08 December 2011

positive energy

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Attention Mr Richard Khoe

Dear Mr Khoe

National Electricity Amendment (Economic regulation of network service providers) Rule 2011

ENERGEX welcomes the opportunity to make this submission on the Australian Energy Market Commission's (AEMC) consultation papers regarding the rule change proposals submitted by the Australian Energy Regulator (AER) and the Energy Users Rule Change Committee (EURCC).

ENERGEX is a Distribution Network Service Provider (DNSP) operating in south east Queensland. ENERGEX is among one of the first DNSP's whose distribution determination was made by the AER under the current Chapter 6 of the National Electricity Rules (NER).

ENERGEX is a member of the Energy Network Association (ENA), the peak national body representing Australia's electricity and gas network service providers. ENA will be making a submission on behalf of its members. The ENA's submission addresses the questions raised in both the AEMC's consultation papers published on 20 October 2011 and 3 November 2011 in relation the AER and EURCC rule change proposals respectively. ENERGEX supports the ENA's responses to the AEMC's questions as set out in the submission.

In addition to the issues raised in the ENA submission, ENERGEX seeks to provide further comments on some general and specific matters in relation to the following issues:

- expenditure approval processes;
- capital expenditure incentive framework;
- decision-making procedure;
- treatment of shared assets; and
- cost of debt.

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General Comments

ENERGEX is concerned with the substantial amendments being proposed by the AER. The current regulatory regime has been in place for three years following a major re-design of the framework to encourage investment in the energy sector. While incremental changes to ensure that the NER remain contemporary are encouraged, changes to the fundamental design of the framework are not considered appropriate at this stage; in particular for investment in long life assets which requires a reasonable degree of regulatory certainty.

ENERGEX submits that a regulatory regime must have the appropriate balance between prescription and discretion. Some level of prescription is required to provide investment certainty while some degree of discretion is necessary to allow the AER and the regulated businesses to take into account a wide variety of potential circumstances such as operational and jurisdictional differences. Overall, ENERGEX believes that the current NER have provided the AER with the appropriate balance of prescriptive and discretionary powers in its role as the economic regulator for the energy industry.

Competitive neutrality, an established key feature of economic reform is the basis for the regulation of network businesses where the ultimate aim is to emulate a competitive market in terms of price and other outcomes (e.g. service levels). The concept of a benchmark firm is used by the AER in its assessment of regulatory proposals from all DNSP's regardless of ownership. The Energy Users Association of Australia (EUAA) has also publicly encouraged the AER to adopt more benchmarking analysis in making its determination. Therefore it seems inconsistent for the EURCC to "cherry-pick" a particular issue and propose that differential approaches be applied on the basis of ownership.

ENERGEX also considers that some form of transitional arrangements should be included in any NER revisions particularly for businesses impacted by changes from a timing point of view.

Expenditure Approval Process

ENERGEX does not subscribe to the AER's view that there is deficiency in the drafting of the NER with respect to the expenditure approval process. ENERGEX's expenditure forecasts for its 2010-15 regulatory proposal were developed through a robust planning and evaluation process. As a prudent business, these forecasts were prepared based on the information available at that time, its expectation of demand forecast, customer numbers growth, asset condition and the prevailing economic environment.

In assessing the ENERGEX's regulatory proposal, the AER made top level (i.e. not "line by line") adjustments to ENERGEX's expenditure allowances on the basis of a lower demand forecasts and input costs escalation allowances. A comparison of the capital and operating allowances sought by ENERGEX and that allowed by the AER for the 2010-15 regulatory control period is provided in the tables below.

ENERGEX's Capital Expenditure Allowances (in 2009/10 $million)

Year	2010-11	2011-12	2012-13	2013-14	2014-15	Total
Regulatory Proposal	1,239.5	1,269.7	1,301.9	1,292.4	1,362.5	6,466.0
AER Draft Determination	1,064.8	1,144.6	1,159.3	1,151.9	1,197.7	5,718.3
Revised Reg Proposal	1,232.1	1,275.1	1,265.0	1,238.5	1,275.7	6,286.4
AER Final Determination	1,125.8	1,171.8	1,157.7	1,143.5	1,184.1	5,782.9

ENERGEX's Operating Expenditure Allowances (in 2009/10 $million)

Year	2010-11	2011-12	2012-13	2013-14	2014-15	Total
Regulatory Proposal	355.1	360.9	371.3	380.4	375.5	1,843.2
AER Draft Determination	313.2	312.2	318.0	324.4	318.7	1,586.5
Revised Reg Proposal	325.8	328.5	336.3	342.6	336.4	1,669.6
AER Final Determination	317.6	319.4	328.3	336.3	332.5	1,634.1

ENERGEX therefore considers that the NER as currently drafted strikes an appropriate balance between prescription and discretion. The existing framework allows the AER to assess expenditure proposals and make adjustments as appropriate in order to ensure prudent and efficient expenditure. The AER's rule change proposal seeks a significant expansion of its discretion without valid justification and in addition increases the risk of regulatory error with the potential to lead to systemic under investment in critical infrastructure.

Capital Expenditure Incentive Framework

ENERGEX is concerned with the proposed changes to codify that only 60% of capital expenditure overspend can be rolled into the regulatory asset base (RAB). ENERGEX disagrees with the AER's assertion that the current RAB roll forward mechanism creates incentives for network service providers to incur more than efficient levels of capital expenditure.

In the case of ENERGEX, the capital overspend for the previous two regulatory control periods (2001-02 to 2004-05 and 2005-06 to 2009-10) was primarily driven by the high demand growth in South-East Queensland. It is worth noting that the above expenditure in these periods was incurred prior to the making of the current Chapter 6 rules which allowed the automatic roll forward of capital expenditure into the regulatory asset base.

ENERGEX therefore submits that the proposal to codify the capital expenditure efficiency incentive scheme into the NER is unnecessary because as set out in the ENA submission, the AER already has the discretion to introduce an Efficiency Benefit Sharing Scheme with respect to capital expenditure in accordance with the existing NER consultation procedures.

Decision-making Procedures

The AER Rule Change Proposal raises a series of procedural issues associated with the current drafting of Chapter 6 (and Chapter 6A) of the NER. In addition to the issues raised in the ENA's submission, ENERGEX is concerned with the timing of the WACC review.

In its first WACC review, the AER lodged a rule change proposal to extend the time for completion of the review from 31 March 2009 each year (and every 5 years thereafter) to 1 May 2009 (and every 5 years thereafter). ENERGEX, Ergon Energy and ETSA Utilities were three parties directly impacted by these changes and requested (and was granted by the AEMC) the change in timing for the WACC review to be a one-off and that a corresponding one-off extension be afforded to the DNSPs to lodge their regulatory proposal in 2009.

While ENERGEX agrees with the ENA that there should be flexibility for the AER to extend timeframes as necessary, any extension should be cognisant of the timing for submission of the regulatory proposals from impacted businesses to ensure that there is sufficient lead time to review, assess and seek expert analysis of the AER's decision, particularly on such a critical matter.

Treatment of Shared Assets

ENERGEX welcomes the recognition by the AER to extend the use of assets in the regulatory asset base for provision of services other than non-standard control services. However, ENERGEX does not support the scope of the changes to the NER as proposed by the AER to give effect to this extension.

ENERGEX submits while revenue adjustment is used by ENERGEX in the current regulatory control period to account for use of shared assets for the provision of alternative control services, there may be other mechanisms to address the issue. Prescription of a mechanism in the NER will be inflexible and will not take into account jurisdictional specific matters and operational differences of the network service providers or existing contractual arrangements.

While ENERGEX supports the concept of benefits sharing with users, the adjustment mechanism must recognise the associated risks and be subject to a materiality threshold to ensure that DNSPs can efficiently provide these services without increasing regulatory burden through extensive accounting or ring fencing procedures.

Cost of Debt

The EURCC's characterisation of the debt management practices applicable to Government Owned Corporations does not reflect the approach taken by ENERGEX. ENERGEX has specific interest rate risk management parameters, within which its Client Specific Pool (CSP) is managed. For example, ENERGEX will determine the target duration and maturity profile of the debt instruments in the CSP, and manage inflation risk.

In addition, ENERGEX is concerned with the EURCC and AER approach of taking a snapshot of actual debt issuance yields without considering inherent re-financing risk as it is an incomplete analysis of the cost of debt.

In conclusion, ENERGEX looks forward to participating in the consultation process and would be pleased to discuss this matter further. Should you have any enquiries please contact Sue Lee, Revenue Strategy Manager - Regulatory on (07) 3664 4055.

Yours sincerely

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