Alternative Transitional Model

Economic Regulation of Network Service Providers

TransGrid

Purpose

To outline an alternative model to that proposed by the AEMC for transitioning to the new National Electricity and Gas Rules (Rules) as set out in the AEMC's draft determination of 23 August 2012.

Principles

The AEMC has identified the following four principles for developing appropriate transitional arrangements:

- the new Rules should apply to all Network Service Providers (NSPs) as soon as possible;
- processes under the transitional arrangements should allow sufficient time for stakeholder consultation;
- the arrangements should allow NSPs to recover their efficient costs; and
- the arrangements should be practicable having regard to both the AER's and stakeholders' resourcing constraints.

TransGrid notes two important additional principles that:

- the transitional arrangements should provide certainty for NSPs and other stakeholders; and
- the fact that changes are occurring in the regulatory framework should not disadvantage a stakeholder during the time that the framework is changing.

Features of the Alternative Model

1. One determination for the upcoming regulatory period for each NSP covering all years of the regulatory period.
2. That determination would be made under the new Rules and guidelines. However, as proposed by the AEMC in its consultation paper, the proposals due in May 2013 will necessarily follow the 13 month regulatory determination process rather than the extended process, due to the timing of publication of the final guidelines.
3. The timetable for making the upcoming round of revenue determinations would be delayed by one year to allow the AER adequate time to complete the guidelines envisaged under the new Rules. Those NSPs currently required to lodge their revenue proposals in 2013 would now lodge in 2014.
4. The upcoming regulatory period would commence on schedule with an "appropriate revenue" agreed between the AER and the NSP as a placeholder for year one until the determination is finalised; an adjustment will then be applied to correct for any difference arising between the year one placeholder revenue and the AER's determination.

5. The year one revenue adjustment would be part of the revenue determination for the full regulatory period and would include a net present value neutral "true up" over the remainder of the period for any adjustments arising as a result of the AER's final determination.
6. Existing incentive schemes would continue to apply for transmission businesses, the detail to make this work consistent with the scheme to be agreed between the NSPs and the AER, and the new capital incentive scheme would apply from year 2 under the AER determination.

Setting the placeholder appropriate revenue for year one

1. The "appropriate revenue" for the first year (2014/15) would be assessed by the AER using a simplified process with the primary objective of matching reasonably expected smoothed Maximum Allowed Revenue in year one of the regulatory determination, to minimise price volatility throughout the regulatory period and be consistent with the National Electricity Objective.
2. The "appropriate revenue" for 2014/15 would be assessed on the basis of information provided by the NSP regarding:
   a. the forecast opening regulated asset base;
   b. current forecasts and historical trends for operating expenditure;
   c. a forecast of tax expense and depreciation; and
   d. an indicative value for the weighted average cost of capital taking into account recently available market information, expected market trends and informed by revenue determinations made in the preceding 12 months and the AER's guidelines.

   None of this would pre-commit the AER when considering the regulatory proposal and making the revenue determination.
3. If the AER was not satisfied with the information provided by the NSP, it may request the NSP to provide revised information failing which the AER may deem an "appropriate revenue" for the NSP taking into consideration the National Electricity Objective, the expected revenue path over the entire regulatory period taking into account optimal revenue smoothing and the objective of minimising price shocks for customers throughout the regulatory period.
4. The timeline for assessing the "appropriate revenue" for NSPs with regulatory periods' commencing in July 2014 would commence in early 2014 in time for prices to be notified to customers

   <u>For emphasis, this revenue would be subject to a correction or "true-up" consistent with the determination for the full regulatory period when made.</u>

Reasons for and benefits from the Alternative Model

The Alternative Model:

- ensures the new Rules apply to all NSPs and their upcoming determinations as soon as possible;

- allows the upcoming regulatory period to commence on schedule with an "appropriate revenue" agreed as a placeholder for the first year until the AER has completed its determination process;
- allows downward pressure to be maintained on consumer prices, including through optimised revenue smoothing;
- allows sufficient time for full stakeholder consultation, as well as completion by the AER of the guidelines and methodologies envisaged under the new Rules;
- minimises administrative costs and avoids unnecessary duplication of costs as NSPs are only subject to a single determination;
- does not deny NSPs the ability to recover their efficient costs or to respond to incentive schemes;
- is practicable given the AER's and stakeholders' resourcing constraints and allows a more efficient use of those resources;
- provides necessary revenue and pricing certainty for NSPs and other stakeholders; and
- ensures that NSPs are not disadvantaged during the period in which changes are being made to the regulatory framework.

A number of these benefits are not apparent and would not be realised under the "two determination" model proposed by the AEMC.

Other Aspects of the preferred Alternative Model

The following features should also be considered as part of the transitional rules, consistent with the above principles:

- no retrospective application of the new Rules — in particular, the proposed review of past capex efficiency would first occur as part of the revenue determinations subsequent to the upcoming determinations and only apply to investment made after the start of each NSPs upcoming regulatory period;
- in the interests of minimising price shocks for customers and ensuring stable and sustainable cash flows for businesses, the AER should consider opportunities for revenue smoothing within period; and
- in the interests of aligning revenue determinations, the AER and each NSP could agree to a shorter upcoming regulatory period — the AER should provide a model as to how this might work across the industry for discussion.