

**Attachment to Jemena  
submission to  
Australian Energy  
Regulator**

**Access arrangement draft guideline**

**12 December 2008**

# 1 Matters for comment in draft guideline

Jemena wishes to comment on the following matters in the draft guideline:

- phase 3 of the draft decision (section 3.1.3)
- submitting commercial-in-confidence material (section 4.1.4);
- cost pass through (section 6.1.3).
- pre- or post-tax approach to setting reference tariffs (various places in draft);
- rate of return (page 59).

## 2 Draft decision phase 3

The draft guideline states (p 14):

One key difference between the consultation and decision making process under the former code and the NGL (and NGR) is the limited opportunity for the AER to respond to new (and substantive) issues once the draft decision is made. The consultation process after the draft decision focuses on the service provider's response including amendments to the proposal to reflect the draft decision. **The decision making process in the NGR does not envisage substantive issues being raised and deliberated on after the draft decision is made.** (Jemena emphasis)

Jemena considers the highlighted statement to be too restrictive. NGR 60(1) requires the Service Provider to submit additions and amendments to the Access Arrangement which 'address matters raised in the access arrangement draft decision.' However, NGR 60(2) clearly contemplates that the AER may approve further amendments to the access arrangement which are not limited to those necessary to address the draft decision. The example given in NGR 60(2) is a change in circumstances of the service provider's business since submission of the access arrangement proposal.

Without a provision such as s 60(2), the Rules would be unnecessarily constraining for good decision-making. Important new issues could arise both out of the draft decision itself, and post the draft decision. Further, given that the final decision will have important economic consequences for at least five years, it is vital to economic efficiency (especially dynamic efficiency) that service providers should be given the flexibility to effectively respond to all known circumstances at the time of the decision.<sup>1</sup>

Jemena submits that the final guideline should explicitly recognise the important issues raised by NGR s 60(2).

---

<sup>1</sup> With provision for cost pass through of certain events which are unknown or unquantifiable at that time.

## 3 Submitting commercial-in-confidence material

### 3.1 What the rules say

NGR s. 43 deals with the submission of access arrangement information. S. 43(2) deals with information confidentiality as follows:

If particular information (sensitive information) is confidential, and its public disclosure could cause undue harm to the legitimate business interests of the service provider, a user or prospective user, the AER may permit the service provider to submit access arrangement information in a form approved by the AER, in which the sensitive information:

- (a) is aggregated or generalised so as to avoid disclosure of the elements that make it sensitive; or
- (b) if that is not possible – is entirely suppressed.

There are no criteria in s 43 for the AER to decide whether or not to allow a confidential submission, and the inference is that the service provider would have to make its case to the AER.

### 3.2 What the draft guideline proposes

In summary, draft guideline s. 4.1.4 stipulates:

- the physical form in which confidential information is to be submitted;
- that parties should provide the reasons why the identified information is confidential and how its public disclosure could cause undue harm to their legitimate business interests or those of other parties;
- that the AER will only accept a claim of confidentiality where the information is 'truly confidential';
- that all information that is not marked as confidential will be treated as public information;
- that where a confidential document is submitted but not accompanied by a non-confidential version of the document, the AER may treat the submitted version as being non-confidential or it may give the confidential part of the submission less weight;
- that there may be circumstances where it would be appropriate for confidential information to be provided to a third party. However, to the extent that confidential information is not made available to third parties, the AER may

give such information less weight, given that third parties had not been provided with an opportunity to provide submissions on it.

### 3.3 Jemena comments

In Jemena's view, the provisions in the draft guideline dealing with confidential information should be basically procedural. This is the case with the first two items above, when the draft guideline requires information to be submitted in a particular form accompanied by reasons why the identified information is confidential.

However, Jemena does not consider the remaining items to be fully within the scope of s. 43(2). In particular:

- the statement that that the AER will only accept a claim of confidentiality where the information is 'truly confidential' offers little guidance in terms of the Rules. The Rules simply require the AER to apply an objective test by deciding whether publishing the information will cause undue harm. Jemena suggests that some examples of what the AER might regard as 'undue harm' caused by confidential information would be more useful than the current statement;
- the statement that all information that is not marked as confidential will be treated as public information is, in Jemena's view, far too prescriptive. The guideline should at least acknowledge plausible possibilities such as service provider error in not marking a document correctly, or not realising that the information was confidential at the time of submission. Upon realising the error, the service provider should be given scope to correct it;
- The last two provisions in 3.2 above particularly concern Jemena. The possibility that the AER would publish identified confidential information for no other reason than that a non-confidential version was not submitted appears to go well beyond the Rules. So does the possibility that the AER would give the confidential part of the submission 'less weight'. The Rules say nothing about the weight to be given to confidential information when it is submitted to the AER in a particular way or under particular circumstances. Likewise, the fact that third parties had not seen particular confidential information for valid reasons should not detract from its potential value, or the weight to be given to it by the AER.

It is possible that the draft guideline is seeking to impose some discipline on service providers in submitting information and making claims for confidentiality. Nevertheless, Jemena submits that the draft guideline appears to confine service providers to a narrow view the Rules, even though the Rules clearly offer service providers an opportunity to claim confidentiality and, if agreed by the AER, have that claim respected.

In Jemena's view, the draft guideline should include an intermediate step to cover instances of confidential information being submitted in a form deemed

unsatisfactory by the AER. One suggestion could be that the AER, on receiving access arrangement information, would formally notify the service provider of any deficiency, and allow the service provider a limited time to supply such information in the form specified in the guideline. This would mirror the provision in s 58(2) of the NGR, which allows a service provider up to 30 days to correct any deficiency in an access arrangement proposal, as notified to the service provider by the AER.

### **3.4 Confidentiality in the NGL**

In Jemena's view, the discussion of confidentiality matters in s. 4.1.4 of the draft guideline is not well integrated with the wider confidentiality provisions of the NGL discussed in s. 4.1.5.

Section 329 of the NGL allows the AER to disclose confidential information if the detriment of doing so does not outweigh the public benefit of disclosure. It sets up a highly formalised consultation process which the AER must follow when it wishes to publish confidential information. If, at the end of this process, the AER remains determined to publish, then s. 263(1) of the NGL provides that:

A person whose interests are adversely affected by an AER information disclosure decision may apply to the Tribunal for a review of the decision.

The draft guideline does refer to the NGL confidential information provisions in section 4.1.5, but that section does not discuss the consultation processes that the AER must follow if it wishes to publish confidential information. In Jemena's view, s. 4.1.4 gives the impression that the AER may immediately proceed to publish confidential access arrangement information without further consultation if the information is submitted in a form deemed incorrect by the AER. Clearly this is not so. Jemena suggests that s. 4.1.4 should reference the further processes which must be followed in order for the AER to publish confidential information, including a service provider's rights of review.

## 4 Cost pass through

### 4.1 What the rules say

NGR s. 97 deals with the mechanics of reference tariff variation. S. 97(1) says:

A reference tariff variation mechanism may provide for variation of a reference tariff:

- (a) in accordance with a schedule of fixed tariffs; or
- (b) in accordance with a formula set out in the access arrangement; or
- (c) as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax); or
- (d) by the combined operation of 2 or more of the above.

In deciding whether a proposed reference tariff variation mechanism is appropriate to a particular access arrangement, the AER must have regard to the list of factors in s. 97(3), including efficient tariff structures, administrative costs and regulatory consistency.

Further, the NGR allow the AER to obtain effective oversight of a service provider's proposed variation mechanism through s. 97(4):

A reference tariff variation mechanism must give the AER adequate oversight or powers of approval over variation of the reference tariff.

### 4.2 What the guideline says

Jemena agrees with two observations made early in s. 6.1 of the draft guideline<sup>2</sup>:

- a service provider has some discretion over the implementation of a reference tariff variation mechanism; and
- The NGR do not specify any requirements in relation to the annual process for administering a reference tariff variation mechanism.

Therefore, as the guideline makes clear, s. 6.1 is simply providing the AER's views on implementing components of the tariff variation mechanism of an access arrangement. Jemena considers most of the AER's proposals to be reasonable; with the exception of how the AER intends to evaluate whether a proposed cost pass through mechanism is appropriate to a particular access arrangement (s 6.1.3). Jemena's comments in the following sections 5.3 to 5.5 explain our

---

<sup>2</sup> Draft guideline p. 71.

concerns. Each section covers a particular category of the draft guideline requirements.

### 4.3 Draft guideline—access arrangement proposal

The guideline states that the nature of events relevant for a cost pass through tariff variation needs to be included in the access arrangement proposal. The AER's view is that the access arrangement must<sup>3</sup>:

(a) *specify the defined events*

Comment: This is obviously necessary. Examples of pass through would include events which have not yet occurred but have a possibility of occurrence. This could include change in tax events or the cost effects of an emissions trading scheme.

(b) *provide for a symmetrical mechanism so that both increases and decreases in tariffs are contemplated associated with additional costs incurred or reduced costs incurred arising from a defined event*

Comment: Jemena considers this provision to be too prescriptive. Nothing in the NGR states that a cost pass through mechanism must be symmetrical. Jemena submits that policy makers would have explicitly provided for negative pass through in the NGR, had this been intended to apply without exception<sup>4</sup>.

Jemena recognises that cost pass through mechanisms submitted by gas service providers would need to be consistent with the National Gas Objective and the relevant provisions of the NGR.

(c) *specify the starting reference tariffs*

Comment: Jemena agrees.

(d) *include details about the proposed form of notification to fulfil requirements under NGR s. 97(4).*

The AER's view of its oversight or approval function is amplified in the guideline as follows:

The AER suggests that a key requirement in fulfilling r. 97(4) is to periodically report or notify the AER (and at least once a year) as to whether a cost pass through event has occurred. Another means of meeting this obligation is to outline the timing of that notification. The AER

---

<sup>3</sup> Draft guideline p. 73.

<sup>4</sup> The National Electricity Rules s 6.6.1 provide for positive and negative cost pass through, and set out the detailed AER notification requirements (for the service provider) and the detailed pass through approval criteria (for the AER).



considers that this should be provided at least 50 business days before a tariff is proposed to change because of a cost pass through event.

Comment: It is reasonable for the guideline to specify that a service provider should indicate how it may notify the AER of a cost pass through event. However, consistent with the draft guideline's earlier recognition of service provider discretion, Jemena submits that the form of that notification is a matter for the service provider.

- (e) *state that in the event that a the service provider fails to provide notification of a cost pass through event, either because no tariff variation is sought or no cost pass through event has occurred, the AER will not vary the reference tariffs for the relevant year in the access arrangement period for a cost pass through event.*

Comment: It is not clear to Jemena what this provision is intended to do. On one view, it could be intended to prevent a service provider claiming a pass through event for a preceding regulatory period which was not notified, and then seeking to have a reference tariff adjusted in the current period. Alternatively, it might mean that if a service provider does not notify a tariff variation within the time proposed in (d) above then the AER will not entertain any subsequent claim. Much depends on what the draft guideline intends by the term 'the relevant year', and this is not clear.

Unlike the NER, the NGR do not specify a time period within which a cost pass through event must be notified. Jemena submits that in fairness to the service provider, legitimate claims for cost pass through should not be tied to notification within a restricted period.

#### **4.4 Draft guideline – justification for proposed reference tariff variation**

The draft guideline also expects that service providers will provide forecasts of costs pass through events in their access arrangement information, together with possible materiality tests, as follows<sup>5</sup>:

- *As part of the justification for any proposed reference tariff variation mechanism to be provided in the access arrangement information service providers are to provide any background information about a known event and the likely nature of costs that may be incurred.*
- *Service providers should also include estimates or forecasts of any relevant costs for the event.*
- *A reference tariff variation mechanism may establish a materiality test that is applied to cost pass through events or it may be silent.*

---

<sup>5</sup> Draft guideline p. 74.

- *The AER will consider any of these approaches to the materiality of cost pass through events as proposed by a service provider.*

Comment: Jemena considers that the first stipulation above is reasonable, but has concerns with the others. Even the first provision is perhaps not well formulated in the guideline.

If a service provider includes a particular event (or class of events) as a proposed cost pass through, then it is reasonable to expect that the service provider should explain the general nature of the event and the kinds of costs that may be incurred. However, the quality of the 'background information and likely nature of costs' is likely to vary substantially, depending on what is known at the time of submitting access arrangement information. An announced tax or levy may be relatively easy to define and estimate. On the other hand, the impact of an emissions trading scheme or similar major policy initiative may be very hard to articulate in detail. The guideline should recognise that there is no particular up-front 'information threshold' that can be set for all potential events.

The draft guideline's stipulation that 'estimates or forecasts of any relevant costs for the event' should be provided is, in Jemena's view, considerably beyond the scope of ss 97(1) – (3) of the NGR. Section 97(3) of the NGR does require the AER to evaluate a proposed reference tariff variation mechanism in terms of certain criteria, but these criteria in no way imply that forecasts of cost pass through must be provided. Jemena submits that it is difficult to make any reasonable case to require forecasts of cost pass through in an access arrangement information given that such events may have both uncertain costs and uncertain probabilities.<sup>6</sup>

Similar considerations apply to the draft guideline's suggestion that service providers could establish a materiality test applied to cost pass through events. Nothing in NGR ss 97(1) – (3) indicates that service providers must establish a materiality threshold test for cost pass through, although s 97(3) does require the AER to have regard to administrative costs<sup>7</sup> in evaluating a proposed tariff variation mechanism. Jemena considers that there is a 'natural' barrier to claims for cost pass through – the service provider must provide information sufficient to substantiate the claim, and if the likely costs of information exceed the claim value, then it may not be worth proceeding.<sup>8</sup>

---

<sup>6</sup> The NER do not have such a requirement.

<sup>7</sup> Administrative costs of the AER, the service provider, and users or potential users.

<sup>8</sup> Allowing that all smaller cost events of a similar category should be aggregated into a significant claim.

## 4.5 Draft guideline - timing of cost pass through applications

To assist users and prospective users and for administrative ease, the draft guideline proposes that several conditions should apply to the submission of cost pass through applications:

- the timing of cost pass through applications should be such that changes to tariffs for all proposed tariff variations in accordance with the tariff variation mechanism can occur simultaneously.
- where tariff variation for a cost pass through commences at the same time as an any other annual tariff variation, the AER recommends that service providers submit the cost pass through notification at least 50 business days prior to the tariff commencement date.
- if more than one tariff variation method operates in an access arrangement, service providers should provide the notification for this method at the same time as a cost pass through notification.
- If a service provider notifies the AER 50 business days before a cost pass through tariff variation takes effect the AER intends to inform the service provider of its decision at least 10 business days before the tariff is scheduled to change.

Comment: Jemena appreciates that the AER may be proposing these timing mechanisms in the light of the s 97(3) provisions discussed earlier (ie consideration of administrative costs). However, Jemena again refers to the comments made in s. 6.1 of the draft guideline:

- a service provider has some discretion over the implementation of a reference tariff variation mechanism; and
- The NGR do not specify any requirements in relation to the annual process for administering a reference tariff variation mechanism.

The above timing mechanisms may represent the AER's current preferences. Nevertheless, it is still open to the service provider to propose its own timing for cost pass through applications, and whether any approved pass through should operate in conjunction with, or be independent of, other tariff variation mechanisms. Jemena also observes that it would be clearly unreasonable for the AER not to agree to a major cost pass through on the ground the timing of the pass through did not coincide with other proposed tariff variations under the tariff variation mechanism.

## **5 Pre- or post-tax approach to setting reference tariffs**

Unlike the NER (s. 6.1.3(10)), the NGR do not specify that service providers must submit a post-tax revenue model to the AER as part of their regulatory proposals.

Jemena is therefore pleased to note that the draft guideline throughout does not mandate a pre- or post-tax approach. For example, the discussion on estimated income tax (p. 61) describes how corporate income tax payable over the forthcoming regulatory period may be proposed on either a pre- or post-tax basis.

While the draft guideline does indicate a preference for a post-tax approach, the NGR leave the choice open to service providers.

## 6 Rate of return

The draft guideline says<sup>9</sup>:

A service provider should refer to recent ACCC and AER regulatory decisions (including any merits review outcomes of these decisions) for guidance including any relevant comprehensive reviews of cost of capital issues periodically undertaken by the AER. The reason for this is that these regulatory decisions will contain the AER's most up-to-date analysis and current views on a relevant rate of return. This is particularly relevant for parameters such as interest rates, inflation and equity beta, which are influenced by prevailing market conditions.

Jemana makes the following observations:

- The NGR are far less detailed and prescriptive than the NER in describing how rate of return is to be calculated. The NER mandate the use of WACC and CAPM<sup>10</sup>, whereas the NGR do not<sup>11</sup>. Gas service providers are therefore free to propose alternatives;
- Nevertheless, Jemana recognises that, at any given time, the most recent AER decisions and reviews would indicate the AER's current thinking on rate of return;
- The AER has indicated that the current extensive review of WACC being conducted under s. 6.5.4 of the NER may be seen as relevant to gas. The AER has said:

This review has no direct or formal applicability to gas access arrangements. However given the similarity of issues across the gas and electricity sectors the AER may use the outcomes of this review for the consideration of WACC issues in future gas access arrangements determined by the AER<sup>12</sup>;

---

<sup>9</sup> Draft guideline p. 59.

<sup>10</sup> NER s. 6.5.2.

<sup>11</sup> NGR s. 87.

<sup>12</sup> AER, Review of the weighted average cost of capital (WACC) parameters for electricity transmission and distribution, August 2008, p. 3.

- Jemena observes that the statement of regulatory intent for WACC values to be published for electricity is not necessarily binding on electricity distribution regulatory proposals. Under the NER, a determination may depart from the statement's values, methods or credit rating if there is persuasive evidence to do so and the departure is justified on the basis of the underlying criteria;<sup>13</sup>
- This basis for exception would apply even more strongly in gas, where the market and operating conditions of gas distribution may differ markedly from those of electricity distribution.

In summary, Jemena submits that the AER should not presume that the WACC values determined for electricity distribution in its five-year reviews are automatically applicable to gas access arrangements. While there may be some common elements, careful consideration should be given to gas in its own right.

---

<sup>13</sup> NER ss 6.5.4(g) and 6.5.4(i).