4 October 2012

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Attention Mr Richard Khoe

energex
positive energy

Dear Mr Khoe

ERC 134 - Draft Determination – Economic Regulation of Network Service Providers

Energex Limited (Energex) welcomes the release of the Australian Energy Market Commission's (AEMC) Draft Rule Determination on the Economic Regulation of Network Service Providers. The Energy Network Association (ENA) will be making a submission on behalf of its members. As a member of the ENA, Energex endorses the ENA's submission and is pleased to provide some additional high level comments.

The AEMC's Draft Determination proposes significant changes to the regulatory framework. Energex is concerned that the AEMC has sought to substantially increase the discretion afforded to the AER without having any certainty as to the service providers' future ability to access the merits review process. In particular, the Draft Determination did not clearly indicate which elements of the rules will be impacted by the outcome of the Limited Merits Review (LMR) consultation. Energex submits that the retention of the LMR in some form is critical, particularly given the increased discretion of the regulator.

It is important to note that Energex has provided comments and endorsed the ENA's submission on the basis that the existing LMR regime is in place.

Rate of Return

- *Rate of Return estimates:* The "best" estimate of the rate of return is the estimate which will best promote the National Electricity Objective (NEO). It should be acknowledged that this estimate may not be the "best" statistical estimate (which some might interpret as the mean estimate) because the best statistical estimate may be unreliable and unstable. The rate of return framework should explicitly require the quality of resulting estimates to be a factor in determining the preferred method(s) to set the rate of return.

- *Rate of Return Framework*: The AEMC has sought to improve transparency and accountability in discretionary decision-making by requiring the regulator to address relevant factors and considerations[1]. It is therefore important that the rate of return estimates take into account the inter-relationships between all relevant financial parameters, including gamma.

[1] AEMC Draft Rule Determinations Page 30

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- *Rate of Return Guidelines*: Given the complexity of the issues, and the desire to provide for enhanced consumer engagement in the regulatory process, Energex strongly advocates that the response timeframes should be extended from 30 to 60 business days for the rate of return consultation process.

Capital and Operating Allowance and Capital Incentives

In relation to the capital and operating allowance and capital expenditure incentive, Energex wishes to emphasise the following key positions as outlined in the ENA's submission:

- *Expenditure forecasting methodology:* Energex submits that the network service provider should have the primary responsibility for the development of the methodology used in preparing the expenditure forecasts in its regulatory proposal. This is consistent with the AEMC's view that the service providers' proposals are the starting point for determination of the expenditure allowances;
- *Benchmarking*: As noted in the ENA's submission, benchmarking of past performance is most relevant in the comparative assessment of a Network Service Provider's (NSP) historical expenditure. The forecast of future expenditure needs to take into account the circumstances that are expected to apply to the business going forward. In addition, Energex is concerned with the weight placed on the AER's annual benchmarking reports and submits that the Rules should refer to benchmarking material generally, as there may potentially be other benchmarking information that may be equally relevant;
- *Shared Assets*: Energex supports a shared assets cost adjustment mechanism to provide non-standard control services. Energex currently uses this treatment for shared assets under the transitional arrangements (clause 11.16.3). However, Energex notes that further drafting to the Rules would be required to give effect to the AEMC's intent for the use of shared assets for non-standard control services.
- *Capital expenditure incentives*: The proposed amendments provide a range of tools to the AER to promote prudent and efficient capital expenditure. Energex is concerned that the simultaneous application of a range of different tools to strengthen capex incentives may increase risks and costs for service providers given the additional complexity and lack of understanding as to how these different tools may interact. Any ex-post capex review should only be applied prospectively.

Energex will be making a submission to the AEMC's consultation paper on the savings and transitional arrangements later this month. Should you have any enquiries please contact Sue Lee, Manager Regulatory Initiatives on (07) 3664 4055.

Yours sincerely

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Strategy and Regulation