17 November 2014

Mr Warwick Anderson
Australian Energy Regulator,
GPO Box 3131,
Canberra ACT 2601

Via email: AERInquiry@aer.gov.au

AER PROPOSED AMENDMENTS TO POST-TAX REVENUE MODELS – ELECTRICITY TRANSMISSION AND DISTRIBUTION

Dear Warwick

The Energy Networks Association (ENA) welcomes the opportunity to provide its comments in relation to the Australian Energy Regulator's (AER) proposed amendments to the post-tax revenue models (PTRM) for electricity transmission and distribution businesses.

ENA notes that the main purpose of the AER's proposed amendments is to give effect to the AER's Rate of Return Guidelines. In addition, the proposed amended PTRMs enable revenue adjustments for the sharing of unregulated revenues earned with shared assets, as well as include some presentational changes directed at improving clarity in the models.

ENA agrees with the AER's approach that minimises the rate of return modelling in the PTRMs by only requiring the overall return of equity and return on debt values as inputs. This is a practical approach given the nature of the revised *National Electricity Rules* (NER) relating to the return on equity, as well as the adoption of trailing average cost of debt approach with annual updating.

Further, the AER's proposed amended PTRMs also include the equity raising costs sheet, which calculates benchmark equity raising costs. ENA notes that the methodology applied to calculate equity raising costs was not reviewed during the Better Regulation Program process. Therefore, further considerations around the appropriate methodology for calculating equity raising costs may arise in businesses' individual regulatory determinations.

In the remainder of this letter, ENA provides its comments on the proposed amended PTRMs, as well as highlights areas where additional consideration may be required.

SHARING OF UNREGULATED REVENUES FROM SHARED ASSETS

ENA's major concern relates to how the sharing of unregulated revenues earned with shared assets is implemented in the PTRM modelling for both electricity transmission and distribution. In particular, the AER incorporates the amount of sharing into calculation of tax allowance, thereby reducing the taxation

building block. As a result of the calculation in the AER's proposed PTRMs, more than 10 per cent of unregulated revenue earned with shared assets is returned to consumers.

ENA considers that such an approach is inconsistent with the AER's Shared Asset Guideline, which provides that the shared asset cost reduction should reduce a service provider's standard control (or prescribed transmission) revenues by 10 per cent of the value of the service provider's expected total unregulated revenues from shared assets.[1] The AER's Shared Asset Guideline Explanatory Statement specifically states that:

> *"Under our method, we will reduce a service provider's regulated revenues from assets providing standard control (or prescribed transmission) services by a fixed 10 per cent of the value of unregulated revenues earned with shared assets. We consider that setting a fixed proportion further enhances transparency and certainty for both service providers and consumers."*[2]

ENA considers that no additional tax adjustment is required under the AER's Shared Asset Guidelines. The correct implementation of the guideline is to simply deduct 10 per cent of unregulated revenues derived with shared assets from a service provider's standard control (or prescribed transmission) revenues. This interpretation is consistent with the worked example provided in the Shared Asset Guideline. The worked example uses the annual revenue requirement from Ausgrid's Draft Decision for 2009–10 regulatory year and does not include any adjustment to tax allowance.[3]

ENA considers that the AER should remove the adjustment for the sharing of unregulated revenue earned with shared assets from the calculation of tax allowance in its proposed amended PTRMs.

DEPRECIATION METHOD

ENA considers that the revised PTRM handbooks should allow for flexibility to nominate the depreciation method as part of businesses' building block (revenue) proposals. The models currently use the straight-line depreciation method as the default position. However, under Cl. 6.5.5 (Cl 6A.6.4 for transmission) of the NER network firms have flexibility to propose alternative depreciation methods. This flexibility is also recognised by the AER in the proposed amendments to the PTRM handbooks for both electricity transmission and distribution:

> *"'The PTRM is configured to use the straight-line method as the default position for calculating depreciation for regulatory and tax purposes. After consultation with the AER, DNSPs may propose that depreciation profiles other than the straight-line method be accommodated within the PTRM as part of pre-lodgment discussions and subject to satisfying the requirements at clause 6.5.5(b) and 6.5.3 of the NER respectively"*[4]

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[1] AER *Shared Asset Guideline*, 2013, p.15.
[2] AER *Shared Asset Guideline Explanatory statement*, p.32.
[3] AER *Shared Asset Guideline*, 2013, p.20.
[4] AER *Electricity distribution network service providers Post-tax revenue model handbook*, October 2014, p.10.
AER *Electricity transmission network service providers Post-tax revenue model handbook*, October 2014, p.8.

The AER's position suggests that, in a case in which businesses wish to propose an alternative depreciation method, they need to discuss their proposal with the AER as part of pre-lodgment discussions. Therefore, the AER reserves the right to reject an alternative depreciation method, as well as the corresponding amendments to the PTRMs prior to the submission of a regulatory proposal. The ENA considers that the AER's proposition denies businesses the opportunity to test the alternative depreciation methods as part of the regulatory determination process. Such an approach also denies other stakeholders the opportunity to respond to that information.

ENA considers that the AER can best resolve this circumstance by inclusion of relevant words in its amended PTRM handbooks for electricity transmission and distribution, which would recognise that network businesses can amend the PTRM to incorporate depreciation profiles other than the straight-line method and submit this amended PTRM as part of their building block (revenue) proposal. This will allow the removal of tension that arises from the AER's current drafting of the PTRM handbooks. This tension relates to the fact that the NER clearly allow network businesses to nominate alternative depreciation methods and also require that that the building block (revenue) proposal is prepared in accordance with the AER's PTRM.

FLEXIBILITY TO NOMINATE UNIT PRICE AND UNIT QUANTITY

ENA notes, that the PTRM for electricity distribution businesses requires that businesses input the data for base year prices for each tariff component and forecast quantities for each tariff component. The PTRM in its current form pre-populates the tariff components, as well as the units of measurements for each tariff component.

Units of measurements may not be the same for each electricity distribution business, depending on their tariff structure. One issue that has been raised by the ENA members is that the AER's proposed amended PTRM can be improved by allowing businesses to nominate the unit for price and the unit for quantity to reflect the different tariff structures.

In order to introduce this improvement, the PTRM should include the appropriate formula so that when the forecast revenues are calculated, they are expressed in dollars (which is a default unit in the PTRM).

ENA considers that this improvement will reduce the risk of errors in the forecast revenue calculations.

EXTENDED LENGTH OF REGULATORY PERIOD

ENA welcomes that the AER's proposed amended PTRMs can now accommodate regulatory periods up to 10 years for both electricity transmission and distribution. ENA understands that the AER has attempted to eliminate the summary and display errors that were caused in the models when the nominated length of the regulatory period was other than 5 years. ENA members have identified two additional cases where changing the length of the period does not change the relevant dependencies in the PTRM for electricity distribution:

» Regulatory control period analysis (within 'Analysis' sheet). All cash flows are summarised on a ten year period (i.e. maximum length), but the RAB residual value (in row 114) does not change in line with the nominated length of the period; and

» Formula check (within 'Assets' sheet). The formula checks (in row 880) appear to refer to the wrong cells (e.g. the reference to Input!R7 cell should be held constant across the years).

If you have any questions, or ENA can be of further assistance in developing the AER's views in relation to this matter, please contact Garth Crawford, Executive Director, Economic Regulation on 02 6272 1555.

Yours sincerely,

Garth Crawford
Executive Director, Economic Regulation