



**Government
of South Australia**

**Minister for Transport
Minister for Infrastructure
Minister for Energy**

12th Floor, Roma Mitchell House
136 North Terrace
Adelaide SA 5000

GPO Box 2969
Adelaide SA 5001
DX 154

Tel 08 8226 1210
Fax 08 8226 0844

1503767

RECEIVED

- 9 OCT 2006

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Dear Dr Tamblyn

Thank you for the opportunity to comment on the Australian Energy Market Commission's (AEMC) proposal to amend the National Electricity Rules (Rules) governing the regulation of transmission revenue.

Under the National Electricity Law (NEL) the AEMC is required to have regard to the market objective – to promote an efficient, reliable and safe electricity system in the long term interests of consumers. Like the Rule Proposal, the South Australian Government considers that the Draft Rule appears to be weighted too heavily in favour of the interests of Transmission Network Service Providers (TNSPs) and is therefore, on balance, unlikely to be in the long term interests of consumers.

The State Government considers that the Draft Rule builds on the highly prescriptive nature of the Rule Proposal, creating the possibility of further limiting the Australian Energy Regulator's (AER) discretion in its decision making powers.

One such example is in the area of the AER's information gathering powers. The State Government considers that the regulator should have wide ranging information gathering powers to enable it to effectively undertake its regulatory functions, and the Draft Rule's specification that the AER only gather information under certain circumstances, limits the AER's powers in this regard. The Rules should include an additional provision that the AER be able to gather information in other circumstances where it considers this necessary to performing its functions.

The State Government considers that the requirement that the AER publish confidential information in the absence of written permission, in an aggregated format, diminishes the transparency of the regulatory process.

As I highlighted in my submission to the Rule Proposal, the State Government considers that the codification of the parameters used in the calculation of the weighted average cost of capital (WACC), and the 'reasonable test' in relation to forecast operating and capital expenditure, is likely to systemically favour TNSPs over consumers.

The Rule Proposal requirement for the AER to accept TNSPs' 'reasonable' forecast capital and operating expenditure according to certain criteria, has been retained in the Draft Rule. As highlighted in my previous submission, reasonableness appears to be a significantly lower and less precise test than the current requirement for 'efficient' investment in regards to electricity or for a 'best estimate' in the case of gas.

The State Government considers that it is uncertain how the large range of criteria associated with the AER determining 'reasonable' will be interpreted in any possible future merits reviews. This has the potential to increase the scope for a business to appeal the regulator's decision at the expense of consumers.

While the Government considers that the BBB+ credit rating included in the Draft Rule is more consistent with the proposed benchmark gearing ratio of 60 per cent, and previous relevant regulatory decisions, it continues to have concerns with the remaining WACC parameters proposed by the AEMC. Codifying an equity beta of 1.0 limits the ability of the regulator to revise the decision, even in the face of strong market evidence to suggest that an equity beta other than 1.0 may be justified.

The State Government notes that a criterion has been included in the Draft Rule that, in undertaking to vary the WACC parameters at subsequent reviews, the AER must satisfy itself that current evidence on the value of the parameter is sufficient to justify a change from the value used in the last review. The Government considers that in the event that the AER undertakes to revise downwards any parameters in subsequent reviews, TNSPs would have an incentive to challenge the AER's evidence in the interests of retaining higher parameter values at the expense of consumers.

The State Government is concerned that in the context of the proposed ex-ante framework, the Draft Rule removes the Rule Proposal requirement for an ex-post prudency review at the next reset prior to roll in.

It is not clear that the inclusion of an allowance for depreciation in the incentive calculation would be a sufficient enough incentive for TNSPs to undertake least cost capital expenditure options, as required under the Regulatory Test. The State Government is not convinced that the benefits to TNSPs from having large amounts of capital expenditure rolled, unaudited, into their regulated asset base at the beginning of the next regulatory period would be outweighed by the relatively minor penalties associated with breaching the Rules regarding applying the Regulatory Test.

In relation to depreciation, I am disappointed that the AEMC has not sought to introduce guidelines on what constitutes an economic life. The absence of such a control creates the incentive for the TNSP to rapidly depreciate assets to gain increased short term returns from higher prices to consumers.

Thank you again for the opportunity to comment on the Draft Rule. Should you or your staff wish to follow-up in more detail on these comments, please contact Mr. Vince Duffy of the Energy Division, Department for Transport, Energy and Infrastructure on (08) 8204 1724.

Yours sincerely



HON PATRICK CONLON MP
MINISTER FOR ENERGY

3 October 2006