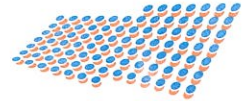


31 May 2007

Mr Drew Clarke  
Manager, MCE Secretariat  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra ACT 2601  
[MCEMarketReform@industry.gov.au](mailto:MCEMarketReform@industry.gov.au)



**EnergyAustralia™**

570 George Street  
Sydney NSW 2000  
Telephone (02) 9269 2112  
+61 2 9269 2112  
Facsimile (02) 9264 2982

Address all mail to  
GPO Box 4009  
Sydney NSW 2001  
Australia

**George Maltabarow**  
**Managing Director**

Dear Mr. Clarke

**EnergyAustralia supplementary submission on National Electricity Rules exposure draft**

EnergyAustralia is pleased to provide a supplementary submission to the exposure draft of the National Electricity Rules, which will focus on the proposed transitional arrangements for NSW and ACT businesses.

Both the ACT and NSW revenue resets will represent landmark decisions. They will be the first distribution network determinations made by the AER and will be the first to commence under the amended National Electricity Law. All market participants are eagerly awaiting the success (or otherwise) of the new regulator and the new regime.

The need for a clear, certain and transparent framework to operate the reset process is therefore vital. This would normally be provided through the Rules framework, but it is now evident that new Rules will not be in place in an appropriate time for use for our regulatory process. EnergyAustralia has been advocating for some time the need for transitional arrangements, which balance the need to move to a new regulatory framework with the certainty the existing framework provides.

While short on detail, the transitional arrangements proposed in the explanatory memorandum offer a pragmatic approach to addressing the balance between new and old. However, we do wish to raise some important issues that will require considered drafting. We explain these issues in the attachment below.



Partner

Most fundamental to EnergyAustralia's concerns is not so much the "what" but the "when". We believe that the further delays in the timetable have reached the point where due process in the upcoming 2009 determinations has been affected. We ask the MCE to consider options which would allow the AER and businesses to understand the arrangements that are likely to apply to the next reset before they commence. Otherwise, the preparation of revenue proposals and guidelines will be severely compromised.

However, this should also not be at the expense of rushing the development of the rules. We demonstrated in our previous submission why the Rules have a way to go before they will be workable in a distribution environment.

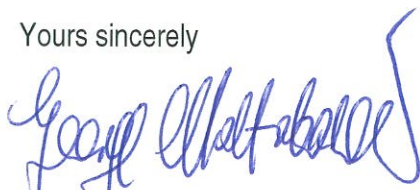
We do note the MCE's recent Communiqué, which stated the intention for MCE Officials to "work closely with the AER, NSW and ACT distribution businesses, and other affected stakeholders, in finalising the transitional arrangements". We strongly support this approach and look forward to the process the SCO will establish to ensure a close working relationship between stakeholders.

We believe any formal working relationship should be based on clear principles and objectives which as a minimum should include:

- Ensuring the DNSP is not disadvantaged by the uncertainty of rules development.
- Minimising uncertainty by establishing transitional rules as a standalone set of arrangements.
- The AER and DNSPs should be consulted on the formal transitional rules in both draft and final form.
- A draft of the transitional arrangements should be available for comment in August and final agreed arrangements available in September so both the DNSPs and AER can proceed with preparations for the regulatory process.

EnergyAustralia would be pleased to discuss this submission with the MCE SCO. It is our intention to liaise with the SCO in developing the legal drafting of the transitional Rules. If you have any queries or comments regarding these or any of the detailed issues discussed in our submission please do not hesitate to contact me on (02) 9269 2111, or Mr. Harry Colebourn, Manager – Network Regulation and Pricing on (02) 9269 4171.

Yours sincerely



**GEORGE MALTABAROW**  
*Managing Director*

Attach.

## Attachment: Initial response to MCE approach to transitional Rules

Approach in Explanatory memorandum	EnergyAustralia Comment
<p>An exposure draft of the savings and transitional rules is expected to be available for public consultation by the time that the NEL is tabled in the South Australian Parliament or soon thereafter.</p>	<p>We have been previously informed by SCO reps that the release of Rules would be concurrent with the release of the NEL, while this comment indicates otherwise. EnergyAustralia would appreciate a clear understanding of the proposed timetable and implications on timing for the development of transitional arrangements. Also, it should be noted that delaying the transitional arrangements to align with timetable for the Rules would not allow the AER or DNSPs sufficient time to prepare for their determinations.</p>
<p>It is proposed that the exposure draft rule will apply for submitting and approving a pricing proposal. Specifically, clause 6.8.2 and Schedule 6.1 will apply in respect to the revenue proposal and clause 6.18.3 will apply in respect to the pricing proposal.</p>	<p>EnergyAustralia has significant concerns with the current drafting of 6.8.2 (as raised in our submission). We also note the preference for standalone drafting. We propose that the DNSP be required to submit a revenue proposal and a pricing proposal and leave the details of these to the Schedules and AER guidelines.</p>
<p>The AER will need to develop its information requirements (possibly in the form of a template) for the content of the revenue proposal to complement the requirements in the initial distribution rules.</p>	<p>Information requirements should relate to the specific rather than the general (ie. specify exactly what is required). It should also be noted that, given the limited time frame allowed, some information content or format may not be possible unless it is relatively correlated to the information already provided under jurisdictional regulation. Content or format that differs from current practice has an increased risk of non-comparability between periods.</p>

Approach in Explanatory memorandum	EnergyAustralia Comment
<p>The rationale for including capital expenditure that is eligible under the jurisdictional regulators' criteria is that it simulates the regulatory environment in which the investment was made, or will be made. Also, it would have been the criteria that the jurisdictional regulator would apply if it was rolling-forward RAB at the next determination.</p>	<p>EnergyAustralia is currently subject to a hybrid incentive approach to asset roll-forward. Actual capex (less allowed depreciation) is rolled into the asset base to the extent that it is "not imprudent". However, the return on any over expended capital (even deemed prudent) is not allowed, reflecting the lower hurdle in the review. IPART's final report (p52) on the last reset, in response to EnergyAustralia's query, noted that its approach was "a strong guide to DNSPs on its approach to and process for assessing the prudence of investment in the future".</p> <p>EnergyAustralia is most concerned that, rather than being subject to the IPART approach, DNSPs will be faced with retrospective application of the AER's historic approach to transmission asset roll forward. The AER "ex-post" incentive framework allows the full value of over expended amounts to be recovered but involves much more intrusive prudence and capital efficiency tests and is applied on a positive assurance basis.</p> <p>We note that the AER and AEMC have now abandoned the AER's "ex-post" incentive mechanism. We therefore believe there is little justification for resurrecting the mechanism when it never applied to NSW DNSPs in the first place.</p> <p>Should the MCE alter the hybrid approach, or allow the AER undertake a different approach for assessing prudence of investment, due process would be undermined.</p>

Approach in Explanatory memorandum	EnergyAustralia Comment
<p>The AER will need to make any other adjustments to the RAB at the next determination that the jurisdictional regulators had envisaged in their determinations, policies or guidelines. However, this does not provide an opportunity to re-open the regulatory asset base.</p> <p>Stakeholder views are sought on whether the national rules should apply giving the AER the discretion to set the parameters for the purposes of the review or whether the AER be required to adopt the transmission WACC parameters in the transitionals for ACT and NSW distributors.</p>	<p>The MCE and AER have already highlighted the possibility of an increase in benchmark comparisons between various DNSPs and across jurisdictions. EnergyAustralia does not believe that any benchmarking is effective unless there is a more detailed understanding of the underlying values which are being benchmarked. While we accept the assertion that a reopening of the entire asset base valuation is inopportune, forbidding the AER from considering specific legacy valuation issues would be a violation of revenue and pricing principles under Section 7A of the NEL.</p> <p>While we would ordinarily argue that a higher WACC is appropriate for distribution businesses, EnergyAustralia has supported the adoption of AEMC parameters for WACC as a compromise, on the basis that a review of WACC would divert time and resource from an already time constrained determination process. However, we reject entirely the rationale suggested by the Explanatory Memorandum. The analysis of the AEMC's decision on debt margin is a misconception. There is nothing to suggest the AEMC intended for any of the parameters to be used for a distribution framework. Its conclusion on debt margin clearly states that "ratings agencies have given higher credit ratings to electricity transmission businesses compared to electricity distribution businesses". And the relevant factor in determining credit ratings is profitability risk, which for DNSPs may increase when outturn volume differs from forecast volume (volume risk) or when cost changes are out of line with average prices (price risk). We suggest that the need for a differential credit rating assumption between transmission and distribution was most probably a decisive factor in the AEMC moving from its initial proposal (BBB) to its draft and final decision (BBB+). The Explanatory Memorandum takes the AEMC's analysis of statistical analysis out of context when incorrectly concluding a correlation between the two networks.</p>