25 October 2012

Jemena Limited
ABN 95 052 167 405

321 Ferntree Gully Road
Mount Waverley VIC 3149
Locked Bag 7000
Mount Waverley VIC 3149
T +61 3 8544 9000
F +61 3 8544 9888
www.jemena.com.au

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By online submission

Dear Sirs

Consultation on Savings and Transitional Arrangements – ERC0134/ERC0135/GRC0011

Thank you for the opportunity to comment on the Commission's Consultation Paper on Savings and Transitional Arrangements for anticipated new Rules arising from the rule change proposals submitted by the Australian Energy Regulator (AER) and Energy Users Rule Change Committee.

Firstly, Jemena notes the concerns that the Energy Networks Association has raised about the procedural correctness of the process that the Commission has adopted to propose and consult on the transitional arrangements and related rules. While we share those concerns, we do not propose to canvass them here.

The proposed transitional arrangements

Given the scope and intensity of the work program that lies ahead for all stakeholders to finalise and then implement the anticipated new Rules, it is essential that transitional arrangements be as efficient as possible. At the same time, businesses are concerned to minimise uncertainty. In Jemena's view, the arrangements that the Commission has proposed fail the first of these criteria. The proposal to have a "mini" determination to set prices for a transitional year followed closely by a "full" determination to set prices for a subsequent period would provide a high level of certainty. However, it is unnecessarily complex and would impose significant stress on the limited resources of businesses as well as the AER and other stakeholders.

Subject to the concerns discussed below, Jemena supports, in principle, the alternative approach developed by TransGrid and the AER. Under that approach, prices for the transitional year would be set on the basis of a "consensus" forecast of costs, with a subsequent NPV-neutral true-up to the level of allowed costs ultimately determined for that year by the AER. The forum which the Commission convened on 23 October discussed two variants on this proposal. Jemena favours the second, hybrid, variant on the basis that it would provide a practical mechanism for arriving at the consensus forecast for the transitional year.

Minimising risk and uncertainty

We note that the forum discussed a number of technical aspects of the TransGrid/AER approach and its variants. Our principal concern is with the way in which the true-up might operate. The AER will be making a determination for a period that includes the transitional year part way through that year. As we stated at the forum, we are particularly concerned that the AER may determine a lower allowance for opex and/or capex for the transitional year than the business's actual expenditure for that year when, if the allowances had been known before the event, the business would have spent differently. This creates a significant risk and may lead to businesses adopting inefficient expenditure patterns. To address this risk, we recommend that the true-up should only take into account the effect of any difference in WACC between the consensus forecast and the final determination.

The schedule for future reviews

Jemena supports the Commission's proposal "to permit the AER with the agreement of the relevant NSPs to set the length of the next full regulatory period at less than five years for all NSPs except for ElectraNet"[1]. It is important to ensure that, to the extent that the AER considers a regulatory period of less than five years is appropriate (in addition to the transitional year), that the reduction in period length is acceptable to each regulated business.

An issue that will arise for Jemena if the timing aspects of the TransGrid/AER approach are adopted unchanged is that, from 2019 onwards, Jemena will be required to submit regulatory proposals for its gas network in NSW and its electricity network in Victoria at the same time. Understandably, Jemena would like to avoid this situation. Accordingly, we support the AER's initiative to move the Victorian electricity distribution businesses from a calendar year to a financial year basis, aligning these businesses with the vast majority of other NSPs. This shift would ensure that the six month separation between Jemena's two reviews, which exists under the current rules, is retained.

Alternatively, the length of Jemena Gas Networks' next regulatory period could be set at something other than 5 years. Most logically, that would be 4 or 6 years.

Ex-post capex reviews

In our submission to the Commission's draft determination we responded at some length to the proposal to make a rule that would empower the AER to undertake ex post prudency reviews of capex. This proposal raises another important transitional issue.

Jemena's primary position is that ex post capex reviews should not be introduced. The threat of ex post reviews is likely to lead to NSPs avoiding expenditure in excess of their allowances, even where that expenditure is prudent and efficient. Moreover, the Commission itself has concluded that there is no incentive for businesses to over-spend, so ex post reviews are unnecessary.

If, contrary to Jemena's position, the Commission proceeds with its proposal, then, for the reasons set out in our previous submission—including that it would likely contravene section 33 of schedule 2 to the NEL—ex post capex reviews must not be applied retrospectively. The relevant rule should make it clear that only capex that a business has committed to and spent in the regulatory period that begins after the commencement date of the relevant rule should be subject to review.

As the Commission itself has said, albeit in another context:

> The NEL prohibits retrospective application of a Rule change to a determination in which participants have proceeded on the premise that a prior provision of the Rules applies.
>
> …
>
> There are compelling reasons against permitting the retrospective application of the Rules. The Commission considers that it would increase the uncertainty and regulatory risks face by the network service providers and would not promote efficient investment. It is likely that the network businesses

[1] AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Consultation Paper on Savings and Transitional Arrangements, 14 September 2012, Sydney, p.10.

> would seek to reflect the increase risk into a higher rate of return allowance. Further, it would create a precedent that revenue determination processes can be amended after they have commenced.[2]

Also, in a recent speech, ACCC chair Rod Sims pointed to what he believed to be the three key drivers of increasing network charges. Gold plating, in the sense of unnecessary and excessive expenditure for the purpose of increasing the regulatory asset base and hence future income, was not one of those drivers. Mr Sims noted:

> It is important to stress that in mentioning these three price drivers that this is not an argument about "gold plating", which is a term I have never used. It is instead about how to appropriately regulate the revenues and therefore profits of monopoly businesses, and the lack of sensible processes in relation to the setting of network standards.[3]

Capex that the business has committed to or spent in the current regulatory period should not be subject to ex post review.

Please contact me on 03 8455 9036 or by email at anton.murashev@jemena.com.au if you wish to discuss this submission.

Yours sincerely

Anton Murashev
a/g General Manager Regulation

[2] AEMC 2008, *Parameter Values, equity beta and gamma*, Draft Rule Determination, 28 August 2008, Sydney, pp. v-vi.

[3] Sims, R., *Addressing the key drivers of electricity price increases*, Speech at EUAA Annual Conference, 24 October 2012, Sydney