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countryenergy

10 January 2008

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Buckley

**Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 – Preliminary positions**

Country Energy appreciates the opportunity to respond to the preliminary positions paper on matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 (the paper).

Country Energy would be pleased to discuss the matters raised in this submission with the AER. If you require further information or clarification in relation to this submission please feel free to contact Natalie Banicevic on 02 6589 8419 or Jason Cooke on 02 6338 3685.

Yours sincerely

Bill Frewen
**Group General Manager External Relations**

# Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 – Preliminary positions

January 2008

Country Energy understands that unless there is sufficient time to consider and implement changes to the existing arrangements, or there is a clear reason to change existing arrangements, the Australian Energy Regulator (AER) will generally consider maintaining the approaches adopted by the Independent Pricing and Regulatory Tribunal (IPART) in the current regulatory period. Country Energy supports this practical approach and looks forward to continuing to work with the AER in the development of the post tax revenue model (PTRM), roll forward model (RFM), efficiency benefit sharing scheme (EBSS), service target performance incentive scheme (STPIS) and the guideline on control mechanisms for direct control services.

Post tax revenue model

Country Energy generally supports the proposed PTRM with the exception of the recognition of capital expenditure for depreciation purposes. Under the current IPART approach, Country Energy recognises capital expenditure on an as-incurred basis for both return on capital and depreciation purposes. This is a practical and straightforward manner in which to recognise capital expenditure for a distribution business, where there are typically large numbers of smaller projects and programs as compared to low volume high cost projects in transmission.

The AER has proposed a hybrid approach to recognising capital expenditure, depreciating assets on an as-commissioned basis while return on capital is calculated on an as-incurred basis. Country Energy believes this is inappropriate for distribution businesses for the following reasons:

- Nature of distribution businesses – distributors capital expenditure is predominantly made up of a large number of small projects and programs of which the majority are completed within an annual timeframe;

- Materiality – due to the nature of a distribution business discussed above, the differences between an as-incurred versus as-commissioned basis from year to year are likely to be insignificant. Country Energy believes a move to a more complex and time consuming as-commissioned approach is not justified by any related benefits. Further, assets will still only be depreciated once under either approach;

- Additional costs – the added complexities of an as-commissioned approach for a distribution business will likely result in increased expenditure requirements;

- Consistency with current arrangements – Country Energy understands that the AER will generally consider maintaining the approaches adopted by IPART in the transitional regulatory period unless there is a clear reason to change existing arrangements. Given the nature of distribution businesses and the added complexity of adopting an as-commissioned approach, Country Energy does not believe a clear reason for change exists in this instance;

- Transitional issues – there is even further complexity in changing methods between regulatory periods due to the timing issue that some capital expenditure allowed in the final year of the current regulatory period may not be commissioned until the first year of the next regulatory period; and

- Timing – the added complexity of an as-commissioned approach will likely lead to additional work having to be undertaken by distributors in preparing their regulatory proposals, but with limited time to complete these tasks in a full and complete manner.

Country Energy agrees with the AER's proposal to continue with the current cash flow timing assumptions. The AER's approach is practical and transparent and avoids having to complicate the model for little benefit.

Consistent with its approach in the transmission guideline, the AER has adopted the straight-line method for calculating depreciation as its default position. While this is an acceptable profile under the transitional rules, Country Energy also has the discretion under those rules to propose alternative depreciation methods. Country Energy therefore assumes that the distributor can propose alternative depreciation schedules and make necessary amendments to the default PTRM. The AER would then assess the proposed depreciation schedules against the transitional rule requirements.

One minor point Country Energy would like to bring to the AER's attention relates to the tariff details required in the input and forecast revenues worksheets of the PTRM. Country Energy currently has many network tariffs, and as a result the AER will need to add more rows in to both worksheets to accommodate this. Other distributors who may not have as many tariffs could then hide the rows not required. This will ensure the PTRM is complete and subject to the appropriate sanity checks by the AER before final release. As an administrative suggestion, Country Energy also believes the AER could standardise these two worksheets by ensuring that the two tables are presented in the same order in both worksheets, and that unnecessary cells in column E of the prices by tariff component table in the input worksheet are deleted.

Country Energy reiterates that significant changes to current practices will be extremely difficult to implement in the time available between the finalisation of the PTRM and the due date for Country Energy's regulatory proposal. Country Energy believes the most practical and reasonable approach is to adopt the PTRM as proposed by the AER, with the only change to adopt a full as-incurred approach to recognising capital expenditure for return on capital and depreciation purposes. This will allow full consultation to be completed on the general PTRM guideline under Chapter 6 of the National Electricity Rules (NER) and any subsequent changes to the transitional PTRM arising from this can be implemented in time for the next regulatory period commencing in July 2014.

Roll forward model

Country Energy supports the approach taken by the AER for the RFM, noting its intention to modify the RFM to reflect a full as-incurred approach consistent with the IPART approach.

Country Energy seeks clarification from the AER as to how it intends to treat the specific provision contained in the transitional rules at Appendix 1 of Chapter 11 of the NER relating to the deferred depreciation approved by IPART for the current regulatory period. The paper and RFM do not seem to mention or incorporate this required adjustment of the regulatory asset base.

Efficiency benefit sharing scheme

Country Energy does not support an EBSS for the upcoming regulatory period. Country Energy believes that the strong incentive framework created by the weighted average price cap (WAPC) is an appropriate means of delivering efficiency. This framework provides the necessary incentives to continuously seek to improve and become more efficient. Any inefficiency on the part of a distributor will be exposed by adverse impacts on their financial and service performance.

Country Energy believes weaknesses of an EBSS are as follows:

- The application of an EBSS is complex and confusing for customers;
- It is extremely difficult to readily separate out and quantify the gains from performance due to management (endogenous) actions and those that are due to windfall (exogenous) events;
- Operating expenditure for the regulatory period is in effect already set by the AER at levels that account for future efficiencies;

- It may not in practice result in a valid measurement of changes in efficiency; and
- It is information intensive and relies heavily on historical data and the interpretation thereof. It would require a detailed calculation and breakdown of actual expenditure over the next regulatory period.

Notwithstanding the concerns expressed above, should the AER implement an EBSS Country Energy does not agree with the proposed operation of negative carryovers for the following reasons:

- It is not economically sound as the effect of a negative carryover would be to restrict the distributors from receiving the full amount of revenue as estimated by the AER as being required to facilitate the efficient operation and maintenance of the network;
- It penalises distributors twice, once for the over spend (with no corresponding revenue stream) and second through the negative carryover. Equally, the expenditure may be deemed prudent yet distributors still receive a penalty;
- Negative carryovers will adversely impact on Country Energy's ability to achieve its Ministerial reliability licence conditions by confiscating prudent and necessary expenditures;
- Customers are no worse off for any overspending, only the distributor loses; and
- Where the AER approved level of efficient operating expenditure is lower than the distributor's level of achievable expenditure submitted in its regulatory proposal, and the distributor subsequently overspends the approved allowance, a negative carryover doubly penalises the distributor. First, by not allowing recovery of the extra expenditure, and second through confiscation of these perceived inefficiencies in future regulatory periods.

If the AER does implement negative carryovers then they should be offset against positive carryovers with a net carryover floor of zero.

Country Energy agrees with the default adjustments listed in the paper that will be excluded from the operation of an EBSS. Country Energy believes that the demand management incentive scheme should also be a default adjustment, as projects covered by this scheme often result in a distributor incurring additional operating expenditure through the deferral of capital expenditure.

If the AER were to introduce an EBSS for the upcoming regulatory period, all changes in scale and scope of business activities need to be recognised and allowed for. Ignoring them would unfairly penalise Country Energy for expenditure that was not forecast, even where this expenditure has been prudent. Country Energy believes that while a distributor may indeed propose other categories of exclusions as part of their regulatory proposal, events not listed in the proposal or as a default adjustment should not be disregarded. As part of the yet to be developed annual information collection framework, there should be scope for Country Energy to recognise and exclude any other cost impacts that were not part of the approved allowances.

Service target performance incentive scheme

Country Energy agrees with the practical position proposed by the AER in the paper. Country Energy supports the AER's assertion that the design and application of a STPIS offers many complexities and challenges. Country Energy believes that there is inadequate time available before Country Energy's regulatory proposal is due in which to develop and consult extensively on a robust and complete STPIS.

Country Energy agrees that the recently imposed Ministerial licence conditions provide additional incentives for distributors to improve and maintain service performance, and a financial incentive under the STPIS in conjunction with this is unnecessary and unwarranted.

Country Energy supports the position reached by the AER that the best approach to service performance reporting for the next regulatory period is to continue information collection and monitoring, supplemented by a paper trial based on the yet to be developed national STPIS under Chapter 6 of the NER. This practical approach will continue to provide effective commercial incentives to maintain and improve service performance levels.

Guideline on control mechanism for direct control services

Country Energy generally supports the proposed guideline on control mechanisms for direct control services. However, Country Energy has reservations with the AER's proposed treatment of miscellaneous services, monopoly services and emergency recoverable works.

Country Energy acknowledges the need for simplicity in the fee structure for these services, and the implementation of a common set of charges for all market participants in New South Wales. Country Energy believes this schedule of prices in the first year of the next regulatory period should be calculated by escalating current charges to today's dollars by an appropriate inflator, consistent with the escalation factors that are used for other expenditure items in the distributor's regulatory proposal.

Country Energy believes that all miscellaneous services, monopoly services and emergency recoverable works should then be escalated by an appropriate inflator at the beginning of each year of the upcoming regulatory period. This could be accomplished simply and transparently as part of each distributor's annual pricing proposal, along with an indicative price list for each of the years of the regulatory period as part of the AER's final distribution determination. Country Energy does not believe it is fair or reasonable that prices are fixed for the entire regulatory period, especially given the substantial increases in input costs that have occurred during the current regulatory period.

Country Energy also has concerns with the recovery of TUOS arrangements presented in section 6.3.1.1 of the paper. While the discussion is consistent with the requirements of the transitional rules, Country Energy's view is that the over or under recovery of TUOS adjustment from the previous regulatory year cannot be practically achieved given that distributors will not have actual TUOS recovery amounts until well after the annual pricing proposal is submitted and approved by the AER. Country Energy looks forward to working with the AER to resolve this issue in a practical and timely manner.

Country Energy notes that the references of the formula illustrated in section 6.3.1 of the paper are inconsistent with the explanatory notes underneath and the discussion presented in 6.3.3.2.