ElectraNet SA
electricity transmission network

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Michelle Groves
Chief Executive Officer
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: michelle.groves@aer.gov.au

Dear Michelle,

Regulatory Accounting Methodologies

I am writing to highlight ElectraNet's concern regarding the regulatory accounting methodology that the AER proposes to prescribe.

The AER released a Position Paper in September on the question of whether it should adopt the "as-incurred" or "as-commissioned" approach to rolling assets into the regulated asset base. The paper concluded with a preliminary position to prescribe the "as-incurred" approach, subject to any new issues identified or comments raised by stakeholders.

Electricity transmission network owners ElectraNet Pty Limited, Powerlink Queensland, SP AusNet and Transend Networks Pty Ltd (the "**TNOs**") made a submission in response to the AER's Position Paper on 17 October 2005.

In this submission, the TNOs stated that they could support moving from the "as-commissioned" to the "as-incurred" framework **provided** that Work in Progress (WIP) was not required to be depreciated (consistent with Australian Accounting Standards). All TNOs using the as-commissioned approach are currently incapable of generating the information that would be required for the as-incurred approach.

ElectraNet, Powerlink and SP AusNet met with the AER's Blair Burkitt and Bruce Mountain on 21 October 2005 to discuss matters arising from the TNO submission.

At this meeting the position put by the AER was that allowing a non-depreciable WIP asset class was inconsistent with the ex-ante incentive regime established by the AER's Statement of Regulatory Principles (SRP). The key point appeared to be that depreciating WIP provides a stronger incentive for TNOs under the ex-ante incentive framework.

MAKE THE connection

ElectraNet is a strong supporter of incentives for efficient capital investment, but is concerned that the AER is taking a "purist" and impractical approach to the treatment of WIP.

Incentives under the AER's ex-ante framework arise from the TNO keeping savings on both the return on and of capital associated with any underspend within the regulatory period and conversely facing potential losses of the return on and of capital associated with any overspend. Given that the return on capital is typically around 8% to 9% and depreciation of network assets is typically around 2½%, the majority of the incentive derives from the return on assets component. Further given that NOT depreciating WIP would only impact on a portion of the return of capital incentive, the overall impact of this concession on the strength of the incentive would be relatively minor at best.

ElectraNet cannot see that this minor difference in the strength of the incentive would have any impact at all on changing the company's behaviour; i.e. in practical terms allowing a non-depreciable WIP asset class would not materially change the incentive properties of the AER's ex-ante capex framework.

ElectraNet believes that any minor increase in the strength of the incentive arising from depreciating WIP is not justified given the cost of the additional administrative burden that would be required, the divergence that would be created between regulatory and financial accounts and concerns that depreciating WIP would negatively impact the valuation of assets in TNO statutory accounts.

ElectraNet urges the AER to reconsider its position on this matter and to only prescribe the "as-incurred" approach to rolling assets into the regulatory asset base if a non-depreciable WIP asset class is allowed in the roll forward.

If you would like to discuss this matter further, please call me on 08 8404 7983.

Yours sincerely,

RAINER KORTE
NEM DEVELOPMENT AND REGULATION MANAGER