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Dear Sir/Madam

**AUSTRALIAN ENERGY MARKET COMMISSION CONSULTATION ON "DRAFT NATIONAL
ELECTRICITY AMENDMENT (ECONOMIC REGULATION OF TRANSMISSION SERVICES) RULE
2006"**

Ergon Energy is pleased to make this submission, which is available for publication, in its capacity as an electricity Distribution Network Service Provider in Queensland. This submission addresses the Australian Energy Market Commission's (AEMC's) "Draft National Electricity (Economic Regulation of Transmission Services) Rule 2006" (the Draft Rules Proposal) and is being made recognising the national reform agenda for greater regulatory consistency across electricity and gas markets, including across electricity transmission and distribution businesses.

In our submission to the AEMC's Issues Paper entitled "Review of the Electricity Transmission Revenue and Pricing Rules", Ergon Energy established a consistent theme that the National Electricity Rules (the Rules) should not seek to impose unnecessary prescription but rather should establish high level principles and provide the AER with discretion in undertaking its functions.

To this end, Ergon Energy favoured a propose/respond regulatory model whereby network service providers (NSPs) would submit a proposal consistent with the Rules and their individual commercial and operating circumstances. Under this propose/respond model, the AER would only be able to reject an NSP's proposal where it is inconsistent with the Rules or where the overall proposal, taken in its entirety, results in values that are outside a reasonable range. To protect NSPs, the AER's decision would be reviewable. Ergon Energy also supported the adoption of an incentive based regulatory framework incorporating a minimum suite of incentive arrangements applying to operating costs, capital expenditure, service quality and asset utilisation.

In light of this preferred regulatory model, Ergon Energy, considers that the AEMC's Draft Rules Proposal provides for a more prescriptive, less flexible regulatory framework than appropriate. While the AEMC has indicated its intention to specify a propose-respond regulatory approach in the Rules, in practice, the intended level of prescription will, in certain important respects, excessively constrain what the TNSP can propose.

The AEMC states that increased codification of the procedures and methodologies to be applied compared to that currently applying under the Rules will provide greater regulatory certainty for TNSPs, other market participants and the AER itself. However, Ergon Energy considers that under the Draft Rules Proposal, there is a material risk that operational differences across TNSPs will not be fully

recognised. Such a regulatory framework, if subsequently applied to DNSPs, would be of particular concern to Ergon Energy given its predominantly rural, atypical, distribution network. Further, such an outcome is likely to be at odds with the views expressed by the MCE Expert Panel on Energy Access Pricing who note:

“...over-restriction of the regulator’s flexibility can lead to an inability to deal with specific situations on their merits - an inefficient attempt to shoe horn all situations into a ‘one size fits all’ approach. Accordingly, the constraints imposed on any guidance given to the regulator should be the minimum necessary to achieve the objectives of the regime with some certainty.”¹

Ergon Energy recognises that its submission to the AEMC’s Issues Paper argued that various levels of prescription are appropriate with respect to different elements of the regulatory framework. Consequently, there are a number of areas where the prescription inherent in the AEMC’s proposal is in accordance with Ergon Energy’s views. In addition, Ergon Energy notes that a critical element of its preferred propose-respond model is access to appropriately specified merits review. In the absence of such merits review, Ergon Energy supports the Rules providing principles to guide the AER in the exercise of its discretion.

Ergon Energy’s views on the AEMC’s Draft Rules Proposal are set out below under the relevant chapter headings in the AEMC’s “Transmission Revenue: Rule Proposal Report”.

Chapter 4 – Scope and Form of Regulation

The Rules are to specify two types of transmission services – prescribed and negotiated. Prescribed services are use-of-system services supplied by the shared transmission network which meet but do not exceed State legislative & Rules requirements.

Negotiated services include connections services, agreed augmentation/extensions for loads, generators and MNSPs, and use-of-system services supplied in excess of State legislative & Rules requirements.

Ergon Energy agrees that the current approach under the Rules for transmission services to be defined by reference to services which are subject to the revenue cap is circular and unhelpful.

Ergon Energy supports the AEMC’s decision to develop a Rules proposal which applies economic regulation to transmission services rather than transmission assets.

Ergon Energy argued in its submission to the Issues Paper that the Rules should set out a threshold test for determining whether services should be deemed to be contestable for regulatory purposes. Ergon Energy considers the proposal in the Draft Rules Proposal is an improvement on the current Rules. However, it is not a threshold contestability test and, moreover, it is not clear that the distinction between a prescribed and negotiated service should turn on whether it is provided in accordance with or, alternatively, in excess of, State legislative and Rules requirements. Ergon Energy reiterates its position that a threshold test to assess contestability should be established in the Rules.

The Rules are to allow only a revenue cap form of regulation based on the building block approach, which is to be applied to prescribed transmission services. Negotiated transmission services are to be subject to a commercial negotiation regime.

Ergon Energy considers that the existing approach applied to DNSPs of allowing for a revenue cap, price cap or hybrid based on the building block approach is appropriate for both transmission and distribution NSPs. The only rationale provided by the AEMC for prescribing the revenue cap form of regulation for

¹ Expert Panel Report on Access Pricing, Draft Report to the Ministerial Council on Energy, March 2006, p10.

the next five years is that TNSPs face largely unmanageable volume risk. Ergon Energy believes that the regulated NSP is best placed to make the decision about whether or not it is able and/or willing to manage such a risk.

Ergon Energy is concerned that prescribing revenue caps as the only possible form of regulation available for TNSPs for the next 5 years may create a precedent for the regulation of DNSPs. As such, Ergon Energy would like to see the AEMC extend the choice of regulatory approach currently available to DNSPs to TNSPs as doing so is more consistent with a propose-respond regulatory approach.

However, Ergon Energy does support the AEMC's decision not to provide for the use of alternative revenue cap methodologies based on productivity indices or benchmarks at this time.

Ergon Energy also fully supports the AEMC's proposal for a TNSP being able to propose a lighter handed form of regulation for those services excluded from the main regulatory control but where some regulation is considered to still be required.

Chapter 5 – Regulatory Procedures

The TNSP is to submit a Revenue Proposal for prescribed services and a negotiation framework, both of which must comply with AER Guidelines and certain parameter values established in the Rules. AER's refusal to approve the NSP's Revenue Proposal will result in the substitution or amendment of the relevant values by the AER.

Ergon Energy believes that a TNSP should be able to propose an approach consistent with the Rules and reflecting its operating circumstances. The AER should only be able to reject the proposal where it is inconsistent with the Rules or where the overall proposal taken in its entirety results in values that are outside a reasonable range.

In the absence of suitable merits review, Ergon Energy recognises the desirability of the AER's discretion being constrained by principles set out in the Rules.

Ergon Energy notes that the AEMC acknowledges that its proposed approach is more prescriptive than the current Rules. Ergon Energy considers that the resulting model is no longer a true propose-respond regulatory model and believes that if such an approach were to be applied to distribution networks, Ergon Energy would be unduly constrained in its ability to make a proposal fully reflecting its commercial and operational circumstances. Further, the AER would similarly be inappropriately constrained in assessing Ergon Energy's proposal.

Ergon Energy believes that the AEMC should reconsider the level of prescription inherent in the Draft Rules Proposal, including with respect to the form of regulation and specification of cost of capital parameter values. Further comment on these and other areas where Ergon Energy considers there is too much prescription is set out in the relevant section of this submission.

The Rules will contain a propose-respond process featuring a fixed 13 month timeframe, including AER preliminary assessment of a TNSP's Revenue Proposal against AER information requirements, an AER draft decision, and scope for a TNSP to submit a revised proposal. The AER's refusal to approve a revised proposal will result in the substitution or amendment of the relevant values by the AER.

The AER must accept a TNSP's Revenue Proposal if the total revenue cap is determined in accordance with the AER's post tax revenue model and the Rules, and forecast capex and opex are a reasonable estimate of the TNSP's requirements having regard to specified criteria.

Ergon Energy regards a timely regulatory process as desirable. However, unnecessarily constraining the timeframe may adversely impact on the ability of the AER to consider the specific commercial and operating circumstances faced by the TNSP.

Ergon Energy has serious concerns that the fixed 13 month timeframe proposed by the AEMC will only be appropriate where a TNSP has a stable, predictable, operating environment so that it will be a relatively straightforward matter for the TNSP to prepare a Revenue Proposal and for the AER to consider and approve it. However, based on Ergon Energy's own experience with distribution regulatory resets, it cannot be assumed that this will always be the case.

The risk for a TNSP is that the six months the AER will have from the submittal of the TNSP's Revenue Proposal to the publication of a Draft Decision will be insufficient for a full consideration of the proposal to be made with the result that the AER will be inclined to reject it so as to gain additional time. The TNSP's right to submit a revised proposal, albeit within the tight timeframe of 30 business days, does not address the risk of the initial proposal being less than fully considered and rejected. Given the AER can ultimately substitute its own parameter values into the TNSP's proposal in its Final Decision, the TNSP's risk of inappropriate parameter values being imposed on it are magnified.

Ergon Energy does not support the specification of a fixed timeframe in the Rules. However, if the AEMC maintains its preference for such an approach, Ergon Energy believes that the timeframe should be extended to 18 months. As part of this extended timeframe, a TNSP should be given at least 60 days to submit a revised Revenue Proposal in order for it manage internal Board approval processes.

The Draft Rules Proposal provides that the regulatory control period must not be less than 5 years.

Ergon Energy considers that an NSP should propose the length of the regulatory period. While Ergon Energy recognises that a minimum length of regulatory period of 5 years is currently a requirement of the Rules for TNSPs, it does not see why this should necessarily be prescribed in the Rules.

The AER will be required to develop guidelines under the Rules relating to the information to be submitted with a TNSP's Revenue Proposal and Cost Allocation Principles.

The Draft Rules establish the minimum information requirements for TNSPs' Revenue Proposals, including information and matter relating to capex and opex and

AEMC sought comment on whether there should be greater guidance in the Rules in relation to the AER's general information gathering powers.

Ergon Energy believes that the minimum information requirements in the Draft Rules Proposal are sufficiently detailed to be all that the AER should reasonably require in order to assess a Revenue Proposal. As a result, Ergon Energy sees no reason why the AER should be required to develop guidelines relating to the provision of additional information to be submitted with a Revenue Proposal.

With respect to the details of the information requirements, Ergon Energy has a particular concern about the requirement that a TNSP should attain certification of the reasonableness of its capex and opex forecasts and underlying assumptions by an independent and appropriately qualified expert. Specifically, if such a requirement is to apply, Ergon Energy does not see why the Rules should also require the AER to undertake an assessment of whether the TNSP's submitted capex and opex forecasts are a 'reasonable estimate', as proposed elsewhere in the Draft Rules. Rather, the AER should simply be required to endorse all capex and opex forecasts submitted with an independent certification that the forecasts are reasonable. To do otherwise would be to introduce wasteful duplication into the

assessment of what is a reasonable level of capex and opex expenditure and moreover, would be a more onerous process than currently occurs under the Rules.

Ergon Energy considers that the Cost Allocation Principles in the Draft Rules Proposal provide sufficient guidance for a TNSP to propose a Cost Allocation Methodology to the AER without the need for additional guidance from the AER. Cost allocation methodologies are a well-established feature of Australian regulatory arrangements and there appears no good reason for the AER to develop supplementary Cost Allocation Guidelines. In addition, Ergon Energy considers that the proposed Cost Allocation Principles should provide for the AER to act reasonably in making any amendments to a Cost Allocation Methodology submitted by a TNSP.

Ergon Energy argued in its submission to the Issues Paper that the AER should be subject to a reasonableness test in relation to any information that it requires to be provided. Ergon Energy still believes that such a test should be included in the Rules to provide guidance in relation to the AER's general information gathering powers.

The Draft Rules Proposal with respect to revocation of a revenue cap remains unchanged from the current Rules, except for the removal of the criterion relating to a change in ownership of a TNSP.

AEMC also sought submissions on whether a change is required to the current provision that the AER can only revoke a determination in relation to a 'material error' where it has obtained the written consent of the affected parties, including whether there would be benefit in further defining what constitutes a 'material error'.

Ergon Energy supports the Draft Rules Proposal. However, Ergon Energy does not consider that there would be any benefit in further defining a 'material error'. The concept of a 'material error' is well established in law and could be assessed on a case by case basis without the need for refinement of the definition. The source of the 'material error' may be the NSP, or alternatively, the AER. Consequently, judgement as to whether a 'material error' in a determination has occurred will depend on the circumstances surrounding the development of the NSP's Revenue Proposal, including its operating circumstances, together with the AER's assessment process and decision regarding the proposal. Any disagreement over whether a 'material error' has occurred should be subject to dispute resolution.

Ergon Energy also disagrees with the AEMC that the AER should only be required to consult, rather than obtain the written consent, of the affected TNSP before revoking a determination. The subjectivity associated with a requirement for the AER to only consult with the TNSP provides limited protection of a TNSP's legitimate business interests. Any disagreement over the need for a revocation should be subject to dispute resolution.

Chapter 6 – Regulated Revenue

The Rules will codify the current 'lock in' approach to asset valuation outlined in the ACCC's Statement of Regulatory Principles.

The Draft Rule Proposal requires the AER to develop and publish a model of the roll-forward, consistent with the Rules' principles and subject to consultation.

Ergon Energy considers that provided a TNSP's initial valuation is accurate, codifying the 'lock in' approach outlined in the Statement of Regulatory Principles within the Rules is appropriate. However, the Rules should allow for TNSPs to propose and justify a revaluation to the AER where they believe and can demonstrate the current valuation is in error.

Ergon Energy supports the AER being required to develop and publish a roll-forward model.

Actual expenditure which is assessed by the AER to be prudent and efficient must be rolled into the regulatory asset base regardless of whether that capex is above or below forecast.

However, the Rules will not mandate a prudency and efficiency review, but rather set out criteria (eg. whether the Regulatory Test was applied by the TNSP and its outcome, whether the TNSP undertook the project in a manner consistent with good business practice) that the AER must have regard to in assessing the prudency and efficiency of investment which is to be rolled into the asset base.

The Draft Rules provide that in determining the prudency or efficiency of capex, the AER must only take into account information and analysis that the TNSP could reasonably be expected to have considered or undertaken at the time that it undertook the relevant capex.

Ergon Energy supports the Draft Rules Proposal.

The Rules will set out the factors that the AER is required to take into account in assessing the capex forecasts, including reasonable estimates of the benchmark capex that would be incurred by an efficient TNSP.

Ergon Energy does not support the Draft Rules Proposal given the proposed information requirement that a TNSP should attain certification by an independent and appropriately qualified expert of the reasonableness of the capex forecasts and their underlying assumptions.

A TNSP will be able to seek a re-opening of the revenue cap where it wishes to undertake capex that has not been included in its forecast capex, but only where the project is either a reliability augmentation, required to satisfy a regulatory obligation, or where it has satisfied the Regulatory Test. It must also be at least 5% of the value of the TNSP's regulatory asset base. The AER can only re-open the cap if by not doing so it would detrimentally affect the TNSP's ability to operate the transmission system safely.

AEMC sought submissions on the appropriate level of the materiality threshold, in particular, whether it should be specified as a dollar number or as a percentage of the TNSPs's RAB.

In principle, Ergon Energy does not believe that regulatory determinations should be reopened in the absence of material error, on the grounds that incentive characteristics of the regulatory arrangements are weakened. Rather, within-period capex attributable to unforeseen circumstances should be recognised (eg. through a holding fund) with such expenditure only able to be excluded where the AER can demonstrate that it was unreasonable given the circumstances faced by the TNSP at the time the expenditure was undertaken.

As a result, Ergon Energy considers a re-opening of the revenue cap for unforeseen capex as a second best approach. Moreover, the materiality threshold of 5% of the regulatory asset base appears far too high to be of any practical use for TNSPs. If it were to be subsequently applied to DNSPs, where capex projects are generally on a smaller scale, it would likely never be used. Based on Ergon Energy's expected 2005-06 regulatory asset base value of around \$4.6 billion, a (non-forecast) capex project of around \$231 million would be required to trigger a re-opening. Ergon Energy notes that under its current regulatory arrangements, the QCA will consider pass-through for totally unanticipated large customer capex projects with a cost in excess of \$10 million.

The regulated asset base should only include the value of assets associated with the provision of prescribed transmission services consistent with the AER's Cost Allocation Principles and the TNSP's approved Cost Allocation Methodology.

It would appear that the Draft Rules Proposal precludes a TNSP including assets which are utilised by both regulated and unregulated services in the regulatory asset base.

Ergon Energy notes that there are two approaches to the treatment of shared assets in the regulatory asset base. First, identify the shared asset portion utilised by the regulated service and only allow that portion to be included in the regulated asset base (AEMC's proposal). Under this approach, a cost allocation methodology is required to separate, in an accounting sense, the remaining assets utilised by non-regulated services. Second, include the full value of shared assets in the regulated asset base and implement a charging mechanism to ensure that the regulated business is fully compensated for the use of these assets by unregulated users (with appropriate adjustments to maximum allowable revenue). Ergon Energy chose the second approach for its regulatory asset base used in the QCA's 2005 Electricity Distribution Final Determination.

Where properly implemented, both approaches should yield the same outcome so the AER should be indifferent to which one is adopted by the TNSP. As a result, Ergon Energy does not support the Rules prescribing only one approach, considering this to be inconsistent with a propose-respond regulatory framework.

Periodic optimisation of the RAB is not provided for in the Draft Rules Proposal.

Ergon Energy supports the Draft Rules Proposal.

The TNSP's proposed depreciation schedules are to comply with the Rules' principles that each asset (or asset group) is to be depreciated over its economic life once and only once, with the sum total of depreciation over the asset life (in real terms) being equal to the initial value at which the asset entered the RAB.

Ergon Energy's preference is for the Rules to specify that the AER could not reject a TNSP's proposed approach unless it fell outside the range of reasonable approaches, including straight line, geometric and annuity based profiles. The Draft Rules Proposal is broadly consistent with this view and is supported.

Operating cost forecasts are to be based on firm-specific efficient forecasts.

The AER must accept a TNSP's expenditure forecast if it is satisfied that the amount is a 'reasonable estimate' of the business' requirements having regard to a number of criteria including: efficient costs; benchmark information; and regulatory obligations borne by the TNSP.

Ergon Energy does not support the Draft Rules Proposal given the proposed information requirement that a TNSP should attain certification by an independent and appropriately qualified expert of the reasonableness of its opex forecasts and underlying assumptions.

However, Ergon Energy supports the AEMC's proposal to specify in the Rules that a TNSPs' operating cost forecasts should be firm-specific.

Ergon Energy agrees with the AEMC that the uniqueness of a TNSP's costs mean that the use of industry-wide benchmark approaches (such as DEA and or TFP) to set efficient costs or expected efficiency improvements is not likely to be appropriate. Ergon Energy raised a similar argument in its submission to the Issues Paper.

The Rules are to set out the initial methodology/values of specified cost of capital component parameters, based on those in the ACCC's Statement of Regulatory Principles. These parameters are to be used in all AER TNSP Determinations for the next 5 years. The parameters are to be reviewed by the AER every 5 years subsequently.

Ergon Energy does not support the Rules specifying values for cost of capital component parameters on the grounds that this is appropriately a matter for a TNSP to propose to the AER reflecting its particular circumstances. The cost of capital parameters should be proposed by NSPs and should only be rejected by the AER where they lie outside a reasonable range. Moreover, the specification of cost of capital parameter values in the Rules is inappropriate given the Ministerial Council on Energy's conclusion that it would be desirable to provide merits review of decisions by the AER in relation to price and revenue control.²

Prescription within the Rules with respect to cost of capital should be limited to the broad approach to estimating the cost of capital (ie. the post tax nominal framework based on CAPM).

The Draft Rules Proposal sets out high level guidance on how the cost of tax should be estimated, based on benchmark parameters and not a TNSP's actual tax costs. The AER will be required to set out its approach to calculating the cost of tax in its published regulatory model.

The AEMC sought submissions on whether the proposed degree of guidance in the Rules is appropriate, or whether increased clarity regarding the methodology to be adopted is warranted.

In principle, Ergon Energy supports the Draft Rules Proposal (except the value of gamma being prescribed in the Rules) and does not consider that further clarity regarding the methodology is required.

However, Ergon Energy notes that its current regulatory arrangements recognise actual tax paid not tax payable based on hypothetical benchmark parameters. Consequently, if the Draft Rules Proposal was to be extended to DNSPs, there is a risk to Ergon Energy that the use of a benchmark tax approach will have an adverse future revenue impact through failure to recognise the different tax profile under the current regulatory treatment. As a result, Ergon Energy proposes that any high level guidance should require the AER to consider past regulatory tax treatments and recognise any required revenue adjustments to ensure an NSP is no worse off due to a switching of regulatory tax treatment.

The Draft Rule requires the AER to develop and publish, following consultation, a post tax nominal revenue model based on principles established in the Rules. The TNSP is to populate the published Model in submitting its Revenue Proposal, including proposing the X-factor for each year of the regulatory period.

Ergon Energy supports the Draft Rules Proposal.

AEMC flags that there are a number of concerns regarding the AER's current Post Tax Revenue Model and in particular, the timing of revenues and costs in the model.

AEMC sought submissions on whether it would be appropriate for the Rules to explicitly incorporate guidance in relation to the assumptions to be made on the timing of costs and revenues in the regulatory model, or whether it is appropriate to leave this to the AER to determine as part of the development of the model.

Ergon Energy considers that it is appropriate for the AER to determine the assumptions to be made with respect to the timing of costs and revenues as part of the development of the post tax revenue model.

² Expert Panel Report on Access Pricing, Draft Report to the Ministerial Council on Energy, March 2006, p7.

The Draft Rules incorporates provisions for pass-through of costs unanticipated at the time of the regulatory reset as a result of the following defined events: insurance, change in tax, terrorism; service standards; and network grid support. The AER can require a TNSP to pass through reductions in costs for these events during a regulatory period. Excepting grid support, a cost pass through event must meet a materiality threshold of 1% of the TNSP's maximum allowable revenue for that year.

The Rules specify the process with which the TNSP and AER are to comply in making and assessing a cost pass-through application.

Ergon Energy supports the inclusion of cost pass through mechanisms in regulatory arrangements. However, it is concerned that there is no defined event relating to major changes in government policy or Law. Under the Draft Rules Proposal, an event like the introduction of full electricity retail contestability in Queensland would not have been covered by the pass-through provision.

In addition, Ergon Energy is concerned that the materiality threshold may prevent a TNSP being allowed an increase in revenue where large cost increases occur over a number of years but which do not meet the 1% threshold in any one year. Ergon Energy considers that the threshold should be assessed on a total project basis and, if the total project cost is greater than 1% of the maximum allowable revenue for the years over which the project was undertaken, it should result in a cost pass-through. This would help mitigate the additional cost risk faced by the TNSP as a result of the existence of the non-trivial 1% threshold. In contrast, the approach proposed by AEMC is likely to result in perverse incentives such as to delay expenditure or to increase expenditure so as to satisfy the threshold.

Chapter 7 – Incentive mechanisms

The Rules will require the AER to develop a service target performance incentive scheme in accordance with specified principles, including to provide greater reliability at times when the transmission system is most valued and in relation to those elements most important to determining spot prices. In addition, the reward/penalty adjustment should be no more than +/- 1 % of the revenue cap and the scheme should take account of the age and ratings of the TNSP's network assets.

It is inappropriate for a TNSP to be exposed to market impacts.

Noting the somewhat different objectives/targets likely to be relevant for distribution networks compared to transmission networks, Ergon Energy, in general, supports the AEMC's principles and their specification in the Rules, in particular that account should be taken of the age and ratings of the TNSP's assets. However, Ergon Energy considers that the principles should not prevent an NSP proposing a higher level of revenue at risk if it suits their particular circumstances.

Ergon Energy agrees that the TNSP should not be exposed to market impacts.

The TNSP should retain the benefit (or bear the cost) in relation to the return on capital if actual capex is less than forecast capex.

In contrast to the Statement of Regulatory Principles, depreciation will not form part of the incentive mechanism.

Ergon Energy supports the Draft Rules Proposal.

The details of the opex efficiency carryover mechanism are to be developed by AER subject to specified principles in Rules, including a continuous incentive to reduce opex below forecast being provided, the desirability of rewarding efficiency gains and penalising efficiency losses and consideration of the incentive to inappropriately capitalise opex.

With the exception of penalising efficiency losses in a future regulatory period, Ergon Energy supports the AEMC's principles and their specification in the Rules if it provides sufficient flexibility to allow a TNSP to propose a different mix of efficiency targets and incentive retention amounts. Such a framework would also be appropriate for DNSPs. Penalising efficiency losses through the carryover mechanism is inappropriate because carrying over an efficiency loss results in the reduction of the TNSP's opex allowance in the next regulatory period below what the AER has assessed to be reasonable to meet the TNSP's requirements. This risks compromising the TNSP's delivery of its service obligations.

One area of concern previously raised by Ergon Energy is that current efficiency incentives are too weak and there is a need to ensure that service providers are able to retain a greater proportion (at least 50%) of the net present value of benefits associated with such improvements. In addition, Ergon Energy considers that performance should be assessed against the average performance of peers not best practice.

AER will have the power to remove assets from the regulated asset base which it considers are no longer contributing to the provision of prescribed services, but only where the TNSP has not taken steps to enter into a contractual arrangement with the user to manage standing risk nor has offered a prudent discount to such a user. The current value of the assets must be greater than \$20m.

Where the NSP faces additional risk that cannot be managed as a result of this provision, compensation via the inclusion of an additional revenue line-item in the building block calculation is required.

Ergon Energy agrees that any risk that is created through asset stranding should be the subject of compensatory allowances for all entities exposed to such a risk.

Chapter 9 – Commercial Negotiation Arrangements

The Draft Rules Proposal provides for a commercial arbitration mechanism to be applied in resolving disputes regarding the price to be paid for negotiated transmission services.

Ergon Energy supports the Draft Rules Proposal.

If you have any questions on this and related matters, please contact our Manager Regulation Networks, Tony Pfeiffer (07 3228 7711).

Yours faithfully



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