure on this project could commence in about two years.

However, absent a contingent project regime, the likelihood is that the project could not proceed immediately when it passes the regulatory test. If the project was commenced within the regulatory period, TransGrid would need to finance the project for up to three years, which would cost in excess of $5 million in foregone returns and regulatory depreciation. This would most likely be unacceptable to TransGrid's shareholders and Board.

It is noted that the interconnector project that did proceed – the Snowy to Victoria Upgrade – was constructed under the ex post regime, under which TransGrid is compensated for the foregone earnings and depreciation during the regulatory period in which the project commenced. This compensation, in turn, removed the disincentive against timely commencement of the project, so that a contingent project regime was not required.

ATTACHMENT B

MEMORANDUM FROM GILBERT+TOBIN

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Dr John Tamblyn
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Dear Dr Tamblyn

Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006

We have been requested by the Electricity Transmission Network Owners Forum to review the framework for review and approval of expenditure forecasts contained in the Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 issued by the Australian Energy Market Commission (**the Commission**).

We understand that the proposed rule 6A is intended to provide a regulatory framework in which a Transmission Network Service Provider (**TNSP**) provides an estimate of its reasonable capital and operating expenditure requirements and the Australian Energy Regulator (**AER**) is then required to exercise its regulatory judgment to determine whether the estimates are reasonable or not, having regard to specific criteria and certain evidentiary matters. We understand that what is intended is that where the AER determines the estimates to be reasonable they must be accepted in the proposed revenue cap. Where the AER determines the estimates not to be reasonable, the AER then determines its estimate of the reasonable expenditure requirements and that estimate is to apply.[1]

This framework reflects the Commission's "fit for purpose" approach set out in the Draft Rule Determination. However, from our review, it appears that the drafting of the operative provisions for review and approval of expenditure estimates, draft rules 6A.6.6 and 6A.6.7, do not conform to the Commission's principles in relation to the regulatory framework, as set out in its Draft Rule Determination.

In particular, for the reasons set out below, the current drafting of 6A.6.6 and 6A.6.7 leave open, in an apparently unintended way, the potential for the arbitrary rejection of a TNSP's expenditure estimates, with no real prospect of recourse to review proceedings.

This apparently unintended consequence can be remedied through relatively straightforward and minor drafting revisions.

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[1] This framework can be seen in the provisions of rule 6A.14(2) and 6A.14(3) which appear to envisage, without requiring, that the AER draft and final decisions will contain a determination as to whether expenditure estimates are reasonable or not reasonable and, in the case that it determines the estimates are not reasonable, that will then include the AER's estimates and its reasons for that conclusion.

In this advice, we:

- review the framework for assessment of expenditure forecasts under the proposed rules;
- analyse the operation of that framework against the Commission's fit for purpose regulatory approach as set out in the Draft Rule Determination;
- propose revisions to align the drafting of 6A.6.6 and 6A.6.7 with the Commission's fit for purpose regulatory framework; and
- assess the consistency of our revisions with the Commission's intention to give primacy to the regulatory judgment of the AER in reviewing expenditure forecasts, in light of the appeal framework proposed in the recent Ministerial Council on Energy decision.

Overview of Framework for Assessment of Expenditure Forecasts

Draft rules 6A.6.6 and 6A.6.7 provide that a TNSP must submit, as part of its revenue proposal, a forecast of the operating expenditure (6A.6.6) and a forecast of the capital expenditure (6A.6.7) for each regulatory year of the relevant regulatory control period which the TNSP considers is reasonably required in order to:

(1) efficiently meet the expected demand for prescribed transmission services over that period;

(2) comply with all applicable regulatory obligations associated with the provision of prescribed transmission services;

(3) maintain the quality, reliability and security of supply of prescribed transmission services; or

(4) maintain the reliability, safety and security of the transmission system through the supply of prescribed transmission services.

The remainder of 6A.6.6 and 6A.6.7 provide for the review of those forecasts by the AER and set out certain matters that the AER is to take into account. The matters the AER is to take into account are an eclectic mix of information, submissions, analysis and factors that may inform the assessment of the reasonableness of the proposed estimates.

The TNSP's forecasts are to be considered by the AER in making its draft decision. Pursuant to 6A.12.1(c) , if the AER refuses to approve the amounts or values referred to in 6A.14.1(1) it must include details of the changes required to be addressed before the AER will approve those amounts. Draft rule 6A.14.1(1) includes the total revenue cap and hence if the AER does not approve the forecast estimates of operating and capital expenditure which form part of the revenue cap, it is expected that it would not approve the revenue cap and would be required to state the changes to those estimates that would be required.

At the final decision stage, the TNSP can either accept the AER's required changes or could persist with its initial estimates. At this stage, in making the final decision, and pursuant to 6A.13.2, if the AER refuses to approve an amount or value in 6A.14.1(1), then one of two rules apply. The general rule that applies to all matters other than forecasts of operating and capital expenditure is that the AER is to substitute the amount or value which is determined on the basis of the revenue proposal and amended from that basis only to the extent necessary to enable it to be approved in accordance with the rules.

Importantly, there is a significantly more relaxed rule which applies to the AER (and is clearly intended by the Commission to apply) for expenditure estimates. If the AER is not satisfied that the forecast operating and capital expenditure is reasonably required it may use its own estimate and is not required to use the revenue proposal as a basis for the assessment of what is reasonable.

Notwithstanding the provisions in relation to draft and final decisions, it is 6A.6.6 and 6A.6.7 that set up the operative decision making process and the decision making rules to be applied by the AER in assessing the TNSP's expenditure forecasts. Applying 6A.6.6 and 6A.6.7, for a TNSP to have its forecast operating and capital expenditure estimates approved in a draft or a final decision the AER must make a positive determination that the estimate is reasonable taking into account the range of matters referred to above.

Importantly, if the AER does not make that determination, the TNSP forecasts do not apply. Further having regard to the specific treatment of expenditure forecasts in rule 6A.13.2, the AER need not consider the TNSP's estimates in reaching its estimate.

Commission's Fit for Purpose Regulatory Framework

It is clear that the Commission intends that the AER be responsible for exercising regulatory judgment as to whether proposed capital and operating expenditure forecasts are reasonable.

This is consistent with the "fit for purpose" approach set out in the Commission's Draft Determination, in which there is a selection, as appropriate between codification of elements of regulatory decisions and leaving certain matters open for the exercise of regulatory judgment.

The Commission's approach is set out at 1.4 of the Draft Rule Determination (at p 7) as follows:

> The Commission also understands that there are significant areas of regulatory decision making that should involve the exercise of judgment and discretion by the regulator. This is because good economic regulation should be sufficiently flexible to adapt to the individual circumstances of regulated businesses across different periods of time. Areas of flexibility and discretion also allow the regulatory process to evolve with experience and learning.
>
> …
>
> The Commission has also concluded that there is significant benefit in specifying in Rules the methodology for the determination of revenue caps. The Commission considers that the mechanics of the building block approach are well understood and have been adopted by economic regulators in Australia and overseas for over 10 years. In these circumstances the Commission sees few if any risks to good regulatory outcomes from codifying the building block methodology in the Rules.
>
> However, the Commission has carefully considered a number of concerns expressed by the AER about components of the building blocks which it believed to have been detailed to an inflexible degree in the Proposed Rule. In a number of areas the Commission agrees with the AER and has reduced the level of codification of those elements in the Draft Rule. This is particularly the case in relation to the operation of the incentive mechanisms (as discussed further below).
>
> Where significant areas of judgment are required, the Proposed Rule also specified criteria for making those decisions. For instance, the reasonable estimate basis for the determination of capital and operating expenditure forecasts is an example of the Rules providing appropriate decision making discretion to the

> regulator (given the inherent uncertainty of such forecasts) with specific guidance on how that discretion is to be exercised. This approach has been maintained in the Draft Rule.

Consistent with this approach, in those areas where particular matters have been left unspecified, the TNSP is required to make a proposal and the AER is then required to exercise regulatory judgment as to whether what is proposed is appropriate having regard to the specified criteria.

No doubt the reference above "to specified criteria for making those decisions" is to provide guidance to the TNSP in making its proposal and to the AER in exercising its regulatory judgment. In addition, specifying criteria remove suggestions of arbitrariness in decision making.

In this regard, we note the Commission's stated view (at p 48 of the Draft Rule Determination) that where legal rules confer discretion on regulators those legal rules should also specify the criteria to be applied in exercising the discretion. The Commission stated that:

> The Rules should specify the basis for determining various components of the building block methodology and where the assessment of a component requires the exercise of judgement the Rules should specify criteria for exercising that judgement.
>
> Unless decision making criteria are determined *ex ante* and are transparent there is a risk that the exercise of discretion by a regulator is perceived to be arbitrary, increasing the degree of regulatory risk for investment and undermining confidence in the ….

We agree with the Commission that where the regulatory framework relies on regulatory judgment there should be specified criteria for the making of that judgment. Specifying criteria is important to avoid the potential for arbitrary decisions. In addition to the specified criteria, the procedural aspects of the decision making process are also important and should be drafted so as to avoid the potential for arbitrary decisions. In this regard, the Commission (at p 41 of the Draft Rule Determination) observes that:

> There are at least three reasons why good regulatory design involves rules which provide guidance or criteria for the exercise of discretion. Firstly, if discretion is unguided there is uncertainty about how it will be exercised. This increases the risks for investors associated with the future exercise of regulatory decision-making.
>
> Secondly, if discretion is unguided it may be applied very differently in different cases even where the underlying circumstances of the regulated business and business environment are relevantly the same. In these circumstances regulatory decision making can appear arbitrary, bringing the regulatory regime into disrepute.
>
> The third reason why rules may appropriately contain guidance for the exercise of regulatory discretion is that regulation and regulators are not infallible. If regulators have unguided discretion in the context of making decisions and the economic regulation of a business, they may adopt interpretations or deliver outcomes that are not reasonably within the scope of a balanced approach to regulation.

Analysis of Draft Rules 6A.6.6 and 6A.7

However, contrary to the approach outlined above, the drafting of 6A.6.6 and 6A.6.7 would enable a TNSP's expenditure forecasts to be bypassed (in the sense of not being accepted) arbitrarily[2] and the TNSP would have little or no effective recourse to review an AER determination as to its forecast estimates. This outcome would appear to run contrary to a propose/respond regulatory decision making procedure.

As drafted, under 6A.6.6 and 6A.6.7, the AER is not actually required to make a determination as to whether the estimates provided are reasonable or not. While a determination of this issue is a pre-condition for the acceptance of the estimates, there is actually no requirement for the AER to make a determination on this matter. This appears unintended as 6A.14.1, which is headed 'contents of decisions' and relates to both final and draft decisions, envisages that the decision will contain either a positive or negative determination by the AER. However, there is simply no provision requiring the AER to make such a determination.

A decision maker that reached the position that it was simply unable to form a view as to whether the estimates were reasonable or not reasonable, could simply say that it is not satisfied that, and therefore will not determine that, the estimate provided is reasonable.

The prospect of this occurring is compounded because the matters to be taken into account by the AER as set out in 6A.6.6(b)(2) and 6A.6.7(3) are unclear and tend confuse criteria as to what is reasonable (which should be the matters set out in 6A.6.6(a) and 6A.6.7(a) which govern the TNSP in determining reasonable estimates) with evidentiary matters.

In determining whether the estimates are reasonable, the AER is not specifically required to consider the criteria in paragraph (a) but is given a separate list which contains only one of the elements of paragraph (a) and a range of other matters, which are largely evidentiary or procedural. The provision is drafted so that some element of evidential or procedural non-compliance may lead to the AER not making any determination in relation to the forecast estimates.

Further, by including the procedural requirement of compliance with the submission guideline (see 6A.6.6(b)3 and 6A.6.7.(c)) as a matter upon which to accept the estimate, an estimate could be rejected simply because of technical non-compliance with the submission guideline. Given the broad and as yet unspecified scope of submission guidelines, it is not possible to say to what extent practical compliance with such guidelines will be achievable. It may be that full technical compliance is not achievable, but substantive compliance is. In these circumstances, rejection of the forecast estimates on the basis of non-compliance with the submission guideline is unnecessarily harsh in its application. It is particularly unnecessary as the appeal framework proposed by the MCE (referred to below) provides considerable incentive for a provider to fully comply to the extent that it can with the information requirements of the regulator (as this is a ground on which leave to appeal can be refused.)

Nor does it appear to be appropriate for an estimate to be rejected (or not accepted) on the basis of material that has not been brought to the attention of the TNSP. In this regard, it would appear appropriate that if the AER is to have regard to material in making its final decision, it should bring that material to the attention of the TNSP, even if this is done through the mechanism of the draft decision. It seems particularly inappropriate that the AER can take into account analysis undertaken for or by it in not accepting a forecast expenditure estimate, where that analysis may be published for the first time in the final decision.

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[2] This is not to say that the AER would do so, simply that the drafting of the rules would permit that to happen.

The practical effect of the current drafting of 6A.6.6 and 6A.6.7 is that a provider's proposal can basically be bypassed without any substantive consideration as to whether it is unreasonable and on the basis of material that the TNSP is unaware of. In this situation, the AER is then free to determine its own estimate.

If the AER does not accept the proposed estimates, it is required to apply the criteria in 6A.6.6(a) and 6A.6.7(a). However, the AER need only generally consider the criteria in 6A.6.6(a) and 6A.6.7(a), and form its own view as to what is reasonably required. Importantly, the AER is not actually required to consider information submitted by the provider or any of those matters that it can take into account in reviewing the TNSP's estimates. Even an estimate which may be unreasonable, is unlikely to be unreasonable in all respects, yet the AER is not required to consider the TNSP's estimates in any respect.

The ease with which a proposal may be bypassed, and the wide latitude the AER has to arrive at its own estimates, appears inconsistent with the fit for purpose/propose respond model of regulation proposed for these items.

As noted above, it may be that this is actually an unintended consequence of the way in which 6A.6.6 and 6A.6.7 have been drafted. It appears from 6A.14.(2) and (3) that it was intended that:

- the AER is to determine whether the estimates are reasonable **or not**; and
- where the AER adopts its own estimate as a reasonable estimate, it is to have regard to the various information and submissions, including the TNSP's revenue proposal, that it must have regard to in determining whether the estimate is reasonable.

However, the drafting of 6A.14(2) and (3) does not specifically mandate that approach, and the drafting of 6A.6.6 and 6A.6.7 together with 6A.13.2, as noted above, gives wide latitude to ignore an estimate without actually reaching the view that it is unreasonable.

Given the above observations, in our view, it would be appropriate to make clear that:

- the decision maker should be required to determine whether the estimates are or are not reasonable, having regard to the relevant criteria and taking into account the various matters specified in 6A.6.6 and 6A.6.7, and not ignore what has been proposed on the basis that it is "not satisfied" that the estimate is reasonable without determining that it is unreasonable;
- non-compliance with a technical procedural requirement, particularly which may not be material to the assessment of reasonableness of the forecasts, should not permit the decision maker to reject what has been proposed without substantive consideration; and
- the criteria that apply, and the material that the AER is to have regard to, when the AER assesses the proponent's estimates should apply equally when it is reaching an alternative estimate.

Suggested Approach is Consistent with Primacy of AER Regulatory Judgment

These suggestions are not intended to, and do not, provide for second guessing of AER regulatory judgment. In fact, the proposed appeal framework for AER decisions in this area gives clear primacy to regulatory judgment and mitigates second guessing.

In this regard, it is important to note the limited scope to review an AER determination. The MCE proposal for merits review[3] of AER pricing and revenue determinations for transmission gives fundamental primacy to the regulatory judgment of the AER. AER decisions will only be subject to merits review on the following grounds:

- that the decision maker made an error of fact and that fact was material to the decision;
- that the exercise of the decision maker's discretion was incorrect having regard to all the circumstances; or
- that the decision maker's decision was unreasonable having regard to all the circumstances.

Clearly the exercise of regulatory judgement does not constitute a factual error and is not reviewable.[4]

Nor does the concept of reasonableness permit second guessing of regulatory judgment. For example, the Full Federal Court recently held in a decision setting aside a decision of the Australian Competition Tribunal varying the exercise of a discretion by the ACCC in relation to the Gas Code that:[5]

> …if the ACCC has exercised its discretion on correct principles and if the particular exercise of the discretion was open to it within the framework of the Code, the Tribunal is not empowered to set aside that decision simply because it thinks another decision would have been preferable. This is emphasised by the provision in s 39 (2)(a)(ii) of the ground of review based on unreasonableness. The exercise of a discretion is not unreasonable simply because another decision-maker would have come to a different view. On the other hand unreasonableness in s 39(2)(a)(ii) is not limited to cases in which the exercise of a discretion was so unreasonable that no reasonable person could have so exercised it.
>
> …
>
> The concept of unreasonableness imports want of reason. That is to say the particular discretion exercised by the ACCC is not justified by reference to its stated reasons. There may be an error in logic or some discontinuity or non sequitur in the reasoning. It may be that the decision has an element of arbitrariness about it because there is an absence of reason to explain the discretionary choices made by the ACCC in arriving at its conclusion."

Furthermore, the MCE proposes that leave to appeal may be refused unless the Australian Competition Tribunal is satisfied that the applicant, without reasonable excuse, failed to comply with any requests for information (or other requests or directions) made by the regulator in the primary regulatory proceedings.

Suggested Revisions

We have enclosed a proposed revision to 6A.6.6 and 6A.7, with consequential amendments to 6A.13 and 6A.14 to reflect the comments above. The proposed revisions provide that:

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3 *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks, Decision*, Ministerial Council on Energy, May 2006.

4 See *TXU Electricity Ltd v Office of the Regulator-General* [2001] VSC 153 at [312-7]; see also the decisions of the Victorian Appeal Panel dated 17 February 2006 in appeals by United Energy Distribution Pty Ltd and Powercor Australia Ltd against determinations of the Essential Services Commission.

5 *Australian Competition and Consumer Commission v Australian Competition Tribunal* [2006] FCAFC 83 at [176], [178]

- The *AER* must determine whether or not the forecast expenditure included in a revenue proposal is reasonably required having regard to the criteria in 6A.6.6(a) and 6A.6.7(a).
- In determining whether or not the forecast expenditure included in a revenue proposal is reasonably required having regard to those criteria, the AER must take into account:
    - the information included in or accompanying the submission of the revenue proposal or any revised proposal; and
    - submissions received in the course of consulting on the revenue proposal.
- Where the AER proposes to have regard to analysis undertaken for or by it, it must publish that prior to the final (but not the draft) decision.
- Where the AER proposes to take into account any of the various evidentiary matters specified in the draft rule in a final decision it shall only do so following disclosure of those matters to the provider and after having afforded the provider a reasonable opportunity to make submissions in relation to those matters.
- The AER may have regard to the extent to which the expenditure forecasts, and the information provided in relation to them, comply with the requirements of the submission guidelines made under 6A.10.2, but that non-compliance would not be a reason for rejection of those estimates.

For completeness we have also incorporated amendments to:

- include a standard of the prudent operator against which to assess expenditure; and
- make clear that the AER may take into account the extent to which forecast operating expenditure is referable to arrangements that are not non-arms length (and not just that might be non-arms length),

as proposed by the ETNOF in their principal submission.

Conclusions

With minor and relatively straightforward revisions to 6A.6.6 and 6A.6.7, and consequential amendments to 6A.13 and 6A.14, the Commission can achieve a framework in which:

- TNSP's propose reasonable estimates of forecast expenditure for assessment by the AER;
- The AER has the primary task of assessing those estimates and exercising its regulatory judgment as to their reasonableness or otherwise;
- The criteria and the matters the AER must take into account are well specified and the prospect of arbitrary decisions is removed; and
- If the estimates are not, in the AER's opinion, reasonable the AER can determine its own estimates against specified criteria and having regard to a well specified set of matters.

The above outcome is, in our view, consistent with the Commission's Draft Rule Determination and can be achieved by adopting our proposed revisions.

GILBERT TOBIN

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Kind regards

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6A.6.6 Forecast operating expenditure

(a) A *Revenue Proposal* must include a forecast of the operating expenditure for each *regulatory year* of the relevant *regulatory control period* which the *Transmission Network Service Provider* considers is reasonably required, by a prudent *Transmission Network Service Provider*, in order to:

(1) efficiently meet the expected demand for *prescribed transmission services* over that period;

(2) comply with all applicable *regulatory obligation*s associated with the provision of *prescribed transmission services*;

(3) maintain the quality, reliability and security of supply of *prescribed transmission services*; or

(4) maintain the reliability, safety and security of the *transmission system* through the supply of *prescribed transmission services*.

(b) The *AER* must determine whether or not the forecast operating expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required operating expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4).

(c) The *AER* must accept the forecast operating expenditure for each *regulatory year* as provided under paragraph (a) if:

(1) the forecast operating expenditure is for expenditure that is properly allocated to *prescribed transmission services* in accordance with the principles and policies set out in the *Cost Allocation Methodology* for the *Transmission Network Service Provider*;

(2) the total of the forecast operating expenditure for the *regulatory control period* as provided under paragraph (a) is determined by the *AER* to be a reasonable estimate of the *Transmission Network Service Provider's* required operating expenditure for the *regulatory control period*.

(d) In determining whether or not the forecast operating expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service* Provider's reasonably required operating expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4), the AER must take into account~~, taking into account~~:

(~~i~~1) the information included in or accompanying the *Revenue Proposal* or revised proposal;

~~(ii) the need to comply with all applicable *regulatory obligations* associated with the provision of *prescribed transmission services*;~~

(~~iii~~2) submissions received in the course of consulting on the *Revenue Proposal*.~~;~~

(e) In determining whether or not the forecast operating expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required operating expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4), the AER may take into account:

(~~iv~~1) such analysis as is undertaken by or for the *AER* and is *published* prior to or as part of the draft decision of the *AER* on the *Revenue Proposal* under rule 6A.12 or prior to the final decision of the *AER* on the *Revenue Proposal* under rule 6A.13 (as the case may be);

(2~~v~~) the actual and expected operating expenditure of the provider during any preceding *regulatory control periods*;

(~~vi~~3) the extent to which the forecast operating expenditure of the provider is referable to arrangements with a person other than the provider, that ~~might~~ is not ~~be~~ on arm's length terms;

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(~~vii~~4) reasonable estimates of the benchmark operating expenditure that would be incurred by an efficient *Transmission Network Service Provider* over the *regulatory control period*;

(~~viii~~5) the reasonableness of the demand forecasts on which the forecast operating expenditure is based;

(~~ix~~6) the relative prices of operating and capital inputs;

(~~x~~7) efficiency of substitution possibilities between operating and capital expenditure;

(~~xi~~8) whether the total labour costs included in the capital and operating expenditure forecasts for the *regulatory control period* are consistent with the incentives provided by the *service target performance incentive scheme* that is to apply to the provider in respect of the *regulatory control period*; and

(~~xii~~9) whether the forecast operating expenditure includes amounts relating to a project that should more appropriately be included as a *contingent project* under clause 6A.8.1(b)~~,~~

provided that where the AER proposes to take account any of the above matters in a final decision it shall only do so following disclosure of those matters to the *Transmission Network Service Provider* and after having afforded the provider a reasonable opportunity to make submissions in relation to those matters ~~;~~ ~~and~~

(f~~3~~) In taking account of the information included in or accompanying the *Revenue Proposal* or revised proposal, the AER may have regard to the extent to which the operating expenditure forecasts and the information provided in relation to those forecasts, comply with the requirements of the *submission guidelines* made under clause 6A 10.2.

6A.6.7 Forecast capital expenditure

(a) A Revenue Proposal must include a forecast of the capital expenditure for each regulatory year of the relevant regulatory control period which the Transmission Network Service Provider considers is reasonably required~~-~~, by a prudent *Transmission Network Service Provider*, in order to:

(1) efficiently meet the expected demand for prescribed transmission services over that period;

(2) comply with all applicable regulatory obligations associated with the provision of prescribed transmission services;

(3) maintain the quality, reliability and security of supply of prescribed transmission services; or

(4) maintain the reliability, safety and security of the transmission system through the supply of prescribed transmission services.

(b) The *AER* must determine whether or not the forecast capital expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required capital expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4).

(c) The AER must accept the forecast capital expenditure for each regulatory year as provided under paragraph (a) if:

(1)~~-~~ the forecast capital expenditure is for expenditure that is properly allocated to prescribed transmission services in accordance with the principles and policies set out in the Cost Allocation Methodology for the Transmission Network Service Provider;

(2)~~-~~ subject to subparagraph (3):

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(i) the forecast capital expenditure is identified in the Revenue Proposal as a reliability augmentation;

(ii) the forecast capital expenditure is necessary for the Transmission Network Service Provider to comply with all applicable regulatory obligations associated with the provision of prescribed transmission services; or

(iii) the forecast capital expenditure has satisfied the regulatory test;

(3) the total of the forecast capital expenditure for the regulatory control period as provided under paragraph (a) (being both capital expenditure referred to in subparagraph (2) and all other capital expenditure referred to in paragraph (a)) is determined by the AER to be a reasonable estimate of the Transmission Network Service Provider's required capital expenditure for the regulatory control period.

(d) In determining whether or not the forecast capital expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required capital expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4), the AER must take into account~~, taking into account~~:

(~~i~~1) the information included in or accompanying the submission of the Revenue Proposal or any revised proposal;

~~(ii) the need to comply with all applicable regulatory obligations associated with the provision of prescribed transmission services;~~

(2~~iii~~) submissions received in the course of consulting on the Revenue Proposal.

(e) In determining whether or not the forecast capital expenditure included in a *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required capital expenditure for the *regulatory control period* having regard to the criteria in sub-paragraphs (a)(1) to (a)(4), the AER may take into account:~~;~~

(1~~iv~~) such analysis as is undertaken by or for the AER and is published prior to or as part of the draft decision of the AER on the Revenue Proposal under rule 6A.12 or prior to the final decision of the AER on the Revenue Proposal under rule 6A.13 (as the case may be);

(~~v~~2) the actual and expected capital expenditure of the provider during any preceding regulatory control periods;

(~~vi~~3) the extent to which the forecast capital expenditure of the provider is referable to arrangements with a person other than the provider, that might is not ~~be~~ on arm's length terms;

(~~vii~~4) reasonable estimates of the benchmark capital expenditure that would be incurred by an efficient Transmission Network Service Provider over the regulatory control period;

(~~viii~~5) the reasonableness of the demand forecasts on which the forecast capital expenditure is based;

(~~ix~~6) the relative prices of operating and capital inputs;

(~~x~~7) efficient substitution possibilities between operating and capital expenditure;

(~~xi~~8) whether the total labour costs included in the capital and operating expenditure forecasts for the regulatory control period are consistent with the incentives provided by the service target performance incentive scheme that is to apply to the provider in respect of the regulatory control period; and

(~~xii~~9) whether the forecast capital expenditure includes amounts relating to a project that should more appropriately be included as a contingent project under clause 6A.8.1(b),~~; and~~

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provided that where the AER proposes to take account any of the above matters in a final decision it shall only do so following disclosure of those matters to the *Transmission Network Service Provider* and after having afforded the provider a reasonable opportunity to make submissions in relation to those matters.

(f)~~4)~~ In taking account of the information included in or accompanying the *Revenue Proposal* or revised proposal, the AER may have regard to the extent to which the~~the~~ capital expenditure forecasts and the information provided in relation to them comply with the requirements of the submission guidelines made under clause 6A.10.2.

(c) Clause 6A.7.1 enables a Transmission Network Service Provider to apply for the revocation and substitution of a revenue cap determination where the circumstances set out in clause 6A.7.1(a) occur.

….

6A.13.2 Refusal to approve amounts, values or framework

(a) If the AER's final decision is to refuse to approve an amount or value referred to in clause 6A.14.1(1), the *AER* must include in its final decision a substitute amount or value which, except as provided in clause 6A.13.2(b), is:

(1) determined on the basis of the current *Revenue Proposal*; and

(2) amended from that basis only to the extent necessary to enable it to be approved in accordance with the *Rules*.

(b) If the *AER*'s final decision is to refuse to approve an amount or value referred to in clause 6A.14.1(1) for the reason that, or a reason which includes the reason that, the *AER* ~~is not satisfied that~~has determined that:

(1) the forecast operating expenditure included in a *Revenue Proposal* for any *regulatory year* is not a reasonable estimate of the *Transmission Network Service Provider's* ~~is~~ reasonably required operating expenditure for that period having regard to the criteria ~~for the purposes~~ set out in clause 6A.6.6(a) (the *AER* not being otherwise required to accept that forecast operating expenditure under clause 6A.6.6(b)); or

(2) the forecast capital expenditure included in a *Revenue Proposal* for any *regulatory year* is not a reasonable estimate of the *Transmission Network Service Provider's* ~~is~~ reasonably required capital expenditure for that period having regard to the criteria ~~for the purposes~~ set out in clause 6A.6.7(a) (the *AER* not being otherwise required to accept that forecast capital expenditure under clause 6A.6.7(b)),

the *AER* must:

(3) include in its final decision the forecast operating or capital expenditure for that *regulatory year* (as the case may be) which it determines to be reasonably required for the purposes set out in clause 6A.6.6(a) or 6A.6.7(a) respectively; and

(4) must use that amount (and its components) in place of the forecast capital or operating expenditure for that *regulatory year* contained in the current *Revenue Proposal* for the purposes of calculating the amount or value that it has refused to approve in its final decision.

…..

6A.14 Requirements relating to draft and final decisions

6A.14.1 Contents of decisions

A draft decision under rule 6A.12 or a final decision under rule 6A.13 is a decision by the *AER*:

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(1) on the *Transmission Network Service Provider's* current *Revenue Proposal* in which the *AER* either approves or refuses to approve:

(i) the *total revenue cap* for the provider for the *regulatory control period*;

(ii) the *maximum allowed revenue* for the provider for each *regulatory year* of the *regulatory control period*;

(iii) the values that are to be attributed to the *performance incentive scheme parameters* for the *service target performance incentive scheme* that is to apply to the provider in respect of the *regulatory control period*;

(iv) the values that are to be attributed to the *efficiency benefit sharing scheme parameters* for the *efficiency benefit sharing scheme* that is to apply to the provider in respect of the *regulatory control period*; and

(v) the commencement and length of the *regulatory control period* that has been proposed by the provider, as set out in the *Revenue Proposal*, setting out the reasons for the decision;

(2) in which the *AER* determines:

(i) whether the total of the forecast capital expenditure for the *regulatory control period* as set out in the current *Revenue Proposal* is a reasonable estimate of the *Transmission Network Service Provider's* reasonably required capital expenditure for the *regulatory control period* having regard to the criteria in clause 6A.6.7(a) and ~~,~~ taking into account as required or otherwise permitted the matters referred to in clause 6A.6.7(d) and (e)~~(b)(3)~~; and

(ii) ~~(~~if the *AER* determines that it is not a reasonable estimate~~)~~, its reasons for that determination and an estimate of the provider's reasonably required capital expenditure for the *regulatory control period* that the *AER* considers to be reasonable having regard to the criteria in paragraph 6A.6.7(a) and~~,~~ taking into account as required or otherwise permitted the matters referred to in clause 6A.6.7(d) and (e)~~((b)(3)~~, together with the reasons for that conclusion;

(3) in which the *AER* determines:

(i) whether the total of the forecast operating expenditure for the *regulatory control period* as set out in the current *Revenue Proposal* is a reasonable estimate of the provider's reasonably required operating expenditure for the *regulatory control period* having regard to the criteria in clause 6A.6.6(a) and ~~,~~ taking into account as required or otherwise permitted the matters referred to in clause 6A.6.6(d) and (e)~~(b)(2)~~; and

(ii) ~~-~~if the *AER* determines that it is not a reasonable estimate, its reasons for that determination and an estimate of the provider's reasonably required operating expenditure for the *regulatory control period* having regard to the criteria in clause 6A.6.6(a) and that the *AER* considers to be reasonable taking into account as required or otherwise permitted the matters referred to in clause 6A.6.6(d) and (e)~~(b)(2)~~, together with the reasons for that conclusion;

….

6A.14.3 Circumstances in which approval must be given

(a) This clause set out the circumstances in which the *AER* must approve certain matters for the purposes of a draft decision under rule 6A.12 or final decision under rule 6A.13. If the *AER* is not required to approve such a matter in accordance with this clause, it may, but is not required to, refuse to approve that matter.

(b) The *AER* must approve:

(1) the *total revenue cap* for a *Transmission Network Service Provider* for a *regulatory control period*; and

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(2) the *maximum allowed revenue* for the provider for each *regulatory year* of the *regulatory control period*, as set out in the current *Revenue Proposal*,

if the *AER* is satisfied that:

(3) those amounts have been properly calculated using the *post-tax revenue model*;

(4) those amounts, and any amount required to be calculated or determined for the purposes of calculating those amounts, have otherwise been calculated or determined in accordance with the requirements of Part C;

(5) the total of the forecast capital expenditure for the *regulatory control period* as set out in the current *Revenue Proposal* is a reasonable estimate of the provider's reasonably required capital expenditure for the *regulatory control period*, having regard to the criteria in clause 6A.6.7(a) and taking into account as required or otherwise permitted the matters listed in clause 6A.6.7(d) and (e)~~(b)~~; and

(6) the total of the forecast operating expenditure for the *regulatory control period* as set out in the current *Revenue Proposal* is a reasonable estimate of the provider's reasonably required operating expenditure for the *regulatory control period*, having regard to the criteria in clause 6A.6.6(a) and taking into account as required or otherwise permitted the matters listed in clause 6A.6.6(d) and (e)~~(b)~~.

(c) If a *Transmission Network Service Provider*'s revised *Revenue Proposal* submitted under clause 6A.12.3(a) includes:

(1) an amount of total forecast capital expenditure for the *regulatory control period* that is the same as that determined by the *AER* in a draft decision under rule 6A.12 to be a reasonable estimate of the provider's required capital expenditure for the *regulatory control period*; or

(2) an amount of total forecast operating expenditure for the *regulatory control period* that is the same as that determined by the *AER* in a draft decision under rule 6A.12 to be a reasonable estimate of the provider's required operating expenditure for the *regulatory control period*,

then, except to the extent that:

(3) either or both of the following apply:

(i) other changes have been made in the revised *Revenue Proposal*, by the provider; or

(ii) the information contained in or accompanying the revised *Revenue Proposal* differs from that contained in or accompanying the previous *Revenue Proposal*; and

(4) the changes would justify the *AER*, in its final decision, in determining that the relevant amount is not a reasonable estimate of the provider's reasonably required operating expenditure or capital expenditure (as the case may be) for the *regulatory control period*, taking into account the matters referred to in clause 6A.6.6(b)(2) or 6A.6.7(b)(3), respectively,

the *AER*, in its final decision, must determine that those amounts are reasonable estimates.

…

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