

The Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

27 March 2006

John
Dear Sir

Review of Electricity Transmission Revenue and Pricing Rules

Integral Energy welcomes the opportunity to comment on the Review of Electricity Transmission Revenue and Pricing Rules (the Review) conducted by the Australian Energy Market Commission (AEMC).

Integral Energy is broadly supportive of the Review, however, considers the following issues need to be revisited in the Review and Draft Rules:

Scope and Form of Regulation

Integral Energy concurs with the definitions of *Prescribed Transmission Services* and *Negotiated Transmission Services*, with the exception of the classification of exit and TNSP to TNSP connection services.

Integral Energy considers network to network connection service costs (and use of systems to augment or extend the transmission network) should be classed as a *Prescribed Transmission Service* as the connection services relate to connecting shared networks, being subject to the same technical requirements of Schedule 5.1 of the Rules and necessary to ensure both the reliability and quality of supply of electricity and the reliability and security of the national electricity system.

Firm access to the shared network of Distribution Network Service Providers (DNSPs) is required in order for Transmission Network Service Providers (TNSPs) to meet their performance requirements under Schedule 5.1 of the Rules and under other legislation of a participating jurisdiction.

Further supporting the classification of network to network connection service costs (and use of systems to augment or extend the transmission network) as *Prescribed Transmission Services* is the recognition that DNSPs have strong economies of scale and externalities such that competition is unlikely to be feasible.

Integral Energy considers the connection costs borne by the TNSP should be determined with reference to regional boundaries. Therefore, in respect to TNSP to TNSP connection

services, each TNSP would bear the costs of connection services within its regional boundaries.

Opening value of RAB

Integral Energy supports the inclusion of assets used to provide *Negotiated Transmission Services* in the Regulated Asset Base (RAB) to the extent that those assets are used to also provide *Prescribed Transmission Services*. For assets which exceed the standard of *Prescribed Transmission Services*, to the extent that the standards provided by the asset exceeds the standards for *Prescribed Transmission Services*, the treatment for valuing these assets in the RAB may be considered in the context of a variant to the treatment of partly funded augmentations.

However, where a regulator sets a standard higher than the standard of *Prescribed Transmission Services*, those assets used to meet that higher standard set by the regulator should have their full value included in the RAB.

Integral Energy is concerned that any roll forward of the RAB into the next regulatory period across jurisdictions properly reflects a uniform and consistent basis of asset valuation and prudence assessment of past investments.

Inconsistent treatments in determining the prudence of investments and the valuation of assets undermine predictability and adversely impacts on investment decisions. Further, Integral Energy considers property rights should be clearly defined and reflected in the RAB.

Accordingly, Integral Energy would support a jurisdictional direction for the Australian Energy Regulator (AER) to either accept the current regulatory asset base value rolled forward or if the jurisdiction chooses the AER should accept a jurisdictional regulatory asset base value developed in accordance with a nationally consistent valuation framework and methodology.

Value of WACC

Integral Energy considers the inclusion of the WACC parameters in the Rules will provide greater certainty for regulated businesses.

However, Integral Energy notes that under clause 6.2.4 of the proposed Rules, the AER must review the values of and methodologies used to calculate the WACC and the use of the BBB credit rating. In order to ensure appropriate transparency, certainty and accountability in future revenue determinations, Integral Energy recommends an amendment to the proposed clause 6.2.4(e) of the Rules such that it reads:

"If, as a consequence of a review under this paragraph (e), the AER decides to adopt revised values or methodologies, it must effect an amendment to the Rules incorporating the revised values or methodologies, prior to those revised values and methodologies being used for the purposes of any revenue cap determination made after 1 July 2011 or after the expiry of that subsequent five year period (as the case may be)."

Depreciation

Integral Energy considers it would be inappropriate to commercially strand assets that were constructed to meet legislated service requirements. In those instances where customers are no longer connected to the network and that part of the network may become

commercially stranded, alternative arrangements should be considered to deal with these existing assets, such as accelerated depreciation.

Forecasts – Capital Expenditure

Integral Energy considers that where the forecast capital expenditure identified in a Revenue Proposal is a reliability augmentation or is necessary for the TNSP to comply with its regulatory obligations, it is inappropriate for the AER to have the discretion to reject the forecast capital expenditure. Any such rejection of forecast capital expenditure clearly threatens the reliability and security of the national electricity system and undermines the national electricity market objective.

Similarly, where the forecast capital expenditure has satisfied the *regulatory test*, it is inappropriate for the AER to reject the forecast capital expenditure.

Accordingly, Integral Energy submits that clause 6.2.6(b)(2) be amended to delete the words “subject to paragraph (3)”

Proposed clause 6.2.6(b)(3) lists several items to be considered by the AER in determining a “reasonable estimate” of the TNSPs required capital expenditure for the regulatory control period. To assist the AER and provide regulatory certainty to TNSPs, Integral Energy considers each item listed in subparagraph 6.2.6(b)(3)(i) and subparagraphs 6.2.6(b)(3)(iii) to 6.2.6(b)(3)(x) should be given an equal weighting.

Subparagraph 6.2.6(b)(3)(ii) relating to *“the need to comply with all applicable regulatory obligations associated with the provision of prescribed transmission services”* should be afforded a higher weighting. This weighting gives due recognition to the reliability, safety and security of the national electricity system in the national electricity market objective and enables the TNSP to meet its legal obligations.

Forecasts – Operating Expenditure

Proposed clause 6.2.7(b)(2) lists ten items to be considered by the AER in determining a “reasonable estimate” of the TNSPs required operating expenditure for the regulatory control period. To assist the AER and provide regulatory certainty to TNSPs, Integral Energy considers each item listed in subparagraph 6.2.7(b)(2)(i) and subparagraphs 6.2.7(b)(2)(iii) to 6.2.7(b)(2)(x) should be given an equal weighting.

Integral Energy considers that it is inappropriate that AER be afforded the discretion to effectively prohibit a TNSP from meeting its legal obligations through an inappropriate weighting of factors applied in its consideration of what is a “reasonable estimate” of operating costs. Accordingly, Integral Energy submits that subparagraph 6.2.6(b)(3)(ii) relating to *“the need to comply with all applicable regulatory obligations associated with the provision of prescribed transmission services”* should be afforded a higher weighting.

Revoking a Revenue Cap

Integral Energy supports the revocation of a revenue cap determination where the revenue cap determination was set on the basis of false or materially misleading information provided to the AER or where there was a material error in the setting of the revenue cap determination and the prior written consent of the relevant TNSP has been obtained by the AER.

However, Integral Energy considers that the relevant TNSP only should be able to write to the AER to revoke a determination in relation to a material error and not affected parties as proposed in the Draft Rules, as potentially all end customers are affected parties.

Standards of Service

Integral Energy considers that in recognition of the MCE framework ensuring a separation of rule making from rule enforcement and economic regulation, and in the context of a propose-respond model, it is inappropriate for the AER to set target service standards.

It is not clear to Integral Energy how new network assets developed by the TNSP for the achievement of higher service standards will be treated by the AER with respect to both the new definition of prescribed transmission services and the value of assets under the regulatory test.

If the AER does set target service standards, Integral Energy believes the AER should accept the value of the asset developed to meet the higher standard in calculating a TNSP's RAB. In order for a TNSP to meet target service standards set by the AER, it must have assets which are able to meet those target service standards above the standard of *Prescribed Transmission Services* and which form a part of the incentive arrangements. For the AER to do otherwise is to penalise the TNSP by firstly restricting its ability to meet the incentive performance standard targets and then reducing the TNSP's MAR for not achieving the incentive standard.

Issues also arise in respect to recognising the value of reliability augmentations. Where a reliability augmentation which provides for a reliability standard above the minimum reliability standard set in *Prescribed Transmission Services* and which enables a target reliability standard set by the AER to be met, that asset must still be recognised as a reliability asset. Further, the value of that asset should not be reduced because it meets the higher target standard for reliability set by the AER.

Alternatively, Integral Energy considers that a TNSP should set its own higher target standards. Integral Energy considers +/- 1% of the MAR is a sensible level of incentive for service standard.

Should you wish to discuss the issues raised in this letter, would you please contact Erik Beerden, telephone number (02) 9853 6904 in the first instance.

Yours faithfully



Richard Powis
Chief Executive Officer