Contact: Leigh Mayne
Phone no: (03) 6270 3691
Our Ref: NW30240680
Your Ref: ERC0134

15 December 2011

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Sir

CONSULTATION PAPER: NATIONAL ELECTRICITY AMENDMENT (ECONOMIC REGULATION OF NETWORK SERVICE PROVIDERS) RULE 2011

Thank-you for the opportunity to provide input to the Consultation Paper, National Electricity Amendment (Economic regulation of network service providers) Rule 2011, released on 20 October 2011.

Aurora Energy Pty Ltd, ABN 85 082 464 622 (Aurora) is an incorporated, State Government owned fully integrated energy and network business, with complementary activities in telecommunications and energy-related technologies. Aurora provides electricity generation, retail and distribution services to more than 270,000 customers in the Tasmanian jurisdiction. In this document, reference to Aurora should be taken as reference to Aurora in its capacity as the provider of distribution services licensed by the Regulator under the Electricity Supply Industry Act 1995.

Aurora is keenly aware of the effect of rising electricity prices on its customers. To this end, Aurora has implemented a business-wide strategy to ensure that it provides its services to its customers at the lowest sustainable price. Planning and expansion of the distribution network is a key cost consideration in the provision of Aurora's services and those provided by all Distribution Network Service Providers. Aurora therefore welcomes any changes within the national electricity market that will lead to better and efficient outcomes for its customers.

Aurora supports and endorses the National Energy Objectives as stated in clause 7 of the National Electricity Law, being to,

> promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to —
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system,

but agrees with the observation made by Mr Stephen Lloyd SC in his Memorandum of Advice to the Australian Energy Regulator that,

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> there is a tension between price and most of the other desirable characteristics (quality, safety, reliability and security) in that improvements in the latter generally come at a higher price.[1]

Aurora recognises that the National Electricity Law directs that the Australian Energy Regulator should contribute to the National Energy Objectives in the performance of its regulatory powers. Aurora understands that part of this set of rule changes is to address concerns that future network expenditure will exacerbate the current rapid electricity price increases, but is concerned that the Australian Energy Regulator has made little comment on the potential trade-offs between price and the other aspects of the National Energy Objectives.

Aurora has provided detailed answers to the questions posed in the AEMC's consultation paper in the attachment to this letter. Aurora, as a member of the Energy Networks Association, also supports and endorses their submission on this matter.

If you have any questions, please address them to the contact noted above.

Yours sincerely

Andre Botha
Chief Operations Officer – Distribution Business
Aurora Energy

[1] Lloyd S, Memorandum of Advice, In the Matter of the Australian Energy Regulator's Rule Change Requests to the Australian Energy Market Commission Concerning Chapters 6, 6A, 10 and 11 of the National Electricity Rules and Part 9 of the National Gas Rules 2008, paragraph 7, provided to the Australian Energy Regulator and released by them with their suite of documentation relating to this current rule change request in September 2011

Response to Questions

The following sections provide Aurora's answers to the questions posed by the Australian Energy Market Commission (AEMC) in their consultation paper *National Electricity Amendment (Economic regulation of network service providers) Rule 2011* published on 20 October 2011 (the Consultation Paper).

Aurora will restrict itself to a discussion in the context of DNSP.

For ease of identification the questions posed by the AEMC are presented boxed and in a different typeface.

The following table explains terms used in this attachment:

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Consultation Paper	*Consultation Paper, National Electricity Amendment (Economic regulation of network service providers) Rule 2011, National Gas Amendment (Price and revenue regulation of gas services) Rule 2011*, published by the AEMC on 20 October 2011
DNSP	Distribution Network Service Provider
Draft Determination	*Draft Distribution Determination, Aurora Energy Pty Ltd, 2012-13 to 2016-17* published by the AER in November 2011
ENA	Energy Networks Association
ESCOSA	Essential Services Commission of South Australia
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NER	National Electricity Rules
NSP	Network Service Provider
RAB	Regulatory Asset Base
RIN	Regulatory Information Notice
Rule Change Proposal	*Rule Change Proposal, Economic regulation of transmission and distribution network service providers, AER's proposed changes to the National Electricity Rules*, published by the AER on 29 September 2011
Rules	National Electricity Rules
SORI	Statement of Regulatory Intent
TNSP	Transmission Network Service Provider
WACC	Weighted Average Cost of Capital

The Problem

Do you agree with the extent of the problems with the framework for economic regulation of electricity and gas networks as characterised by the AER? We would also welcome views and analysis on the effectiveness of the current rules as they have been applied over the last five years.

Extent of the problems with the framework for economic regulation of electricity networks as characterised by the AER.

Aurora understands the basis of the AER's Rule Change Proposal to be a desire to streamline the revenue setting process. The AER has presented in the Rule Change Proposal several issues categorised into three major types that it considers are problems with the current framework for the economic regulation of electricity and gas networks. With respect to electricity distribution networks, Aurora understand these to be:

1. Capex and Opex Framework
   - 1.1. approach to setting estimates of required expenditure;
   - 1.2. revision of the expenditure factors, expenditure objectives and expenditure criteria;
   - 1.3. incentives against capex overspend;
   - 1.4. introduction of a "contingent projects" mechanism for DNSPs;
   - 1.5. introduction of a mechanism to re-open a distribution determination on the occurrence of an unforeseeable and uncontrollable event;
   - 1.6. introduction of a definition of "materially" in relation to positive and negative pass-through events;
   - 1.7. a mechanism for the exclusion of related party margins from the RAB;
   - 1.8. a mechanism for the exclusion of the costs due to changes in DNSP capitalisation approaches from the RAB;
   - 1.9. the ability for the AER to introduce incentive schemes as it sees fit; and
   - 1.10. the ability for the AER to reduce a DNSP's revenue by the amount received through using regulated assets for unregulated business.
2. Weighted Average Cost of Capital Issues
   - 2.1. whether to use the Statement of Regulatory Intent (SORI) values;
   - 2.2. the role of the persuasive evidence test to diverge from SORI values;
   - 2.3. timing of WACC reviews;
   - 2.4. the definition of debt risk premium; and
3. Regulatory Decision-making Process

3.1. a restriction on the ability of DNSPs to lodge submissions on the AER's draft determination;

3.2. an alteration in the treatment of confidential submissions received from DNSPs;

3.3. alterations to the Framework and Approach paper process;

3.4. a rationalisation of the approach to correcting errors in determinations;

3.5. the timeframe allowed to complete a WACC review;

3.6. the timeframe allowed for assessment of cost pass through events, contingent projects and capex reopeners; and

3.7. change the requirement from the AER "having to make a decision on certain matters" to "having to make a determination on certain matters".

Aurora will discuss these issues in more detail in the following sections.

1.1 Expenditure Framework: approach to setting expenditure estimates

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.2 of the Rule Change Proposal.

Aurora understands the AER's issues to be:

- that it must approve an expenditure forecast that is reasonable, and may not reduce the forecast to what it believes to be the lowest "efficient, prudent and realistic" forecast;
- that, if permitted to amend an expenditure forecast, the AER is restricted to amending the forecast such that it falls within the upper bound of a range of efficient expenditure rather than amending the forecast to what it believes to be the lowest "efficient, prudent and realistic" forecast; and
- that, in making a substituted forecast, the AER must base any substitute on the original regulatory proposal, rather than being permitted to make a "top-down" assessment based upon something other than the regulatory proposal.

Aurora does not agree with the extent of the problems presented by the AER in relation to these issues.

With regard to the first two points, the AER notes that there may be a range of efficient, prudent and realistic forecasts of expenditure[2]. It follows that any forecast of expenditure that falls within this range must be acceptable. Aurora

[2] Rule Change Proposal, page 27

observes that the determination of what constitutes an efficient forecast already lies with the AER under the current regulatory framework[3]. Aurora is uncertain as to how the proposed alteration to the NER will solve the AER's problems, given that the determination of the efficient range (the apparent issue) is intended to remain with the AER.

Aurora agrees that the ability to apply "top down" checks against "bottom-up" forecasts provides a useful measure of the appropriateness of forecast expenditure. Given that the AER already has the ability to apply this approach[4], Aurora is uncertain about the AER's concerns. Aurora agrees that the requirement to assess expenditure forecasts line-by-line is onerous. The AER does have, however, the ability to target its expenditure reviews to achieve the most "bang for its buck": such an approach was used in Victoria[5].

In relation to the last point, Aurora notes that the expenditure forecasts submitted to the AER in a regulatory proposal must be based in fact. The National Electricity Law (NEL) requires it and, in Aurora's case at least, the AER in its RIN dated 21 April 2011 served on Aurora explained the legal ramifications of failing to provide true information. Since the forecasts are based in fact, the desire for the AER to need to have no regard for the forecasts is mildly concerning. At the very least, such an approach would seem to leave the AER open to challenge.

1.2 Expenditure Framework: revision of the expenditure factors, expenditure objectives and expenditure criteria

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.3 of the Rule Change Proposal.

Aurora understands the AER's issue to be that the expenditure factors, objectives and criteria framework is not consistent with the AER's proposed rule changes to allow it to determine NSP capex and opex forecasts.

Aurora agrees with the AER's assessment of the issues with the current framework of expenditure factors, objectives and criteria, and agrees that this framework should be altered as the AER suggests to allow it to determine expenditure forecasts, but only in the event that the power is given to the AER to determine expenditure forecasts.

Aurora notes, however, that the AER has not demonstrated that there are significant issues with the current process to which this framework applies that the

[3] NER, clauses 6.5.6(c) & (d), 6.5.7(c) & (d)

[4] For example, in assessing Aurora's forecast expenditure in the current distribution determination process the AER and its consultants applied top-down checks and benchmarking against Aurora's capex and opex forecasts.

[5] Rule Change Proposal, page 29

AER's proposed changes can address. Since the AER has not shown that the determination process needs to be altered to permit it more freedom to create forecasts, it is not appropriate to tinker with the expenditure factors, objectives and criteria framework.

1.3 Expenditure Framework: incentives against capex overspend

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.4 of the Rule Change Proposal.

Aurora understands the AER's issue to be that, since there is no incentive upon NSPs to restrict expenditure to the *ex ante* forecast because all expenditure is rolled into the RAB at the end of the regulatory control period, NSPs overspend their allowances.

There are two presumptions in the AER's discussion of the issue:

- that any expenditure in excess of allowed forecast is inefficient; and
- that NSPs will overspend without incentive.

Aurora does not agree that any expenditure in excess of an allowed forecast is necessarily inefficient. It may, for example, reflect the difficulty in providing an accurate estimate of expenditure for a period or project that may be up to seven years into the future.

Aurora does not agree with the extent of the problems presented by the AER in relation to these issues. Indeed, it is rather difficult to ascertain whether the situation is as the AER claims. The AER has failed in its analysis of the expenditure in excess of forecast in Queensland[6] to demonstrate that any of that expenditure is inefficient. The AER has noted its reluctance to perform *ex post* reviews that would identify whether or not expenditure is inefficient[7], further reducing the likelihood of obtaining supporting evidence for the AER's claims.

The introduction of an incentive regime should be prefaced by an investigation as to the reason for the behaviour deemed inappropriate. The AER's has presented no non-hypothetical evidence that the main reason for expenditure in excess of forecast is to obtain a return on unnecessary assets. Given the lack of supporting information, Aurora considers a proposal to introduce any capex incentive scheme, let alone an asymmetric incentive regime where over-spend is "punished" and under-spend is not considered, to be premature.

1.4 Expenditure Framework: "contingent projects" mechanism for DNSPs

[6] Rule Change Proposal, page 40

[7] Rule Change Proposal, page 43

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.6 of the Rule Change Proposal.

Aurora understands the AER's issue to be that DNSPs should be afforded the same "contingent project" mechanism as TNSPs to manage uncertainty in forecasting. Under such a mechanism, large projects to address possible future network conditions may be flagged as "contingent projects". These projects are excluded from the initial approved expenditure forecasts. In the event that the conditions arise on the network such that the project is required, the DNSP may activate the contingent project mechanism, and the project may be built (subject to AER approval) without being considered "excess expenditure".

Aurora agrees in principle that this is a useful mechanism. Aurora's major reservation is that the mechanism, as proposed[8], may be used to artificially lower the initial approved expenditure forecasts by classifying a number of projects as contingent projects.

1.5 Expenditure Framework: introduction of a mechanism to re-open a distribution determination on the occurrence of an unforeseeable and uncontrollable event

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.6 of the Rule Change Proposal.

Aurora understands the AER's issue to be that DNSPs should be afforded the same distribution re-opening framework as TNSPs to manage large, unforeseeable events that are beyond the control of the DNSP. Under the proposed framework, on the occurrence of a qualifying event the DNSP may apply to the AER for the AER to re-open the relevant distribution determination to account for the effects of the event[9]. The AER seems to imply that the uncertainty associated with the potential for these events results in elevated expenditure forecasts by DNSPs.

Aurora observes that it has not traditionally inflated expenditure forecasts to account for unforeseen large events that may require a large amount of expenditure to correct because section 36(2)(c) of the Electricity Supply Industry (Price Control) Regulations 2003 provides determination re-opening provisions for unforeseen, uncontrollable events that have a material adverse effect. Aurora understands that this provision will no longer apply when the AER takes over its economic regulation in July 2012, and welcomes the introduction of an analogous scheme to cover any events not identified under the existing cost-pass through mechanism[10].

[8] NER, proposed rule 6.6A.1

[9] NER, proposed rule 6.6.4

[10] NER, rule 6.6.1

1.6 Expenditure Framework: introduction of a definition of "materially" in relation to positive and negative pass-through events

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.6 of the Rule Change Proposal.

Aurora understands the AER's issues to be:

- that the existing RAB roll-forward rules create a potential for "double-recovery"; and
- that the absence of a definition of "materially" in the NER creates uncertainty for stakeholders for some reasons that Aurora cannot ascertain from the Rule Change Proposal.

Aurora agrees that the current rules seem to provide the potential for "double-recovery" of expenditure incurred as a result of a pass-through event.

Aurora neither agrees nor disagrees with the AER's proposition of stakeholder uncertainty due to the absence of a definition of "materially" in respect of a cost pass through event as per rule 6.6.1. Aurora notes, however, that it has no fundamental objection to the definition of "materially" as per Part C of the Rule Change Proposal.

1.7 Expenditure Framework: a mechanism for the exclusion of related party margins from the RAB

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.7 of the Rule Change Proposal.

Aurora understands the AER's issues to be that, due to the RAB roll-forward approach mandated in the Rules[11], NSPs may receive returns on "inefficient" margins charged by related parties performing capital works.

Aurora agrees with the AER's assessment of the issue. Aurora notes, however, that the proposed approach is, in effect, an *ex post* review of capital expenditure which the AER has indicated in another section of the Rule Change Proposal that it does not wish to perform[12].

Aurora further recognises the difficulties encountered by the AER in the recent Victorian distribution determination process with regard to creating an assessment framework "on the fly". To ease the burden on the AER that is so often noted in the Rule Change Proposal, it seems prudent that the rules direct the creation of an assessment framework to ensure that the determination of efficient margins for

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[11] NER, clause S6.2.1(e)(1)

[12] Rule Change Proposal, page 43

related parties is assessed appropriately. Since this is clearly in the province of a policy decision, it seems appropriate that the MCE / AEMC take the lead in the development of this framework.

1.8 Expenditure Framework: a mechanism for the exclusion of the costs due to changes in DNSP capitalisation approaches from the RAB

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.7 of the Rule Change Proposal.

Aurora understands the AER's issues to be that, due to the RAB roll-forward approach mandated in the Rules[13], NSPs may receive returns on expenditure that has been categorised as capital in nature in a manner different to that presented in the capitalisation methodology approved by the AER as a part of the distribution determination process.

Aurora agrees with the AER's assessment of the issue. Aurora notes, however, that the proposed approach is, in effect, an *ex post* review of capital expenditure which the AER has indicated in another section of the Rule Change Proposal that it does not wish to perform[14].

1.9 Expenditure Framework: the ability for the AER to introduce incentive schemes as it sees fit

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.8 of the Rule Change Proposal.

Aurora understands that the AER's issues to be that the AER be able to introduce incentive schemes for DNSPs beyond the rules-mandated Service Target Incentive Scheme, Efficiency Benefits Sharing Scheme, and Demand Management Incentive Scheme to keep up with regulatory best practice.

Aurora agrees that it is prudent regulatory practice to continually refine regulatory processes, but disagrees with the AER's proposal that it be given the power to introduce schemes as required.

Aurora notes the concept that, in the NEM, the MCE makes policy, the AEMC makes the Rules, and the AER enforces the Rules. Precedent places the requirement for incentive schemes in the Rules, restricting the AER to implement those schemes that the policy and rule makers have deemed necessary. Given this precedent, it would seem inappropriate to allow the AER licence to apply schemes as it sees fit. Rather, Aurora considers the appropriate approach to be that the

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[13] NER, clause S6.2.1(e)(1)

[14] Rule Change Proposal, page 43

AER, as the regulatory specialist, should institute new schemes through the standard rule change process. In this way, such schemes will be subject to a proper and transparent scrutiny by stakeholders and, additionally remove the perception of conflict of interest whereby a rule enforcer becomes rule maker.

1.10 Expenditure Framework: the ability for the AER to reduce a DNSP's revenue by the amount received through using regulated assets for unregulated business

The AER presents its issues with the approach to setting estimates of required expenditure in section 6.9 of the Rule Change Proposal.

Aurora understands the AER's issue to be that the current pricing framework is such that consumers receive no benefit from the use of regulated electricity assets by third parties for purposes other than associated with the provision of electrical services.

Aurora agrees with the extent of the problems presented by the AER in relation to this issue. Further, Aurora commends the ESCOSA approach as providing an appropriate recognition of revenues from unregulated activities.

Aurora notes in passing that the current definition of "distribution service" in the NER appears to extend to non-electrical services that are provided through the use of regulated electrical assets.

2.1 WACC: whether to use the Statement of Regulatory Intent values

The AER presents its issues with the approach to setting estimates of required expenditure in section 7.2 of the Rule Change Proposal.

Aurora understands that the AER seeks more discretion in the WACC parameter setting process.

Aurora understands the AER's concerns, but does not agree with their assessment, nor their proposed solution. Aurora notes that the AER already has the power to review and vary the WACC parameters before each determination[15]. This, in conjunction with the proposal to restrict the ability to vary from the SORI parameters and the proposed deletion of rules 6.5.2(c), (d) and (e), would give the AER full authority to set and apply its preferred WACC rates with absolute discretion.

[15] NER, clause 6.5.4(b)

2.2 WACC: the role of the persuasive evidence test to diverge from SORI values

The AER presents its issues with the approach to setting estimates of required expenditure in section 7.3 of the Rule Change Proposal.

Aurora understands that the AER's issue to be that the persuasive evidence test "represents a problematic and potentially unnecessary threshold which may inappropriately restrict the AER's ability to determine an efficient benchmark rate of return"[16].

Aurora does not agree with the extent of the problems presented by the AER in relation to these issues.

Aurora is currently undergoing the pricing determination process. In its Regulatory Proposal, Aurora agreed to all of the SORI values, except the value for gamma in light of the Tribunal decision[17]. In the Draft Determination, the AER presented arguments justifying its departure from the SORI values for two of the WACC parameters, reducing the vanilla WACC rate dropped from 10.33 per cent to 8.08 per cent. In light of this, Aurora does not consider that the persuasive evidence requirements of the NER are overly restrictive upon the AER to determine a rate of return.

2.3 WACC: timing of WACC reviews

The AER presents its issues with the approach to setting estimates of required expenditure in section 7.4 of the Rule Change Proposal.

Aurora understands the AER's issue to be that the timing of the WACC reviews in chapters 6 and 6A do not align, thereby introducing a potential duplication of effort for the AER.

Aurora does not agree with the AER's assessment of the problem. The rules as written provide the AER with the capacity to perform a review at any time, with a limit of five years between reviews. The AER's proposed changes do not alter this.

2.4 WACC: the definition of debt risk premium

The AER presents its issues with the approach to setting estimates of required expenditure in section 7.5 of the Rule Change Proposal.

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[16] Rule Change Proposal, page 71

[17] Australian Competition Tribunal, *Application by Energex Limited (Gamma) (No. 5)[2011] ACompT 9*, 13 May 2011, paragraph 42.

Aurora understands the AER's issues to be that the current Rules restrict the ability for the AER to set an "efficient" cost of debt due to:

- ambiguity in setting the benchmark;
- inflexibility in dealing with market conditions; and
- the relevance of the benchmark with respect to the actual cost of debt.

Aurora agrees with the AER that the factors associated with bonds create difficulty in ascertaining the appropriate debt risk premium. Aurora notes, however, that the AER's proposal to allow itself carte blanche in determining a debt risk premium[18] leaves the AER more open to challenge than the existing prescriptive method, which seems something of a retrograde step.

Aurora does not agree with the AER's assessment that the current WACC framework does not allow it the flexibility to cope with changing market conditions. Aurora presents as evidence chapter 9 of the AER's Draft Distribution Determination in which the AER presents its reasons for varying the applicable debt risk premium to cope with changing market conditions.

Aurora is uncertain as to why the AER has raised the final issue as being caused by the NER. The NER is not prescriptive in directing how the AER should perform the benchmarking.

3.1 Decision-making Process: a restriction on the ability of DNSPs to lodge submissions on the AER's draft determination

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.2 of the Rule Change Proposal.

Aurora understands the AER's issues are that DNSPs have made public submissions to AER draft determinations. These submissions:

- contain information that the AER believes should be properly contained within the original or revised regulatory proposals; and
- require significant effort on the part of the AER to consider given the restrictive timeframes in the NER surrounding the determination process.

Aurora does not question the assessment of the issue made by the AER, but suggests that the proposed solution is inappropriate, not the least because it reduces transparency in the regulatory process through removing a DNSP's ability to respond to public submissions on its revised regulatory proposal.

[18] By the proposed deletion of NER, clause 6.5.2(e)

Given that the fundamental issue behind both points is the shortness of time allowed for the NSPs to lodge a revised regulatory proposal and the AER to complete its consideration of submissions, it would seem more appropriate to alter the rules to allow more time.

3.2 Decision-making Process: an alteration in the treatment of confidential submissions received from DNSPs

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.3 of the Rule Change Proposal.

Aurora understand the AER's issues to be:

- that the AER wishes to be able to disregard information that is identified by DNSPs as confidential; and
- that the AER has issues with the word "indicate".

Aurora does not agree that the substitution of the word "identify" for the word "indicate" will solve the problems identified (or indicated) by the AER.

Aurora notes that the AER has not provided in the Rule Change Proposal an analysis of the extent of the problem caused by its inability to disregard confidential information. Aurora understands the principle of transparency in regulation to provide general confidence that the regulatory process is fair and above board. Aurora notes, however, that DNSPs are businesses and the publication of all data and information requested by the AER in the determination process potentially places the business at a disadvantage in business negotiations and in the exploitation of intellectual property. The publication of information may also affect the stock prices of listed companies.

Aurora considers that the AER's proposed rule change gives NSPs two, equally poor, choices:

- permit the AER to publish everything and face the possibility of adverse business outcomes due to the loss of negotiating power or control of intellectual property; or
- face the possibility that the AER will disregard information that the NSP considers to be confidential thereby facing a material impact upon expenditure and / or revenue.

3.3 Decision-making Process: alterations to the Framework and Approach paper process

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.4 of the Rule Change Proposal.

Aurora understands the AER's issues to be:

- that the current rules result in three consultations on the distribution incentive schemes;
- that there is a potential for mismatch between service classifications and control mechanisms; and
- that positions in the framework and approach paper are not binding on the AER or the DNSP.

While Aurora agrees that running consultations can be onerous, Aurora does not consider that the AER has demonstrated that there is a benefit in reducing the opportunities for valuable stakeholder input in the application of schemes that have a potentially large impact on future revenues.

Aurora also agrees that there is a potential for mismatch between the service classifications and control mechanisms between the framework and approach paper and the final stages of the determination process. Aurora observes, however, that the AER's final point that the framework and approach paper is not binding upon either the AER or the DNSP provides a ready solution to this issue.

3.4 Decision-making Process: correcting errors in determinations

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.5 of the Rule Change Proposal.

Aurora understands the AER's issues to be:

- that the prescriptive nature of the rules with regard to the correction of errors in distribution determinations is restrictive; and
- that there is an inconsistency between the transmission and distribution pricing rules as to the degree of correction permitted.

Aurora agrees with the AER's assessment of both of these issues.

3.5 WACC: the timeframe allowed to complete a WACC review

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.6 of the Rule Change Proposal.

Aurora understands that the AER wishes to harmonise the transmission and distribution pricing rules to permit the AER to extend the time to conduct a transmission WACC review, if required.

Aurora agrees with the AER's assessment of the problem. Aurora considers that the AER should be allowed sufficient time to complete a proper review of such important inputs to the revenue setting process.

3.6 Decision-making Process: extension of time to make cost pass through events, contingent project and capex reopener assessments

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.7 of the Rule Change Proposal.

Aurora understands the AER's issue to be that the current rules place undue time pressures on the AER in making assessments of applications from DNSPs to reopen their determinations under certain circumstances.

Aurora agrees with the extent of the problems presented by the AER in relation to these issues.

3.7 Decision-making Process: change the requirement from the AER "having to make a decision on certain matters" to "having to make a determination on certain matters"

The AER presents its issues with the approach to setting estimates of required expenditure in section 8.8 of the Rule Change Proposal.

Aurora understands the AER's issue to be that it wishes to rationalise the rules such that it is required to determine certain matters associated with the making of a distribution determination, rather than "approve" or "decide".

Aurora observes that the changes proposed by the AER in this matter will allow the AER to have more control over the inputs to the revenue and expenditure forecasts than it currently enjoys. Aurora is not certain that the policy direction for the NEM was that the AER was intended to dictate NSP revenues, which would be the end result of the AER's proposed changes in this section in conjunction with the AER's proposal to "determine" capex and opex forecasts. Rather, Aurora understands that the intention was for the AER to ensure that expenditure proposals were efficient, return on investment rates were reasonable and commensurate with those of an entity operating in a free, competitive market, thereby leading to appropriate revenues through the application of the building block approach given in the NER.

Views on the effectiveness of the current rules as they have been applied over the last five years

Aurora considers that, on the whole, the current Rules have been effective as they have been applied over the last five years. Aurora endorses the analysis of this point in the Energy Networks Association submission to this consultation process.

Aurora further notes that the first two sets of distribution determinations for New South Wales and Queensland were performed under transitional arrangements set by the respective jurisdictions. It seems inappropriate to judge the effectiveness of the Rules by including results from determinations conducted under special conditions. It would seem more useful to consider the results from the recent suite of Victorian distribution determinations, yet these received scant mention in the Rule Change Proposal.

Prescription and Discretion

Rules that are more prescriptive set out more detail around the how the AER makes its decisions. Rules that allow for more discretion give the AER more scope to decide for itself how decisions are to be made. Have the proposed Rules achieved the right balance between prescription and discretion?

Aurora considers that the proposed rules have not achieved the right balance between prescription and discretion. Aurora refers to the analysis of this point in the Energy Networks Association submission to this consultation process.

AER's Use of Its Discretion

Among other things, the proposed Rules would give the AER greater discretion to assess and respond to capital and operating expenditure proposals. Could the AER instead achieve the same outcomes through greater use of the discretions it currently has, avoiding the need for expanding these discretions?

Under the existing rules, the AER already possesses the necessary discretions to assess and respond to capex and opex proposals. In particular, the rules give the AER the power to deem expenditure inefficient and to substitute alternative forecasts[19]. Aurora notes that the AER has used these powers in the majority of the distribution determinations performed so far under the current NER. Aurora endorses the more in depth analysis of this aspect in the Energy Networks Association submission to this consultation process.

Solutions

On the basis of the problems raised by the AER, are there any more preferable solutions to those problems? Please note that the AEMC may only implement Rule changes that respond to the problems raised by the AER, and it may not consider proposed changes that respond to other problems raised in submissions.

Aurora indicates some alternative solutions to some of the problems raised by the AER in its responses to sections 1.3, 1.7, 1.9, and 3.1. Aurora also refers to the Energy Networks Association submission to this consultation process.

[19] NER, rules 6.5.6 & 6.5.7 in conjunction with clauses 6.12.1(3) & 6.12.1(4).

Other Issues

Removal of Requirement for Regulatory Proposal

While the AER does not propose to remove the requirement for NSPs to lodge regulatory proposals, the current set of rule changes proposed by the AER, in particular proposed ability for the AER to determine capex and opex forecasts and cost of capital parameters, actually render unnecessary the need for a DNSP to lodge a regulatory proposal and supporting information submitted by a DNSP. Of particular note in this respect are:

- the changes to rule 6.12.1 that require the AER to "determine" rather than making a decision about a proposal;
- the alterations to rules 6.5.6 and 6.5.7 where the AER will determine the expenditure forecasts rather than accepting a proposal on the basis of set criteria; and
- the alterations to rule 6.5.4 whereby the AER will determine the WACC parameters rather than accepting the proposal of the NSP and the values in the Statement of Regulatory Intent.

Permitting the AER to determine the values for these effectively sets the expenditure "buckets" and the allowed revenue that can be collected by the NSP without the need for extensive submissions. While this approach will greatly simplify the entire determination process, it also places the *de facto* responsibility for network planning and maintenance upon the AER. By setting the expenditure forecasts without the need to consult the NSPs, the AER is claiming expertise in network operations above and beyond that of the NSPs. Aurora is concerned that this falls outside of the policy directions for the National Energy Market.